

support programs.³⁶ The second dealt specifically with one of the issues raised in the CALLS proposal, and asked the Joint Board whether interstate access charges should be reduced to reflect the transition from implicit to explicit support.³⁷ The Joint Board considered the matter and found that it is within the Commission's discretion to determine the level of implicit support in access rates and propose a method of making the support explicit.³⁸ Therefore, while GTE expects consultations to continue as they have in the past, further consultation should not be used to delay implementation of the CALLS proposal.

Finally, the six points that NARUC urges the FCC to consider when reviewing the modified CALLS proposal are each already addressed by the plan.³⁹ The filings submitted by the Coalition throughout this proceeding demonstrate in detail the benefits that end-users will enjoy as a result of the plan, as well as the proposal's consistency with the 1996 Act.⁴⁰ As a comprehensive package of reforms negotiated by participants

³⁶ *Federal State Joint Board on Universal Service*, 12 FCC Rcd 87 (1996) (Recommended Decision).

³⁷ *Federal State Joint Board on Universal Service*, 13 FCC Rcd 13749 (1998) (Order and Order on Reconsideration).

³⁸ *Federal State Joint Board on Universal Service*, 13 FCC Rcd 24744, 24755 (1998) (Second Recommended Decision).

³⁹ See Comments of the National Ass'n. of Rural Utilities Commissioners at 2 ("NARUC Comments").

⁴⁰ The previous comments of CALLS also show careful consideration of the other concerns that NARUC raises: potential impact on jurisdictional allocation of costs, accommodation of the interests of affordability and comparability, the impact of the Internet on the Plan, as well as the merits of market based versus prescriptive approaches. See, e.g., Revised Plan Memorandum at 3-5, 8-10, 12; Comments of the Coalition for Affordable Local and Long Distance, CC Docket No. 96-262, et al., at 3, 7-
(Continued...)

from every sector of the telecommunications industry, the CALLS proposal includes discussion and resolution of all of these important elements of interstate access charge and universal service reform.

D. The Eighth Circuit Has Already Ruled That Section 254(k) Does Not Require Loop Costs Be Billed to Particular Service Providers.

Some commenters argue that Section 254(k) prevents the Commission from rolling the presubscribed interexchange carrier charge ("PICC") into the SLC, since this would allegedly combine supported and unsupported elements and pose a danger of cross-subsidization.⁴¹ These commenters, however, fail to even acknowledge the existence of an Eighth Circuit holding which directly counters their argument, even though this precedent was brought to their attention in earlier rounds. In *Southwestern Bell Telephone Co. v. FCC*,⁴² the Eighth Circuit held that the SLC is a method of recovering loop costs, rather than a way of apportioning loop costs between services that are supported by universal service and those that are not. Since the subscriber causes local loop costs simply by requesting telephone service, whether the loop is used for inter- or intrastate calls, the court found that it was appropriate to recover these charges directly from the end user. Given this reasoning, Section 254(k) is simply not

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8, 10, (filed November 12, 1999).

⁴¹ See Comments of Montana Public Service Commission, at 3; Comments of National Telephone Cooperative & National Rural Telecom Ass'n., at 14-16; Supplemental Comments of National Ass'n. of State Utility Consumer Advocates, at 21 ("NASUCA Comments"); Comments of The Public Service Commission of Wisconsin, at 5.

⁴² 153 F.3d 523 (8th Cir. 1998).

implicated when costs are recovered through the SLC, and federal law does not require the permanent retention of the confusing PICC in order to split cost recovery between specific providers. At bottom, the Commission should give no weight to arguments that have already been considered and rejected by the Eighth Circuit.

IV. CALLS' MODIFIED SLC RESTRUCTURING IS IN THE PUBLIC INTEREST AND WILL ACHIEVE CONSUMER BENEFITS.

The Commission's current rules, adopted in 1997, already provide for a transition to recovery of interstate common line costs through flat charges, thus eliminating the usage-based CCL charge. The original CALLS plan proposed to further reform the structure of interstate common line rates by eliminating the PICC for primary and non-primary lines immediately, by phasing out the PICC for multiline business over time, and by eliminating the CCL more rapidly. Where flat-rate common line charges might otherwise be unaffordable, a new universal service fund would provide explicit, portable support, which in turn would help maintain caps of \$7 and \$9.20 for single-line and multiline rates, respectively. The new, combined SLC charge for single line customers was to begin at \$5.50, which is the level most customers are paying today for the SLC and the passthrough of PICC charges by IXCs. Subsequent increases in the SLC would have closely paralleled the increases in PICC charges already adopted in the Commission's rules. This original CALLS proposal would have improved the efficiency of common line recovery, promoted the development of efficient competition, and simplified customers' bills. At the same time, it would have ensured that SLC rates remained both affordable and reasonably comparable. The modified CALLS proposal responds to concerns raised by other parties by striking a different policy balance. The

cap on the new SLC charge for single-line customers will be lower, throughout the life of the plan, than under the original CALLS proposal. This ensures that monthly flat rates will be even more affordable, and that rates in different areas will be even more comparable. Because the SLCs increase more slowly under the modified plan, the gains in efficiency and promoting competition will be achieved more gradually than under the original proposal, but will still be significant, as Dr. Tyson makes clear in her study.⁴³

It is important to note that many of the concerns raised as “new” by parties commenting on the modified CALLS proposal are in fact recycled from earlier proceedings and litigation in which these issues have been thoroughly examined, and settled. The current rules base common line recovery on the Commission’s price cap mechanism; they will eliminate usage-based interstate common line recovery and replace it with flat charges; they will result, in some places, in recovery entirely through SLC charges, with no charges to IXCs; and they already allow for rates to differ by geography. Yet some parties persist in raising again questions which have been asked and answered.

A. Limiting the SLC Cap to a Lower Level Will Fail To Achieve Adequate Cost Recovery.

The CALLS plan bases common line recovery on the amounts that the FCC currently allows ILECs to recover and is therefore a legitimate and reasonable basis upon which to base the plan. Under rate of return regulation, which the Commission

⁴³ See *Tyson Study* at 21.

abandoned in 1990, ILECs were given the opportunity to recover their embedded costs. In the ten years since the implementation of price cap regulation, however, prices have not been tied to a rate of return calculation. Rather, prices have been established on the basis of the price cap formulas that lower access charges each year.

The FCC has repeatedly found that price caps, which provide the basis for the recovery level in CALLS, have maintained access charges at reasonable levels. Initially, the Commission set the price cap index at a level based upon rates in effect on July 1, 1990, which it explicitly held to be reasonable.⁴⁴ In fact, the Commission found that the July 1, 1990 rates were in general “the best that rate of return regulation can produce.”⁴⁵ Moreover, since January 1, 1991, access rate ceilings have been adjusted downward each year by application of the X-factor. In addition, the FCC has ordered additional reductions in access charges.⁴⁶ Consequently, price caps and thus access charges have fallen by more than 50% since 1991.⁴⁷ Throughout this period, access charges have remained at levels consistent with the Commission’s plan. And they are at reasonable levels today.⁴⁸

⁴⁴ See, e.g., *Policy and Rules Concerning Rates and Dominant Carriers*, 5 FCC Rcd 6786, 6814-16 (1990) (“*LEC Price Cap Order*”).

⁴⁵ *Id.* at 6815.

⁴⁶ See, e.g., *Access Charge Reform*, 12 FCC Rcd 15982, 16111-18 (1997) (First Report and Order) (“*Access Reform Order*”) (ordering ILECs to make an exogenous cost decrease to account for the completion of amortization of equal access charges).

⁴⁷ See Comments of William E. Taylor, Attached to Comments of USTA, CC Docket No. 96-262, *et al.*, at 16 (filed Oct. 29, 1999).

⁴⁸ In fact, because the X-factor has been overstated since 1991, access charges are now *below* levels that would be reasonable under the price cap plan adopted by the
(Continued...)

On the other hand, common line recovery cannot legitimately be based on the Hybrid Cost Proxy Model. The FCC adopted the model only for determining the relative portion of state cost support to allocate among states. The FCC itself expressed doubt that it would be appropriate to use that cost model in any other context.⁴⁹

Moreover, the arbitrary downward adjustment to common-line recovery advocated by some commentators – whether based on model estimates or any other method – is particularly inappropriate because it represents bad economic policy and precludes ILEC recovery of the actual costs of providing access services. If the Commission adopts a policy that deprives ILECs of the ability to recover their actual costs, it will thwart the reasonable expectations in place at the time the investments were made. As a result, the FCC would have to address the inevitable takings claims seeking recovery of just compensation for stranded investments.⁵⁰

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Commission in 1990. For example, under one analysis the present 6.5% X-factor is more than 2.44% above the measured productivity rate of 4.06% over the past five years. See Reply Comments of the United States Telecom Ass'n., CC Docket No. 96-262 et al., (filed Nov. 29, 1999), Attachment 3, Professor Frank M. Gollop, *Economic Evaluation of "Q" Factor Proposed by AT&T*, at 2 (Nov. 22, 1999).

⁴⁹ See *Ninth Report & Order* at ¶ 41. "[T]he federal cost model was developed for the purpose of determining federal universal service support, and [] it may not be appropriate to use nationwide values for other purposes"

⁵⁰ See, e.g., *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 225 (1986) (holding that, to establish a taking by a federal agency in violation of the Fifth Amendment, the plaintiff must show "(1) the extent to which regulation has interfered with distinct investment-backed expectations; (2) the character of the government action; and (3) the economic impact of the regulation on the claimant.")

Additionally, the Texas Public Counsel/CFA/CU (Texas Counsel) analysis is fatally flawed, and cannot be relied upon to establish cost recovery levels. The Texas Counsel would reduce subscriber line charges and eliminate PICC charges immediately. This proposal is problematic both for competition and universal service. The Texas Counsel plan does not address universal service funding to replace implicit universal service support currently in interstate access charges. It also does not call for deaveraging of rates. In fact, the SLCs produced by the Texas Counsel plan are even below the interstate share of the forward-looking cost predicted by the FCC's existing Hybrid Cost Proxy Model in many wire centers. This result would severely undermine the very competition that Congress and the Commission seek to promote.

On the other hand, the ALTS/Time Warner plan low-balls the estimates in the record for implicit support. This approach is no better. Compared with the Modified CALLS plan, the use of too low an estimate by the ALTS/Time Warner plan will harm rural customers.

Finally, the LEC members of CALLS have committed to providing data on the cost associated with the provision of retail voice service, by UNE zone, after the SLC cap has reached \$5.00. If, after reviewing these data, the Commission finds that it wishes to alter the relationship between SLCs and other forms of common line recovery in certain zones, it can set different caps for those zones. However, because the current level of common line recovery is reasonable, and because SLCs are, as the Commission has long recognized, the most efficient means for recovering those costs, any further reductions in the SLC caps will perpetuate less efficient recovery through the existing PICC and CCL charges.

B. CALLS Benefits the Public Interest.

Some parties argue that geographic deaveraging of SLC rates will undermine the comparability of rates.⁵¹ This argument reflects a misunderstanding of the Plan. The CALLS plan provides greater affordability and comparability of rates than current FCC rules do. The CALLS plan fosters competition, which, together with geographic deaveraging and the universal service fund, will help ensure that rates continue to be affordable and comparable.

1. Affordability and comparability of rates is maintained better under the CALLS' proposal than under the current FCC rules.

Affordability of rates is better maintained under the CALLS' proposal than under FCC's current rules. For example, the CALLS plan caps SLC rates at levels *lower* than customers would *currently* be paying. Today, single-line customers pay a SLC of \$3.50 plus an average PICC pass-through charge of \$1.50, for a total monthly flat-rate charge of \$5.00.⁵² In July 2000, the PICC is scheduled to increase by 50 cents, resulting in a new total monthly flat-rate charge of \$5.50. The CALLS SLC cap, however, starts at \$4.35. This figure reflects the fact that the modified CALLS plan reduces SLC caps and reduces the SLC cap increases, ensuring even greater affordability than the original plan. Finally, simply because the SLC cap increases over time does not mean that rates will increase to the same extent. The estimated average primary SLC at the end

⁵¹ See NASUCA Comments at 3-4; Comments of Wyoming Public Service Commission, at 6, 8; NARUC Comments at Appendix A.

⁵² The current PICC charge cap for single-line customers is \$1.04. The pass-through of this charge by IXCs reflects costs of administration, billing, and uncollectibles, as well as the averaging of recovery across primary and non-primary lines.

of the plan is \$5.80, only 30 cents more than the combined flat rate amount customers would be paying on July 1, 2000 in the absence of CALLS. Thus, the average flat rate charge under CALLS will decline significantly on July 1, compared to what customers would pay under the current rules, and, at the end of the plan, the scheduled increases in the SLC would result in a charge only slightly higher than current rules would have called for in the first year.⁵³

The CALLS proposal also maintains comparability of rates better than current FCC rules. Existing rules provide for further increases in the PICC charge of 50 cents (plus inflation) per year. Unlike the CALLS plan, there is no upper limit to these increases. Rather, the increases continue until the rates recover the common line revenues allowed under the price cap. Since common line revenues are higher in high-cost areas, by 2003, the sum of the SLC and the PICC pass-through from the interexchange carrier under current Commission rules could well reach levels comparable to the highest SLC allowed under the CALLS plan for low-cost areas, and would be considerably higher in high-cost areas. The SLC caps under the CALLS plan minimize this difference between low-cost and high-cost areas, ensuring more comparable common line rates.

PICC charges in some of GTE's higher cost study areas will exceed \$4.80 for primary lines, and \$12 for multiline business. In many lower-cost areas, these PICC

⁵³ These figures do not include other benefits resulting from the elimination of minimum usage by IXCs, from lower per-minute charges for long distance service, or from the enhanced Lifeline benefit under CALLS.

charges will be zero. This will result in a greater disparity of flat-rate charges than would be created under the CALLS plan.

2. CALLS is beneficial because maintaining a lower cap will substantially inflate the size of the needed universal service fund.

The CALLS proposal reduces implicit subsidies in part by realigning rates, and in part through the new explicit universal service mechanism. To the extent that rate recovery is not reformed, the need for explicit universal service funding will be increased. The CALLS proposal represents a reasonable balance between rate reform and universal service. It will result in SLC rates that are both affordable and reasonably comparable. If the Commission were to adopt lower SLC caps, it would increase the burden of universal service funding that will have to be provided.

3. CALLS promotes competition because relying on common line cost recovery from SLCs does not insulate rates from competitive forces.

The CALLS proposal will foster competition, particularly in rural and high-cost areas, by creating incentives and opportunities for competitive carriers to compete for all types of customers. For one, CLECs are not required to impose SLC charges, thereby encouraging them to compete for residential and single-line business customers. Also, geographic deaveraging heightens CLEC incentives to compete in rural and high-cost areas. Finally, CLEC competition in high-cost areas is encouraged by the fact that a significant portion of previously implicit subsidies are made explicit under the CALLS' plan, and are portable to all competitors.

Carriers that might seek to take advantage of the opportunity to charge higher rates in high-cost areas will be more likely to face competition from CLECs, which are

not required to impose SLC charges. Moreover, since ILECs are not required to price SLCs at the cap, these competitive forces will help keep SLC charges down.

4. Deaveraging SLC rates is in the public interest.

Under the CALLS plan, carriers may deaverage SLCs based upon variations in state-approved prices for UNE loops and ports. The FCC has already found that deaveraging SLC rates is in the public interest.⁵⁴ Claims that the plan unreasonably discriminates against customers in high-cost zones are mistaken. In the absence of voluntary reductions, the difference between the SLC in the highest zone and the SLCs in the lower cost zone will be less than the difference in state-approved UNE prices. Further, because the CALLS plan provides for \$650 million in targeted universal service support to rural areas, rural customers pay a much smaller share of the cost of providing service than urban customers do.

As noted above, the average primary SLC charge at the end of the CALLS plan is estimated to be about \$5.80. The maximum primary SLC charge permitted in any zone is \$6.50. Thus, the highest primary SLC will exceed the national average by only 70 cents, or about 12 percent. In its earlier proceeding on the high cost fund, the Commission assumed that rates within 35 percent of the nationwide average would be reasonably comparable. Vermont is thus simply incorrect when it suggests that CALLS would lead to SLCs that are not reasonably comparable.⁵⁵ Further, as shown above,

⁵⁴ See *Access Charge Reform*, 14 FCC Rcd 14221, 14252-53 (1999) (Fifth Report and Order and Notice of Proposed Rulemaking) (“*Pricing Flexibility Order*”).

⁵⁵ Vermont Comments at Section V.

this range of SLC rates is actually smaller than the range of the sum of the SLC and PICC charges that would occur under the current rules.

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.⁵⁶ Historic FCC geographic rate averaging and rate integration policies applied only to interexchange service itself, not to exchange access, whether paid by the carrier or the end user.⁵⁷ Loop costs are incurred by ILECs, not IXCs. PICC charges, as part of ILEC recovery of loop costs, are not forever transformed into IXC costs simply because the PICCs were passed on to IXCs. Thus, incorporating PICC charges into the SLC does not transform the SLC into a “rate charged by” IXCs, and Section 254(g) does not apply. In any event, under the current rules, SLCs and PICCs already vary from one geographic area to another. Therefore, if the claims that CALLS violates Section 254(g) were valid, then the current rate structure would be illegal, which is clearly not the case.

⁵⁶ 47 U.S.C. § 254(g).

⁵⁷ 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 F.C.C.2d 380 (1976).

V. CALLS TARGETED SWITCHED ACCESS RATE REDUCTIONS AND TARGET LEVELS ARE REASONABLE AND WILL PRODUCE SIGNIFICANT PUBLIC INTEREST BENEFITS.

The switched access rate reductions contained in the modified CALLS proposal will provide both immediate and continuing public interest benefits arising from significantly reduced long distance charges, if the proposal is adopted. First and foremost, the proposal guarantees benefits flowing from switched access rate reductions of \$2.1 billion that will take effect on July 1, 2000. In addition, by targeting the X-factor productivity adjustment on switched access rates, the proposal will reduce these rates by almost 50% within the five-year duration of the CALLS plan. Because AT&T and Sprint have committed to flow these savings through to consumers, the proposed switched access rate reductions will generate enormous public benefits.

Several parties have criticized two aspects of the CALLS methodology for achieving these access rate reductions. First, some commenters assert that the plan calls for an arbitrary departure from existing price cap regulation.⁵⁸ In particular, they are concerned that the X-factor is targeted exclusively to the switching basket until switched access rate caps are reduced to target rates of 0.55 cents for the Bell Companies and GTE and 0.65 cents for most other price cap ILECs.⁵⁹ They argue that such targeting is inconsistent with the existing price cap regulatory regime and

⁵⁸ See ALTS/Time Warner Comments at 8-12; Comments of Focal Communications Corporation, at 5-14 ("Focal Comments").

⁵⁹ The Coalition has agreed to a slightly higher rate for certain very rural price cap carriers. See Valor/CALLS Joint *Ex Parte* letter to Larry Strickling, Chief Common Carrier Bureau (filed April 14, 2000).

Commission precedent.⁶⁰ Second, several parties assert that the rate reductions for switched access are too steep and will thus inhibit entry of CLECs into the local exchange access market.⁶¹ For the reasons stated below, none of these concerns has any merit.

A. The CALLS Methodology for Achieving Switched Access Reductions by Targeting the X-Factor's Effect on Average Switched Access Rates Is Reasonable and Consistent with the Commission's Stated Objective.

The CALLS methodology is fully consistent with the Commission's stated objective of "opening all telecommunications markets to competition."⁶² To that end, the Commission has committed to "accelerat[ing] the development of competition"⁶³ in the local exchange market and facilitating "the removal of service from price cap regulation as competition develops in the marketplace."⁶⁴ It has repeatedly acknowledged that price cap regulation is not a permanent edifice; instead, "price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary."⁶⁵ Price caps thus merely represent the pricing methodology chosen by

⁶⁰ See ALTS/Time Warner Comments at 8-10; Focal Comments at 5-7, 10-14.

⁶¹ See ALTS/Time Warner Comments at 2-3, 10.

⁶² *Access Reform Order* at 16094.

⁶³ *Pricing Flexibility Order* at 14224.

⁶⁴ *Id.* at 14225.

⁶⁵ *Access Reform Order* at 15994.

the Commission to replace traditional rate of return regulation and commence the transition toward an unregulated, competitive market for access services.⁶⁶

Consistent with this stated objective, the CALLS plan represents an important additional step towards full competition in the local exchange market. It replaces the existing price cap methodology with one that significantly accelerates the decline in traffic-sensitive switched access and transport rates. Although the plan retains most of the attributes of the existing price cap regulatory regime, it departs from the existing price cap methodology in several important respects. A primary distinction is that participating⁶⁷ price cap ILECs will target all price cap reductions arising from the 6.5% X-factor to reduce the Average Traffic Sensitive rate, which comprises traffic-sensitive local switching and transport components, until the Average Traffic Sensitive rate cap reaches a prescribed target level.⁶⁸ By promptly reducing switched access rates from the present levels the CALLS plan will substantially achieve the Commission's goal of

⁶⁶ See *Pricing Flexibility Order* at 14227.

⁶⁷ The CALLS proposal is purely voluntary. In the event that the Commission adopts the proposal, ILECs that are not presently signatories to the plan may elect to take advantage of the benefits of the proposal by becoming signatories at any time prior to implementation. See Modified Universal Service and Access Reform Proposal, at § 6 (filed Mar. 8, 2000).

⁶⁸ Further, once the Average Traffic Sensitive rate reaches the prescribed target rate, the X-factor is set at the rate of inflation for the remainder of the five-year term of the plan. See *id.* § 3.2.1.

reducing switched access rates to cost-based, competitive levels,⁶⁹ and it will do so quicker than would be possible under the existing price cap methodology.⁷⁰

The modified CALLS plan also furthers the Commission's objective of obtaining a more appropriate allocation between flat-rate and MOU pricing of access services. In the *Access Reform Order*, the Commission emphasized that the "NTS [non-traffic-sensitive] costs should be recovered through flat fees, while traffic-sensitive costs should be recovered through usage-based [i.e., MOU] rates."⁷¹ It acknowledged that "[t]he present structure violates this basic principle of cost causation by requiring incumbent LECs to recover many fixed costs through variable, per-minute access rates."⁷² The *Access Reform Order* rectified a number of these "distortions" in the price cap regime by requiring ILECs to recover non-traffic sensitive ("NTS") costs through NTS pricing components, thereby reducing traffic-sensitive access rates.⁷³ Nevertheless, numerous distortions remain in the price cap regime, even as modified by the *Access Reform Order*.⁷⁴ The modified CALLS plan furthers the Commission's

⁶⁹ See *Access Reform Order* at 15995, 15998.

⁷⁰ ALTS and Time Warner argue that it is "simply too early" to depart from the existing price cap regime "to drive down access charge prices." ALTS/Time Warner Comments at 8. They agree, however, as discussed in the text below, that the CALLS target rate caps provide the most appropriate end result for price cap regulation. Their objection is that the correct outcome is reached too quickly. This is an argument based on self-interest, not economic principle.

⁷¹ See *Access Reform Order* at 15998.

⁷² *Id.*

⁷³ See *id.* at 16004-07.

⁷⁴ See *Pricing Flexibility Order* at 14326-33 (seeking comments on replacing
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continuing efforts to realign the allocation of access rates between flat-rate and traffic-sensitive components by further reducing the proportion of access fees that ILECs recover from traffic-sensitive Average Traffic Sensitive rates and by increasing the proportion that they recover from flat-rate common line charges.

The CALLS plan would achieve dramatic reductions in switched access rates by initially targeting all X-factor adjustments to the Average Traffic Sensitive switched access and transport components. This proposal is entirely consistent with Commission precedent in the *Access Reform Order*, which adopted a similar strategy to accelerate the elimination of the traffic-sensitive tandem interconnection charge (“TIC”). In that *Order*, the Commission directed ILECs to “target to the TIC price cap *reductions arising in any price cap basket* as a result of the applications of the ‘GDP-PI minus X-factor’ formula.”⁷⁵ The CALLS plan applies this same strategy to reduce switched access rates rapidly to more competitive levels.

ALTS/Time Warner and Focal Communications assert that there is no economic justification to depart from the present system of applying the X-factor equally to all price cap baskets.⁷⁶ This objection, however, is the same objection raised by ALTS in the recent *Access Reform* proceeding. The Commission expressly rejected this argument, noting in essence that the end to be achieved – “eliminat[ing] the

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existing MOU pricing of local switching and transport with capacity-based pricing).

⁷⁵ *Access Reform Order* at 16081 (emphasis added).

⁷⁶ See ALTS/Time Warner Comments at 8-10; Focal Comments at 8-9.

anticompetitive aspects of the TIC”⁷⁷ – justified the means, i.e., not applying any productivity adjustment to price caps until the TIC was eliminated, even if economic data supported widespread application of the X-factor to all baskets.⁷⁸ In any case, the economic data here shows that switched access rates contain significant implicit supports, and therefore targeting all X-factor adjustments to these rates will effectively promote universal service and efficient competition. Thus, the CALLS approach is not based on any conclusion as to the relative level of productivity gains in different baskets. Rather, it is based on the need to address the relative rate distortions in the price cap plan caused by decades of earlier policies.

For the same reasons, the FCC should reject ALTS/Time Warner's argument here.⁷⁹ As the *Access Reform* precedent demonstrates, it is entirely reasonable to

⁷⁷ *Access Reform Order* at 16082.

⁷⁸ The Commission further noted that its targeting proposal was unobjectionable because TIC revenues would be spread evenly across all price cap baskets and service categories so that the reallocation would not insulate the TIC revenues against “the pressures of the competitive marketplace.” *Id.* at 16082. The CALLS plan follows this same approach by applying the same (zero) productivity adjustment to all non-Average Traffic Sensitive rates.

⁷⁹ Focal’s attempt to distinguish the application of a targeted X-factor to eliminate the TIC from the CALLS proposal to target the X-factor to significantly reduce the traffic-sensitive switched access rates is unavailing. Of course, two applications of the same methodology to different factual circumstances can always be distinguished at some level if one looks hard enough. The point is, however, that the two situations have sufficient common traits to justify the targeting of the X-factor proposed under the CALLS plan. For example, in both situations, the primary objective of the targeting is to further the Commission’s objective of fostering competition by eliminating or reducing charges that are not set at competitive levels.

As Focal notes, the elimination of the TIC was necessary “to remove an otherwise objectionable non-cost-based charge that thwarted the development of
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accelerate price cap reductions for a specific service category or subcategory where the goal is to obtain a reasonable, pro-competitive end result. In this case, ALTS/Time Warner have acknowledged that the CALLS target rate caps are an appropriate end result by adopting these same targets in their own proposal.⁸⁰ Accordingly, the CALLS plan's targeting of the X-factor to the Average Traffic Sensitive rate cap in order to more rapidly attain cost-based switched access rates is both reasonable and consistent with Commission precedent.⁸¹

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competition in the interstate access market." Focal Comments at 11-12. The same is also true of switched access rates. Focal's suggestion that IXCs have not found the present access rate levels to be objectionable is disingenuous. See, e.g., AT&T Ex Parte Letter, CC Docket No. 96-262, Attachment at unnumbered p. 9 (filed Feb. 25, 1999) (presenting data to support AT&T's argument that switched access rates were at levels substantially above economic cost). Because the CALLS plan seeks to use the targeted X-factor to significantly reduce switched access rates, this aspect of the CALLS proposal furthers the same pro-competitive goal as the Commission's provision of the *Access Reform Order* which directed ILECs to target the TIC.

⁸⁰ See ALTS/Time Warner Comments at 18 and attached Exhibit.

⁸¹ ALTS/Time Warner's further argument that the CALLS proposal would deny consumers the benefit of productivity gains in the local loop while the X-factor is targeted on the Average Traffic Sensitive rate also lacks merit. First, because the Commission is dealing here with price *caps*, not prescribed *rates*, there is nothing to prevent local loop prices from falling below the price cap levels. Second, this argument is unavailing for the same reason it was unavailing in the *Access Reform* proceeding – the pro-competitive benefits resulting from the accelerated reduction of one price cap outweigh any "harm" imposed by temporarily deferring reductions to other price caps.

The Ad Hoc Telecommunications Users Committee ("Ad Hoc") raises a related concern: it asserts that the CALLS proposal provision which precludes ILECs from applying "exogenous cost" increases to Average Traffic Sensitive rate elements will shift recovery of these costs to NTS components such as special access. See Comments of Ad Hoc, at 7-8. Although this statement is correct, it is the natural and beneficial consequence of targeting revenue reductions to the traffic-sensitive switched access service categories (which enables the rapid attainment of competitive Average Traffic

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Remarkably, ALTS/Time Warner's opposition to targeting of the X-factor is totally inconsistent with their alternative proposal, which also targets the X-factor to specific access baskets and service categories, albeit different ones than CALLS proposes. Under the first phase of the ALTS/Time Warner proposal, revenue reductions flowing from application of the existing 6.5% X-factor would initially be targeted as follows: (1) 50% of the reductions would be targeted to eliminate the carrier common line charge ("CCLC") and the multi-line business PICC ("MLB PICC"); and (2) the other 50% of the revenue reductions would be directed to reducing Average Traffic Sensitive rates.⁸² This aspect of the ALTS/Time Warner proposal clearly requires the X-factor reductions to be targeted (though in a less focused and more complicated manner than the CALLS proposal). Further, under the second phase of their proposal, once the CCLC and the MLB PICC have been eliminated, all X-factor revenue reductions would be targeted at the Average Traffic Sensitive elements, as under the CALLS proposal.⁸³ Accordingly, although the ALTS/Time Warner proposal differs from the CALLS plan, it employs *exactly the same* methodology – targeting of the X-factor to specific service categories – to achieve its goals. ALTS/Time Warner's objection to the use of X-factor targeting in the modified CALLS proposal thus rings hollow. Rather than being grounded in any principled objection to the CALLS methodology, ALTS/Time Warner's objection should

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Sensitive rates). In any event, the Commission has authority to review exogenous cost claims and require reallocation of exogenous costs if it deems necessary.

⁸² See ALTS/Time Warner Comments at 4, 15-16.

⁸³ See *id.* at 4, 17-18.

be seen for what it really is: mere disagreement with *how* the X-factor should be targeted (CALLS advocates that all rate reductions should be directed to traffic-sensitive access categories, whereas ALTS/Time Warner asserts that selected flat-rate service categories should receive equal priority).⁸⁴

Nor does the CALLS proposal's targeting of X-factor reductions to Average Traffic Sensitive rates constitute "premature pricing flexibility" as Focal asserts.⁸⁵ Rather than granting ILECs unlimited flexibility to allocate the X-factor revenue reductions among the traffic-sensitive local switching and transport service categories, as Focal suggests, the CALLS proposal instead requires ILECs to continue to comply with pricing flexibility constraints that currently exist under the price cap regime. Nothing in the modified CALLS proposal alters the existing band limitations on ILEC pricing flexibility contained in Section 61.47(e), which have existed in some form since price caps were introduced in 1990.⁸⁶ Thus, far from granting ILECs premature pricing flexibility, the CALLS proposal retains the existing limitations on pricing flexibility contained in Section 61.47(e).⁸⁷

⁸⁴ GTE disagrees that any of the access rate reductions should be targeted to flat-rate common line basket service categories.

⁸⁵ See Focal Comments at 14.

⁸⁶ See *LEC Price Cap Order* at 6810-11; In a subsequent Order, the Commission removed the lower pricing bands. See *Access Charge Reform*, 11 FCC Rcd 21354, 21487-88 (1996) (Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry).

⁸⁷ Moreover, because the CALLS proposal does not modify the existing pricing flexibility rules, there is no restriction on the allocation of Average Traffic Sensitive rate reductions among its constituent service categories, which include traffic-sensitive tandem switching and tandem transport. With regard to the modified CALLS plan's
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Focal asserts that the CALLS plan's targeting of the X-factor to the Average Traffic Sensitive rate results in the creation of "an arbitrary selection of X Factors scattered throughout the price cap scheme."⁸⁸ This assertion is unsupported.⁸⁹ With only one minor exception for special access services in the first year of the plan, the modified CALLS proposal requires the application of only one X-factor.⁹⁰ Until switched access rate caps are reduced to the target levels, the proposal retains the existing 6.5% X-factor. Once the target levels are attained, the X-factor becomes equal to GDP-PI to offset any upward inflation adjustment to price cap levels.⁹¹ The proposal is simple, straightforward, and, contrary to Focal's assertion, does not establish a multitude of X-factors.⁹²

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proposed one-time rate reductions on July 1, 2000, the plan guarantees that local switching will receive a proportionate share of the decrease. See Modified CALLS Proposal § 3.2.4. Other rates will be reduced in accordance with the existing price cap rules.

⁸⁸ Focal Comments at 12.

⁸⁹ Notably, Focal fails to provide citations to *any* examples of the alleged wide "selection" of X-factors that it contends exist in the CALLS proposal.

⁹⁰ See Modified CALLS Proposal § 3.2.1. The exception provides for the application of a 3.0% X-factor to special access services in 2000. See *id.* § 3.2.7.

⁹¹ See *id.* § 3.2.1.

⁹² The *Access Reform Order* is again also dispositive of Focal's argument. The *Order* does not reflect any contention by any party that the targeting of the TIC would result in a multitude of X-factors. See *Access Reform Order* at 16081-86. Nor did the Commission interpret the targeting mechanism as creating multiple X-factors. See *id.* In describing the *Access Reform Order's* targeting of the TIC, Focal states:

[T]he targeting of the X Factor to the TIC did not involve an arbitrary selection of X Factors scattered throughout the price cap scheme.

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Focal also challenges the reduction of the X-factor to GDP-PI, once the target Average Traffic Sensitive rate is reached, as arbitrary.⁹³ On the contrary, the CALLS proposal to reduce the X-factor to the rate of inflation once switched access rates have been dramatically reduced is justified by expected productivity increases that would be possible at these lower rate levels. As GTE explained in its Reply Brief to the initial CALLS proposal, there are numerous reasons why the X-factor would need to be reduced. First, productivity gains are rapidly declining, due in part to a decline in switched access minute growth over the past decade.⁹⁴ Second, at lower access rate levels, further significant productivity gains become increasingly difficult to achieve.⁹⁵ Notably, even Focal stops short of asserting that productivity advances will even approximate 6.5% over the next five years. Third, even with the application of a reduced X-factor for the remainder of the five-year plan, switched access price caps will be at lower levels than would be achieved if the existing 6.5% X-factor is applied to existing rates over the five-year period covered by the CALLS plan. Finally, because

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Instead, other baskets and charges governed by price caps receive no X Factor reductions until the TIC is eliminated. Thus, targeting of the X Factor to the TIC merely defers X Factor reductions for other rate elements and baskets until the TIC is phased out, and, therefore, does not involve application of different X Factor reductions to different price cap baskets.

Focal Comments at 12. This analysis applies equally to the CALLS plan's targeting of the Average Traffic Sensitive rate until target rates are achieved.

⁹³ See Focal Comments at 9-10.

⁹⁴ See Reply Comments of GTE, at 40-41 (filed Dec. 3, 1999).

⁹⁵ See *id.* at 39.

the price caps represent price ceilings, not prescribed switched access rates or, as some continue to claim, price floors, there is nothing to prevent market conditions from driving down rates faster than the X-factor rate.⁹⁶

Moreover, the adoption of GDP-PI as the X-factor once the target price caps are reached is entirely reasonable.⁹⁷ It will enable price caps to be frozen at the target levels, thus ensuring consumers that switched access rates will continue to decline in real terms. It will also continue to require ILECs to achieve productivity gains. Indeed, because of the impact of rising input costs, carriers will continue to be forced to achieve productivity gains to remain profitable, which is consistent with the existing price cap incentive scheme.⁹⁸ Further, the CALLS proposal to reduce the X-factor to GDP-PI once target switched access rate caps are achieved has garnered the support of the largest CLEC trade association, ALTS. The ALTS/Time Warner proposal mirrors the CALLS proposal by advocating the reduction of the X-factor to the level of inflation once the target switched access rates are achieved.⁹⁹

⁹⁶ See *id.* at 42-43.

⁹⁷ Focal's assertion that the CALLS plan may entail a "startling proposal to eliminate" the X-factor, Focal Comments at 9, is patently false.

⁹⁸ Furthermore, the GDP-PI-based X-factor will be applied evenly to all price cap baskets, as under the current price cap scheme.

⁹⁹ See ALTS/Time Warner Comments at 18. Moreover, ALTS/Time Warner also argue for adoption of the *same* target rate caps that are contained in the modified CALLS proposal. See *id.* at 4, 18 & Exhibit.

B. CLECs' Belated Attempts to Argue that the Glide Path to the Target Switched Access Rates Is Too Fast Should Be Rejected.

ALTS/Time Warner argue that the glide path to the target Average Traffic Sensitive rates set out in the CALLS proposal is too steep. By targeting the entire X-factor adjustment to the Average Traffic Sensitive rate element, CALLS predicts that the target rates will be achieved within the five-year term of the plan.¹⁰⁰ ALTS/Time Warner contend that, because switched access rates are a major source of CLEC revenue, dramatic reductions in these rates will competitively disadvantage CLECs, thereby raising their investment risk and cost of capital; the increased cost of capital in turn, they argue, reduces the ability of companies to enter the local exchange market as facilities-based competitors to ILECs.¹⁰¹

At the outset, it must be noted that none of the commenters argue that the target rates proposed in the modified CALLS proposal are too low.¹⁰² Although a declaration submitted with Focal's comments includes a discussion of the issue of predatory pricing, neither the declaration nor Focal's comments allege that the CALLS plan would establish predatory pricing levels.¹⁰³ Indeed, the commenters that expressly object to the level of the target caps in the CALLS proposal argue that the rates are too *high*.¹⁰⁴

¹⁰⁰ See Memorandum in Support of the Coalition for Affordable Local and Long Distance Service Plan, CC Docket No. 96-262 et al., at 37 (filed Aug. 20, 1999).

¹⁰¹ See ALTS/Time Warner Comments at 10.

¹⁰² The Rural Independent Competitive Alliance ("RICA") contends that the proposed reductions in ILEC switched access rates will exacerbate the amount of charges that are disputed by IXCs. See RICA Comments at 5. It does not assert, however, that the target rates are too low.

¹⁰³ See Focal Comments at 8; Declaration of Jeffrey I. Bernstein, Apr. 3, 2000 ("Bernstein Declaration") at 1-2. The Bernstein Declaration states that the cost

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