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State of Vermont
Public Service Board

December 8, 1999

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Ms. Magalie Roman Salas,
Secretary, Federal Communications
Commission, Office of the Secretary,
445-12th Street, SW, Room TW-204B,
Washington, DC 20554.

CC Dockets No. 96-262, 94-1, 99-249, 96-45

Dear Ms. Salas:

Please accept for filing the Reply Comments of the Vermont Public Service Board and the Vermont Department of Public Service regarding the Commission's Notice of Proposed Rulemaking in the above dockets. I enclose an original and nine copies in order that copies may be made available to Commissioners.

I would ask that you consider this filing timely, even though the date for filing reply comments expired on December 3. The attached document was filed electronically through the Commission's Electronic Comment Filing System on December 3 and again on December 7, but in both cases the ECFS system was unable to process the document we filed. We have talked with Rosemarie Mueller at ECFS on December 7 and with Andra Cunningham on December 8 regarding the need to make a substitute paper filing, which we are hereby making. I enclose for your review photocopies of the acknowledgment by ECFS of our original filing.

I also want to explain why we have waited until Wednesday of the week following the filing deadline to make this paper filing. After the ECFS failure, we received an automated Email from ECFS instructing us as to what we should do next. That email contained two telephone numbers, one for ECFS, and the other to the Secretary's office. We did successfully discuss this matter with Rosemarie Mueller at ECFS. As it happens, however, the number given for the Secretary's Office, 2022-418-0304, is the number for Mr. Caton's voice line. We did try to reach him on a number of occasions and left voicemail requests that he return our call. However, we did not receive a return call. This morning we then called the Secretary's main number and were advised that Mr. Caton is on vacation. We are

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making this paper filing as soon as possible after receiving instructions from your office.

In summary, this paper filing is being mailed on Wednesday because we have been attempting over the last two days to cure the problem that led to rejection of the ECFS filing last Friday and then to obtain instructions for a paper filing with your office. Under these extraordinary circumstances, we will greatly appreciate it if you can accept the enclosed filing as timely.

As directed in the NPRM, we have previously filed copies with Wanda Harris of the Competitive Pricing Division, and we have filed a diskette with ITS.

Also enclosed is a "stamp and return" copy of the filing, with a postage paid envelope addressed to the Board.

Sincerely,

George Young
Associate General Counsel

Enclosures:
Original and nine copies of Comments
Stamp and Return copy
Copy of ECFS acknowledgements

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

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

REPLY COMMENTS OF THE VERMONT PUBLIC SERVICE BOARD AND VERMONT DEPARTMENT OF PUBLIC SERVICE ON NOTICE OF PROPOSED RULEMAKING

INTRODUCTION

The Commission has asked for comments on the interstate access proposal denominated "CALLS." The Vermont Public Service Board and Vermont Department of Public Service are pleased to submit the following reply comments.

SUMMARY

For the reasons stated below, the Commission should reject CALLS as filed. The Commission should also empanel a larger process on access charges, involving more than just the IXCs and large LECs who participated in developing CALLS. CALLS raises many valid questions, but answers to those questions require participation by a broader audience. One question that should be considered in this broader forum is whether there are new and useful ways to collect IXC contributions to joint and common costs other than through flat charges on customers.

As submitted, CALLS has many flaws. Because it relies upon existing Commission regulations, it exacerbates the existing overstatement of Non-Traffic-Sensitive Costs, and it thereby produces excessive flat charges. CALLS increases flat charges and authorizes deaveraging in ways that are not based upon sound economic theory and that neither reflect consumer preference nor predict market behavior. CALLS also would create an implicit subsidy in violation of section 254(e), a subsidy that would flow from end users who are required to pay for loop costs to those who would be permitted to use the loop at no cost. CALLS also authorizes deaveraging of interexchange rates beyond the range of reasonable comparability, and thereby violates section 254(b)(3). Deaveraging also violates section 254(g), which prohibits this practice for interstate interexchange rates. CALLS also violates section 254(k) because it requires LEC customers to pay the full cost of their loops, thereby failing to make a reasonable allocation of the costs of joint and common facilities to interstate interexchange services. Finally, several procedural aspects of the calls submission reduce the commission's discretion over its elements and make effective judicial review unlikely.

CALLS offers one advantage that, if properly adjusted, should be adopted. Combining the SLC and PICC can produce consumer benefits, but before the PICC is eliminated the Commission must first find a new way to get contribution from IXCs for use of the loop. These new ways might include adopting the methods now in place in Washington State, or they might include establishing a per-call termination charge payable by IXCs, similar to charges now imposed for the use of pay phones.

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I. CALLS OVERSTATES NON-TRAFFIC-SENSITIVE COSTS AND PRODUCES EXCESSIVE FIXED CHARGES.

Except for some universal service support, the CALLS proposal requires customers to pay a flat per-month charges to cover all Non-Traffic-Sensitive (NTS) costs. This charge, the Subscriber Line Charge (SLC), currently exists, but it would become substantially larger under CALLS. Therefore CALLS greatly increases the consequences of any errors in estimating NTS costs.

Unfortunately, existing Commission rules significantly overstate true NTS costs. Therefore, even assuming for the purposes of argument that the economic theory behind the flat charges advocated by CALLS is valid (an issue considered below), flat charges under CALLS would be too high, and usage charges would be too low.[1]

First, some circuit equipment that the Commission treats as NTS is actually traffic sensitive. In other words, equipment has been placed, in part, based upon traffic level predictions such as average hold times. Specifically, some kinds of Subscriber Loop Carrier systems have concentration ratios that make them block traffic under certain heavy traffic conditions. The same applies to some varieties of Digital Loop Carrier systems. Many of these systems are multiplexed in a way that does not permit simultaneous access line use by all connected customers. That this equipment is not really NTS has become ever more evident under increased traffic volumes and longer holding times. Calls are occasionally blocked as too many customers seek dial tones through the same concentrator equipment..

Second, line units in switches have historically been treated as NTS costs, yet they are traffic sensitive. In some communities in Vermont, customers have experienced delayed dial tones because

[1] The CALLS economic theory is also premised upon the assumption that access charge reductions will flow through to toll prices. If that does not occur, consumers will have the worst of both worlds, high fixed charges and high toll rates.

their loops are connected to the switch through line units that happen to be shared with high-usage customers like Internet service providers.[2] Thus even where a customer has a traditional dedicated loop, when one-eighth of the other customers served by that same line unit are off-hook, no dial tone is available, and the loop becomes temporarily unusable. It has become more apparent that this equipment is truly traffic sensitive as some customers have dramatically increased their call durations and thus tie up line units. Internet usage in particular has increased average holding times substantially beyond the levels anticipated in most current network designs.

It is also worth noting that CALLS would essentially freeze for 5 years the existing obsolete distinction between TS and NTS equipment. This may be unwise because network design is constantly evolving. For example, it is foreseeable that within 5 years some sophisticated concentrator equipment may actually be providing limited switching functions, both as between packet and non-packet traffic and as to routing of certain limited classes of traditional calls.

The overall result of overstating NTS equipment is that flat charges will be too high. This would in all likelihood lead to reduced toll charges, but the Commission should be prudent in pursuit of this seemingly worthy goal. Low usage rates are not a desirable outcome if they are the result of an implicit subsidy or are below the rates that would be produced by an unregulated market. Two kinds of distortions could occur. First, customers could receive incorrect price signals about the true costs of toll usage, and thereby create new costs that they will not pay. Second, the high flat rates that result from CALLS could encourage uneconomic bypass of wireline facilities by wireless, cable TV and satellites. This could unintentionally compromise the Commission's long-held stance that it will be economically neutral as among technologies.

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[2] Bell Atlantic-Vermont loads many line units so that not more than one customer in eight can be off-hook at any one time.

Finally, the CALLS plan reinforces the increasingly outdated notion that ILECs are "entitled" to "recover their revenue requirements" through regulatory prescription. As discussed above, CALLS set in place a "cost recovery" mechanism for five years that is based on a formula which results in excessive fixed charges. Competitive markets do not work this way, and establishing a five-year low-risk mechanism for loop cost recovery may only make more difficult the inevitable transition to competition.

II. CALLS WOULD INCREASE FLAT CHARGES BASED UPON ECONOMIC THEORY THAT NEITHER REFLECTS CONSUMER PREFERENCE NOR PREDICTS MARKET BEHAVIOR.

A major underlying premise of the CALLS plan is that the individual customer is the sole cause of local loop costs and should pay all of the costs. In other words, as noted in comments by NRTA and NTCA, CALLS assumes that all remaining interstate carrier common line charges and an additional portion of switching costs (hereafter "loop costs") constitute implicit support for ILEC services.[3] CALLS therefore offers a rate design in which the end user customer pays the costs of his or her loop (subject to amelioration through universal service charges). CALLs proponents claim broadly that their pricing plan, based upon this principle, and others, is a more "economically logical" pricing system[4] with "straightforward" charges.[5]

CALLS underestimates the importance of consumer preferences in setting rate designs. CALLS simply assumes that the Commission's pricing policy should follow maximum economic efficiency, as CALLS defines it, and without regard to other factors.

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[3] Comments of NRTA and NTCA at 9.

[4] Comments of the Coalition for Affordable Local and Long Distance Service at 6.

[5] *Id.* at 9.

This is not the way that unregulated markets work. While flat charges may increase consumer value and efficiency in an economic sense, they overlook the important element of consumer preference which, in truly competitive markets, is as important or more important than cost structure.

As a general rule, consumers do not accept, and competitive markets generally do not require, the payment of flat charges to recover non-volumetric costs, even when they are imposed to cover volume-insensitive costs. Examples abound in retail sales and professional services where the nearly universal practice is to recover fixed costs as an increment to the unit price of goods and services.[6] It doesn't matter whether the sale is of automobiles or of auto repair services, most retail transactions occur at a price which permits the seller to recover volume-insensitive costs through volume-sensitive charges.

For example, only a very few specialized grocery stores charge an admission fee to recover the costs of their coolers and display racks, fixtures that must be installed regardless of sales volume. By far the majority of retailers seek to recover their non-volumetric costs with revenue from sales of their products.

If any doubt remains that the CALLS flat charges are at variance with what would occur in an open market, the Commission should consider the many ways in which, to make CALLS actually work, the Commission must constrain consumer choice. If CALLS is to work, the Commission must prescribe numerous ground rules, few or none of which are imaginable in an unregulated market:

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[6] Admittedly, consumer preference can cut both ways, and there are examples of consumer preference causing service providers to overlook volumetric costs. For example, Internet Service Providers typically offer consumers unlimited service for flat charges. Consumer preference causes the ISPs to overlook their volume-sensitive costs such as for routers and high capacity communications links. However, regulatory action relating to the Internet reduces the probative value of this example. Decisions by the Commission and by numerous state commissions generally have produced an environment in which ISPs have no-cost or very low-cost access to local loops.

1. The Commission must direct that customers who desire to receive local exchange service must also purchase interstate interexchange service, and they must pay a flat charge, the SLC, to their LEC, to cover the loop costs separated to interstate services.
   a. Customers and LECs who might prefer to have this cost paid through a per-minute charge may not do so.
   b. Customers who might wish to decline access to the interstate network in order to avoid paying to pay a SLC may not do so.
2. After the customer has paid the SLC, the Commission must direct that the loop then will be made available to the IXC and to the IXC's customers at no cost:
   a. even if they agree between themselves, the LEC and the customer may not impose loop usage charges on an IXC for loop access; and
   b. the customer, who has paid the costs of his or her own loop with the SLC payment, has no means to seek compensation for the use of his or her loop from others who may use the loop for their own purposes.[7]

In summary, the CALLS proposal to recover NTS charges through a flat charge is economically unjustified, contrary to consumer preference, and inconsistent with what would occur in an unregulated market.

[7] This use by others becomes particularly problematical when it is associated with unsolicited marketing. Many consumers have been bothered at dinner time, for example, by unwelcome telemarketing solicitations.

III. CALLS WOULD AUTHORIZE DEAVERAGING BASED UPON ECONOMIC THEORY THAT NEITHER REFLECTS CONSUMER PREFERENCE NOR PREDICTS MARKET BEHAVIOR.

Another major underlying premise of the CALLS plan is that the costs of local loops vary significantly from place to place, and therefore a rational rate design for recovery of loop costs should include only minimal geographic pooling of those costs. This principle has been previously approved by the Commission in permitting LECs to file different access charges in different study areas. However, CALLS applies it in a much more powerful and largely unprecedented application. CALLS permits any LEC to deaverage within study areas, and permits participating LECS to establish up to four cost zones within a single study area.

The CALLS proposal to deaverage flat charges is flawed, for many of the same reasons discussed in the preceding section. First, although CALLS proponents assert that deaveraging of fixed charges is a "logical" and "straightforward" rate design, they fail to produce any evidence of consumer preference on this point. As noted above, consumer desire is a fundamental issue for rate design in any truly competitive market.

Common experience is generally to the contrary. Many providers of services that are not price-regulated adopt uniform pricing structures over large areas. This is in large part a response to the need to communicate clearly and simply with consumers. It also is the result of mass media markets being larger than wire centers. When a cable TV company wants to introduce a new Internet service, it does not generally offer different prices in different towns. Rather, a uniform system-wide price is adopted and that price is communicated in offers through radio, television and newspapers. In short, the providers of goods and services commonly overlook localized cost differences in order to provide a coherent message to customers through a unified campaign using print and electronic mass media.

CALLS proponents have not pointed to a single industry that has adopted its theory of the advantages of a deaveraged rate design. Indeed, nearly all other similar industries do not follow this plan. For example, consider the package delivery industry. Although the cost of delivering a package varies enormously between urban and rural areas, so far as we are aware, no package delivery service imposes higher charges to rural delivery than urban delivery.

There is no evidence in the record that the electric power industry, which is becoming increasingly competitive, is adopting anything like the CALLS proposal rate design. Even where "wire companies" already exist or are being considered, we are not aware that there is any serious discussion of deaveraging distribution charges.

Even within the Cable TV industry, the rates of which are largely unregulated, there does not appear to be a perceived need to deaverage rates over small geographic areas. The costs of cable TV facilities is generally funded by capitalization of the service provider, and is recovered through an averaged uniform charge from all customers in the franchise area.[8] There appears to be no assumption in Cable TV that customers within franchise areas need to pay different costs to reflect differences in underlying costs.

These examples should demonstrate that, even if the Commission finds the economic logic of CALLS to be compelling, it should nevertheless proceed cautiously. The fact that efficient markets do not generally adopt pricing systems that economists consider economically optimal should guide the Commission away from adopting such arguably "rational" but unpopular systems here.

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[8] Customers outside existing service areas typically are offered service if they pay the full cost of construction, and this is an exception to the rule.

IV. CALLS WOULD CREATE AN IMPLICIT SUBSIDY IN VIOLATION OF SECTION 254(e).

The CALLS proposal postulates that the individual customer is the sole cost-causer of loop costs,[9] and it then requires that each local group of customers pay 100% of the cost of their loops.[10] The second step should not follow from the first.

CALLS proponents illogically conclude that the customer should pay all loop costs. The corollary is that no other user of the loop, even those who terminate calls on that loop, should pay anything. This result is not required simply because the customer is the "cost-causer," and it overlooks significant benefits accruing to other users of the loop. Under the CALLS logic, the customer must pay for his or her loop, and then everyone else in the world may use that loop without charge.[11]

In other words, CALLS overlooks the fact that telecommunications is a network service that provides benefits two ways, to those who initiate calls on the loop and to those who terminate calls on the loop. In short, in a network there are many consumers of each loop. Contrary to the claims of CALLS proponents, there is nothing particularly "logical" about requiring a customer to pay for his or her loop and then mandating that the customer provide that loop free to every person in the world who might wish to use it. Indeed, to provide such a free service to calling customers, and to their carriers, is an implicit subsidy that is prohibited by section 254(e) of the Act.

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[9] It is true that but for the existence of the customer, no loop would be needed. However, it is equally true that but for the existence of the network, no loop would be needed.

[10] The only exception is that for some high-cost customers universal service will provide some assistance to keep SLC payments within prescribed ranges.

[11] As noted in comments by NRTA and NTCA, the District of Columbia Circuit Court of Appeals has held that it is not confiscatory to require an IXC to pay part of the costs of non traffic sensitive costs of local exchanges. Comments of NRTA and NTCA at 11.

In classical economics theory, a good or service is providing a "subsidy" when it is being sold above its stand-alone price, and a good or service is being "subsidized" when it is being sold below its incremental cost. The Commission has recognized this definition of "subsidy" in the context of separations, and also recognizes that these subsidies can produce economic inefficiencies.[12]

This narrow classical definition of subsidy is not, however, the sense in which the Commission has recently used the term under the Telecommunications Act. For example, in its major 1997 access order, the Commission stated that high-volume users were "subsidizing" low-volume users solely because high-volume users were paying a larger portion of NTS costs. The order made no finding that low-volume users, the asserted beneficiaries of the subsidy, were paying costs below incremental cost; nor did it find that high-volume users were paying more than stand-alone cost. Rather, it appears that the Commission appears to have concluded that there is a single "cost" that is relevant for 254(e) purposes.[13] It appears that, in the 1997 access order, the

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[12] In its 1997 NPRM on Separations, the Commission utilized the classic definition of "subsidy."

> In order to avoid cross-subsidization and the resulting inefficient investment incentives, the *cost attributed to a given service class should be less than or equal to the stand-alone cost but greater than or equal to the incremental cost of that class*. Hence, these two measures of cost are the upper and lower bounds within which cost apportionment should fall. Costs of a service class may include incremental costs and any portion of joint and common costs that are allocated to that service class. Accordingly, economic efficiency requires that the amount of joint and common costs allocated to a given service class not exceed the difference between incremental and stand-alone cost.

In re Jurisdictional Separations Reform, Notice of Proposed Rulemaking, Oct. 2, 1997, FCC 97-354, at ¶ 27 (emphasis added, footnote omitted).

[13] In its 1997 Access Charge Order, the Commission stated that:

> Because NTS costs, by definition, do not vary with usage, the recovery of NTS costs on a usage basis pursuant to our current access charge rules amounts to an implicit subsidy from high-volume users of interstate toll services to low-volume users of interstate long-distance services.

In re Access Charge Reform, Docket 96-262 et.al., Order of May 7, 1997, FCC 97-158, at ¶ 6. It also stated:

> To the extent these rates do not reflect the underlying cost of providing access service, they could be said to embody an implicit subsidy. Some of these subsidies are due to the rate structures prescribed by our rules, which in some cases prevent incumbent LECs

Commission found that a subsidy could be said to exist whenever some users were paying more joint and common NTS costs than other users.

More recently, the Commission has used the phrase "implicit support" instead of "implicit subsidy," but its logic appears unchanged. In a recent universal service order, the Commission stated that "implicit support" exists whenever one customer is paying more than "cost" and another customer is paying less than "cost."[14] Once again the Commission appears to be uninterested in incremental cost and stand-alone cost, and to believe that there is a single cost that applies to 254(e) analysis.

The courts also appear to be taking a loose approach to what is a "subsidy." Last July, the United States Court of Appeals for the Fifth Circuit struck down the Commission's rules requiring interstate carriers to pay universal service charges, for some purposes, based upon intrastate revenues. The court's opinion recited an extensive background of the Telecommunications Act, and noted that an implicit subsidy exists whenever some customers are paying "above-cost" rates while others pay "below-cost" rates. The Court appears to have adopted the FCC's practice of assuming that there is a single relevant "cost" for 254(e) purposes.[15]

> from recovering their access costs in the same way they have been incurred. For example, although the cost of the local loop that connects an end user to the telephone company's switch does not vary with usage, the current rate structure rules require incumbent LECs to recover a large portion of these non-traffic-sensitive costs through traffic-sensitive, per-minute charges. These mandatory recovery rules inflate traffic-sensitive usage charges and reduce charges for connection to the network, in essence creating an implicit support flow from end users that make many interstate long-distance calls to end users that make few or no interstate long-distance calls.

Id. at ¶ 28.

[14] The Commission concluded that states provide several forms of "implicit support" within their rate designs because they charge some customers more than "cost" and others less than "cost." *In re Federal State Joint Board on Universal Service*, Ninth Report and Order and Eighteenth Order on Reconsideration, released Nov. 2, 1999, at ¶ 15.

[15] The court said:

> Implicit subsidies are more complicated and involve the manipulation of rates for some customers

In this new sense that there is a single cost that applies to all services, the Commission should conclude that CALLS would create an implicit subsidy. It would do so in the same sense that the existing system has been found to create a subsidy. Under CALLS, customers who are required to pay 100% of the cost of their loops would be paying more than the "cost" of that loop and providing it below "cost" to users who seek to terminate calls on that loop.

V. THE CALLS PLAN AUTHORIZES DEAVERAGING OF INTEREXCHANGE RATES BEYOND THE RANGE OF REASONABLE COMPARABILITY, AND THEREBY VIOLATES SECTION 254(b)(3).

The comments by NRTA and NTCA persuasively demonstrate that rates under the CALLS proposal would not comply with the reasonable comparability standard set forth in subsection 254(b)(3).

The new combined SLC rate under CALLS is still a "rate" that is associated with the provision of "interexchange services," and thus it falls under the reasonably comparable rural and urban rate requirements of section 254(b)(3). Under CALLS, price cap LECs may establish up to four cost zones with different SLC charges, and they have a largely unconstrained right to lower interstate SLC costs to low-cost end users. It seems highly likely that, under these facts, end user charges for access to interexchange services cannot be reasonably comparable for rural and urban households.[16]

> to subsidize more affordable rates for others. For example, the regulators may require the carrier to charge "above-cost" rates to low- cost, profitable urban customers to offer the "below-cost" rates to expensive, unprofitable rural customers.

Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393, 406 (July 30, 1999).

[16] Comments of NRTA and NCTA at 13.

Estimating the differences in rates is difficult since CALLS proponents have not explained how low the SLC charges will be in urban areas. However, the District of Columbia is the only purely urban area now served by a price cap LEC. Although SLC charges in some areas could possibly be lower than this under CALLS, this is a reasonable estimate of a SLC in a low-cost urban area under CALLS. The residential SLC in D.C. is currently $3.32 per month.

CALLS would explicitly limit SLC payments by residential customers in high cost areas to a maximum of $7.00 per month. Many rural areas have high costs and would have SLCs at this level. Therefore, it seems likely that CALLS would produce a maximum rural to urban ratio of SLC charges of $7.00 / $3.32, or 211%. This is well beyond the range within which one might plausibly argue that rural rates are "reasonably comparable" to urban rates[17] or are within a "fair range" of urban rates.[18]

On a related point, CALLS appears inconsistent with the thrust of the Commission's recent universal service efforts. Under CALLS, SLC increases generally will be experienced in areas with high overall costs, and therefore with high local rates. Thus, deaveraged SLCs will increase fixed monthly charges in precisely those areas where costs, and rates, are already highest. This works against the Commission's recent efforts to reduce local rates to reasonably comparable levels. It is not consistent policy to give $113 million of universal service support to Bell South so that it can reduce rates in rural Mississippi, and then turn around and increase SLCs in rural Mississippi.

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[17] 47 U.S.C. § 254(b)(3).

[18] Federal-State Joint Board on Universal Service, Access Charge Reform, CC Docket Nos. 96-45, 96-262, Seventh Report & Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, 14 FCC Rcd at 8092, para. 30.

VI. THE CALLS PLAN DEAVERAGES INTEREXCHANGE RATES AND THEREBY VIOLATES SECTION 254(g).

Under the CALLS plan, all interstate costs currently recovered via SLCs, PICCs and CCL, and a portion of local switching charges, will be folded into a single SLC. The resulting SLC could be deaveraged, both across study areas and within study areas. The question, therefore, is whether this violates section 254(g).

1. Rates for Interexchange Service

A threshold question is whether a SLC charge is a "rate" charged by a provider of interexchange service, within the meaning of subsection (g). The SLC is indeed a "rate" for "interexchange service" within the meaning of that subsection. It is undisputed that the costs supported by the SLC payments under the CALLS proposal are separated to the interstate jurisdiction because interstate services are provided to customers. It is also undisputed that, except for universal service payments, under the CALLS proposal the SLC would recover *all* interstate loop costs. Finally, it is undisputed that, when a customer pays the SLC, the LEC applies that payment to its costs, arising from the loop, that have been separated to the interstate jurisdiction because of the existence of interstate interexchange service.

Therefore, but for this SLC payment and application of the proceeds by the LEC to support its loop costs, the IXC would have no access to loop facilities. It is true that the SLC is not paid to the IXC, but that is not the essential point. The IXC is in essence the third party beneficiary of the payment. Therefore, the SLC is one of the "rates" charged by IXCs for interexchange services, even if indirectly, within the meaning of section 254(g). This is true even though under current FCC rules and under the CALLS proposal the IXC would never actually handle the money.

In the alternative, even if the SLC is not considered to be a "rate" of an IXC, then it must be a "rate" of the customer's LEC. Even in this case it remains a charge for interstate interexchange services. The analysis under section 254(g) would be unchanged.

In summary, subsection (g) does not disappear because the Commission directs that customers shift their loop cost payments from their IXC to the IXC's wholesale provider, the LEC. In both cases the payment facilitates the service, and in both cases it is a "rate" under subsection (g).

Congress left a limited record with regard to subsection (g). If it intended to provide an exemption for the SLC from the reach of section 254(g), we are not aware that it said so directly.[19] Moreover, even if Congress did intend to shield the existing level of SLC payments, CALLS would quite substantially increases the size of this exception, by increasing the proportion of costs recovered through the SLC. If section 254(g) can be avoided simply by making the IXC the third party beneficiary of a Commission-mandated payment, section 254(g) will have been deprived of virtually all of its meaning.

2. Summary

CALLS would relieve IXCs of virtually all responsibility for the costs of the loops they use to originate and terminate their long distance traffic. The comments filed by NRTA and NTCA, and

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[19] The House and Senate conferees agreed that:

> New section 254(g) is intended to incorporate the policies of geographic rate averaging and rate integration of interexchange services in order to ensure that subscribers in rural and high cost areas throughout the Nation are able to continue to receive both intrastate and interstate interexchange services at rates no higher than those paid by urban subscribers. The conferees intend the Commission's rules to require geographic rate averaging and rate integration . . . .The conferees are aware that the Commission has permitted interexchange providers to offer non-averaged rates for specific services in limited circumstances (such as services offered under Tariff 12 contracts), and intend that the Commission, where appropriate, could continue to authorize limited exceptions to the general geographic rate averaging policy using the authority provided by new section 10 of the Communications Act.

Telecommunications Act of 1996, S.652 of 104th Congress, Joint Explanatory Statement of The Committee of Conference, House Rpt. 104-458.

their citation to the Congressional Conference Report,[20] convincingly showed that CALLS would violate both the terms of and the Congressional Intent behind subsection 254(g).[21]

The following table summarizes the difficulties that CALLS faces under subsection 254(g):

	First Sentence (rural/urban)	Second Sentence (state to state)
Different SLCs in different study areas	254(g) violated	254(g) violated
Deaveraging within study areas	254(g) violated	--

These conclusions are explained in more detail below. Although the logic in both cases is similar, it is set forth in detail.

3. First Sentence

The CALLS proposal would violate the first sentence of Section 254(g) in two ways. This sentence states that:

> [R]ates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas.

The CALLS proposal authorizes SLC charges to be established on a study area basis. These SLC charges will be small in urban study areas such as the District of Columbia. In rural areas, they

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[20] According to NRTA and NTCA, that report states:

> New section 254(g) is intended to incorporate the policies of geographic rate averaging and rate integration of interexchange services in order to ensure that subscribers in rural and high cost areas throughout the Nation are able to continue to receive both intrastate and interstate interexchange services at rates no higher than those paid by urban subscribers.

Comments of NRTA and NTCA at 6.

[21] Comments of NRTA and NTCA at 4-8.

will be constrained only by the maxima set by the CALLS plan itself, such as $7.00 per line per month for residential customers in 2003. Accordingly, study areas that are predominantly rural will have higher SLC charges, and study areas that are predominantly urban will have lower SLC charges. Since the SLC is a "rate" of an IXC, this will violate section 254(g).

The CALLS proposal also authorizes LECs to deaverage the costs of certain facilities within study areas and then to recover those costs on a deaveraged basis from a single SLC charged to the customer. To the extent that the SLC is deaveraged within a study area, it is certain to produce higher charges in rural and high cost areas than in urban areas, thus violating 254(g).

As noted in comments by NRTA and NTCA, the Commission has already prohibited deaveraging by IXCs of the collection mechanism for PICC costs. The Commission held that "assessing subscribers flat-rated charges on a deaveraged basis could lead to significantly higher rates for subscribers in high-cost areas."[22] To the extent that CALLS would replace a deaveraged PICC charge to a deaveraged SLC charge, the same analysis should apply. In both cases, rural customers wind up with higher charges for the right to originate and receive interexchange calls.

4. Second Sentence

The CALLS proposal would violate the second sentence of Section 254(g). The analysis is similar to the first sentence, except the topic is interstate differences, not differences between urban and rural. The sentence states that:

> a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.

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[22] Comments of NRTA and NTCA at 7-8, citing to *Access Charge Reform et.al.*, CC Docket Nos. 96-262 *et.al.*, 12 FCC Rcd 15982 &97 (1997).

As noted above, the CALLS proposal authorizes LECs to establish SLC charges on a study area basis. These SLC charges will be low in predominantly low cost study areas such as the District of Columbia. In other study areas, such as Vermont, the only constraint will be the SLC limits set forth by the CALLS plan itself. Study areas that are predominantly rural will have higher charges, and study areas in different states that are predominantly urban will have lower charges. Since we have concluded that the SLC is a "rate" of an IXC, this difference in rates will violate section 254(g).

VII. THE CALLS PLAN REQUIRES LEC CUSTOMERS TO PAY THE FULL COST OF THEIR LOOPS, AND THEREBY VIOLATES SECTION 254(k).

1. First Sentence

CALLS violate the first sentence of section 254(k), the sentence that prohibits carriers from using services that are not competitive to subsidize services that are subject to competition. By providing the loop to IXCs (and their customers) for terminating interexchange calls at zero cost, the CALLS plan would be creating a subsidy. The subsidy would flow from those customers who must pay for their own loops and to all other customers who seek to use those loops at no cost. However, toll services are subject to competition. Also, the funds to pay for these loop costs will be derived from SLC payments. Because any customer who seeks to receive local exchange service must pay the SLC, payments are a precondition of receiving local exchange service.

Local exchange service to residential customers is not yet a competitive service in most parts of the country, and therefore the subsidy is derived from noncompetitive service. Since under CALLS a noncompetitive service would subsidize a competitive service, CALLS would violate the first part of section 254(k).

2. Second Sentence

CALLS also would violate the second sentence of section 254(k), the sentence that prohibits collecting from universal service more than a reasonable share of joint and common costs of facilities that are joint and common with other services.

For two reasons, the Commission should conclude that the SLC payment is a payment for a service included in the definition of universal service. First, Local exchange service is a service included in the definition of universal service. At present and under the CALLS plan, customers who wish to receive local exchange service must pay the SLC. Therefore the SLC is a payment that entitles the customer to universal service. In addition, as noted in the comments of Smithville Telephone Co., Inc., the SLC is nominally paid to the LEC in order to compensate the LEC for providing access to the interexchange network.[23] The SLC payment thereby gives the customer the ability to access the network for making and receiving interstate calls. This closely matches the "access to interexchange service" included in the Commission's rules defining the elements of universal service. [24]

Loop facilities are joint and common facilities for local exchange service and for interexchange service. As noted in comments by NRTA and NTCA, ever since 1930 when the Supreme Court decided *Smith v. Illinois*,[25] it has been generally understood that the loop is a joint and common facility for interstate interexchange services. This conclusion is also supported by

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[23] Comments of Smithville Telephone Co., Inc. at 4-5.

[24] 47 CFR § 54.101(a)(7).

[25] Comments of NRTA and NTCA at 10.

numerous state commission decisions, including recent decisions of the Washington Utilities and Transportation Commission[26] and the Indiana Utility Regulatory Commission.[27]

As noted by comments of Smithville Telephone Co. Inc., under the CALLS plan, the Carrier Common Line charge would go to zero, and thus interexchange service would pay nothing for the use of loop facilities. It is undisputed that interexchange service itself (as opposed to access to such service) is not a service included in the definition of universal service.

Since under CALLS a service that is not included in universal service (interstate interexchange service) would bear no cost whatever of joint and common facilities, the Commission should conclude that CALLS directly violates the second sentence of section 254(k).

CALLS proponents respond to the 254(k) issue by arguing that the Commission has adopted a "functional definition of universal service" consisting of "all the functionality of a voice grade loop, along with local usage."[28] They view this to be in contrast to a service-based definition of universal service. CALLS proponents conclude that the "loop is a facility installed specifically to allow provision of voice grade access and is therefore a dedicated, not a common, cost of providing universal service."[29]

These arguments are unpersuasive. Subsection 254(k) explicitly states that the Commission shall establish rules "that the *services* included in the definition of universal service bear no more

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[26] Comments of Washington Utilities and Transportation Commission at 8.

[27] See, comments of Smithville Telephone Co., Inc. at 4, *citing* Indiana Utility Regulatory Commission, *In re Matters Relating to Access Charge Reform and Universal Service Reform*, Cause No. 40785, Order Approved October 28, 1998

[28] They report that the Commission has "defined universal service as: the ability to place calls; the ability to receive calls; the use of the loop, as well as that portion of the switch that is paid for by the end user . . . necessary to access an interexchange carrier's network; and the ability to use voice grade access to the public switched netowrk to call to an Internet Service Provider." CALLS comments at 15.

[29] *Id.*

than a reasonable share of the joint and common costs of *facilities* used to provide *those services*" (italics added). The law, therefore, requires the Commission to look at the services that are included within universal service and at the facilities used to provide those services. This law applies without regard to whether the CALLS proponents believe that the FCC has adopted a "functional definition."

The critical facts underlying the application of 254(k) also remain unchanged by any "functional definition." Customers must pay the SLC in order to obtain local service and access to interexchange service. Both are included in the definition of "universal service."

The only question, then, is whether the loop is a joint and common facility between local service and interstate interexchange service. Although the CALLS proponents claim the loop is dedicated to "voice grade access," that argument has no bearing on the subsection 254(k) analysis. Whatever relation the loop may or may not have in relation to "functional" terms, it is a joint and common facility for interstate interexchange *service*. As noted above, both the Unites States Supreme Court and numerous state commissions have expressed this view, in years past and in recent times.

CALLS proponents claim that their interpretation of section 254(k) would not render meaningless the last sentence of that section.[30] This also is unpersuasive. If all plant between the Class 5 switch and a customer's premises are considered dedicated to "voice grade access," it is difficult to imagine that there are any joint and common facilities to which the last sentence of 254(k) might be applied.

The CALLS proponents suggest that the Commission can adequately implement subsection 254(k) merely through the existence of Part 32 and Part 64 "cost allocation" regulations "to ensure that such common costs are allocated among services and that these common costs are not borne

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[30] CALLS comments at 15.

entirely by regulated services."[31] The existence of these regulations is not relevant. The issue is not whether the commission adequately allocates costs for joint and common facilities. Rather, the issue requires definition of just what is included in the phrase "joint and common costs of facilities," and in particular whether the loop should be included. If the loop is improperly excluded from joint and common facilities, the existence of these regulations will not cure that defect.

VIII. SEVERAL PROCEDURAL ASPECTS OF THE CALLS SUBMISSION REDUCE THE COMMISSION'S DISCRETION OVER ITS ELEMENTS AND MAKE EFFECTIVE JUDICIAL REVIEW UNLIKELY.

The CALLS plan, as filed with the Commission, has several unusual characteristics. First, the CALLS proponents submitted the plan to the commission and asked that it be adopted by the Commission without modification as an integrated package, and implemented for the five-year period beginning in January 2000. Second, the CALLS plan has elements of "social compact,"[32] under which that the Commission will not be permitted to change the plan's terms or conditions for five years. Third, the plan is strictly voluntary and would be applicable only to those price cap ILECs that choose to sign on to the plan.[33]

All three of these features are likely to restrict the legitimate authority of the Commission or the ability of aggrieved parties to obtain effective relief from the judicial system. The fact that the plan has been submitted as a "package" could prevent the Commission from exercising its judgment

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[31] CALLS comments at 15-16.

[32] CALLS proponents propose a "social compact" under which traffic-sensitive switched access rates are reduced annually until they reach an agreed level; once that level is reached, rates for all access elements are frozen until July 1, 2004. NPRM at ¶ 2.

[33] NPRM Appendix B, page 1.

over the merits of individual features of the plan. The fact that the plan is a "social compact" will substantially reduce the Commission's discretion to act during the five-year term of the plan in relation to problems that may arise during that term. It will also tend to make the courts unwilling to overturn the FCC's discretion in adopting the CALLS plan. Finally, the fact that the plan is voluntary for incumbent LECs will further restrict, if not eliminate, the ability of the FCC, and the willingness of the courts, to address any major negative impact on consumers.

The end result is that consumers will be vulnerable and without recourse to unforseen negative impacts of the CALLS plan.

IX. COMBINING THE SLC AND PICC CHARGES (AS PROPOSED BY CALLS) CAN PRODUCE CONSUMER BENEFITS, BUT ONLY IF IT IS MATCHED WITH A NEW FORM OF CONTRIBUTION FROM IXCS FOR USE OF THE LOOP.

The CALLS plan suggests replacing the existing SLC and PICC charges with a single SLC charge. While Vermont does not support increasing the size of fixed charges, it does support consolidating the existing PICC and SLC into a single SLC charge, provided that the Commission can find another way to require IXCs make a reasonable contribution to joint and common costs.

CALLS proponents accurately describe a variety of problems with PICC charges. They accurately point out that the PICC adds significantly to customer confusion.[34] Customers are understandably confused by the myriad ways in which IXCs recover PICC payments from customers.

CALLS proponents are also largely correct when they observe that this "division of loop charges is now pointless -- [customers] end up paying the combined total regardless of which carrier

[34] CALLS comments at 19.

ultimately does the billing."[35] They accurately observe that there is no reasonable prospect that PICC charges will be "competed away." The incidence of these charges may vary from carrier to carrier as they gain and lose customers in high PICC areas. However, aside from these minor variations, we are not aware of any basis in the record that would support a conclusion that increasing network efficiencies will allow carriers to forego recovering these charges from customers. The charges are set by the Commission and by the incumbent LEC, and more efficient competition by the IXC cannot reduce them.

PICC charges also can hurt low-income subscribers, because PICCs generally are collected as fixed charges. A significant drawback of PICC charges is that they cannot be offset by Lifeline benefits.[36]

Permanent PICCs also can hurt low-volume customers, because of the way that IXCs have implemented them. According to CALLS proponents, some IXCs charge a fee to recover their PICC payments, and make the recovery charge a flat amount per account, regardless of the number of lines the subscriber uses.[37] This disadvantages low-volume users, who tend to have only one line.

Permanent PICCs may also hurt all customers generally, because of the way that IXCs have chosen to implement them. One problem is that many IXCs bill customers for PICC recovery even when those customers receive local exchange service from an incumbent LEC that does not receive PICC payments. Also, some customers today are paying more to their IXCs than the IXCs pay to the

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[35] CALLS comments at 8. Vermont does not agree that the existence of PICC charges creates, as asserted by CALLS proponents, "inefficiencies" in the form of transaction costs. While such transaction costs no doubt exist, to characterize them as "inefficiencies" suggests that there is no proper purpose served by requiring IXCs to make contributions to joint and common costs. See CALLS comments at 18.

[36] CALLS comments at 16.

[37] CALLS comments at 18.

LEC. CALLS proponents admit that IXCs charge customers an unstated amount of "transaction costs."[38]

Finally, PICCs hurt all customer generally because of the opportunity they create for customer confusion. IXC rates are not regulated because the market has been declared competitive. However, an effective competitive market requires consumer knowledge of price and quality. PICC charges offer carriers an opportunity to raise revenue from customers while characterizing the charges as being government-based. Thus the IXC can purport to offer low rates, while nevertheless collecting profit from charges that it is permitted to characterize as recovering of "governmentally imposed" costs.

Combining the SLC and the PICC can solve many of these problems. It would simplify billing. It would also improve eligibility of low-income customers for Lifeline benefits, and it reduces the opportunity of IXCs to disguise their own revenues as government charges.

Unfortunately, for the reasons described above, despite these advantages, the CALLS proposal should not be adopted as presented. If a new plan could be devised that required an adequate contribution from interexchange carriers for joint and common costs, the Commission should then consider combining the SLC and PICC charges.

X. RATHER THAN ADOPTING CALLS, THE COMMISSION SHOULD EXPLORE NEW WAYS TO ELIMINATE THE PICC AND TO RECOVER JOINT AND COMMON COSTS FROM IXCS.

The Commission should explore new ways to recover joint and common costs from interexchange carriers. As noted above in several contexts, IXC contribution for loop costs will remain a legal requirement under section 254 of the Act for the foreseeable future. Nevertheless,

[38] CALLS comments at 18.

we agree that per-minute charges are a less and less plausible method of collecting that contribution. Defining new forms of contribution will become increasingly important as the public switched network shifts to a packet environment. When that happens, minutes of use will be increasingly irrelevant, and some new means of obtaining contribution must be found.

One option that should be considered is the method now in effect in Washington State.[39] The Washington design shows that it is possible to make IXC contributions explicit, without establishing flat customer charges.

In Washington, the state commission recognized that originating and terminating access services face different bypass risks and thus may have different rate designs.[40] Terminating access is less at risk of bypass, and is therefore more subject to monopoly power. In Washington, an effort has been made to reduce terminating access charges to incremental cost and to derive all remaining terminating access contributions from universal service charges.[41] Washington also permits incumbent LECS to set higher rates for originating access, since this service is more subject to competition and thus is more likely to be subject to market-based price limits.[42]

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[39] Comments of Washington Utilities and Transportation Commission at 8-12.

[40] Comments of WUTC at 8-9.

[41] The method of collecting that universal service is constrained in Washington because of the lack of a state universal service fund. However, that deficiency is not material to the validity of the economic concept underlying Washington's access pricing system.

[42] Comments of WUTC at 9.

Essentially, the Washington approach is to declare all costs above incremental cost to be universal service. This is one way to collect IXC contributions, since IXCs normally contribute to universal service.[43]

The Commission should also examine other forms of contribution from IXCs. For example, the Commission should consider establishing a per-call termination charge payable by IXCs to replace the per-minute access charge now in place. Similar charges are now imposed for the use of pay phones, and this kind of charge might be an efficient way to collect a contribution for interexchange calling.

XI. CONCLUSION

In summary, the Commission should reject the CALLS plan as submitted. In setting fixed charges too high and in authorizing deaveraging it conflicts with consumer preference, and it relies upon unproven economic assumptions. All of this may result in inaccurate price signals to consumers. CALLS also improperly establishes an implicit subsidy, and it violates numerous subsections of section 254. Finally, it establishes a legal context that is likely to leave consumers vulnerable and without recourse to any unforseen negative impacts of the CALLS plan.

The Commission should empanel a larger process on access charges, involving more than just the IXCs and large LECs who participated in developing CALLS. CALLS raises many valid questions, but answers to those questions require participation by a broader audience. One question that should be considered in this broader forum is whether there are new and useful ways to collect IXC contributions to joint and common costs other than through flat charges on customers.

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[43] Indeed, under the recent decision by the 5th Circuit, IXCs will contribute a large portion of federal universal service funds.

RESPECTFULLY SUBMITTED,
DECEMBER 3, 1999

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