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

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

SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1
REPORT AND ORDER IN CC DOCKET NO. 99-249
ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45

Adopted: May 31, 2000 **Released:** May 31, 2000

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

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I. INTRODUCTION

1. In this Order, we adopt an integrated interstate access reform and universal service proposal put forth by the members of the Coalition for Affordable Local and Long Distance Service (CALLS).[1] This action provides many benefits. It will bring lower rates and less confusion to consumers; and create a more rational interstate rate structure. This, in turn, will support more efficient competition, more certainty for the industry, and permit more rational investment decisions.

2. This Order resolves historically vexing issues, some going back nearly two decades, in a manner that benefits consumers. Consumers that make no or few long distance calls and consumers that make many long distance calls will both enjoy meaningful savings. The savings from the elimination of the Presubscribed Interexchange Carrier Charge (PICC) and the long distance companies' pass-through of that charge exceed the modest increases to the Subscriber Line Charge (SLC) that this plan allows. In addition, the commitments by AT&T and Sprint to offer reasonably priced long-distance plans without any Minimum Usage Charge (MUC) ensures that low-volume users will enjoy substantially lower overall rates. At the same time, significant and immediate reductions to per-minute carrier access charges will bring those rates closer to cost and translate into lower per-minute long-distance rates, benefiting high-volume consumers.

3. By simultaneously removing implicit subsidies from the interstate access charge system and replacing them with a new interstate access universal service support mechanism that supplies portable support to competitors, this Order allows us to provide more equal footing for competitors in both the local and long-distance markets, while still keeping rates in higher cost areas affordable and reasonably comparable with those in lower cost areas.

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[1] CALLS consists of the following members: AT&T, Bell Atlantic, BellSouth, GTE, SBC, and Sprint. They represent four of the five largest local exchange companies and two of the three largest long distance companies in the nation. These local and long distance companies have historically been adversaries in our access reform and universal service proceedings. CALLS first submitted its proposal on July 29, 1999 (Letter from John T. Nakahata, Counsel to CALLS, to Magalie Roman Salas, Secretary, FCC, July 29, 1999; resubmitted with edits on August 20, 1999 (Original Proposal)). CALLS submitted a modified proposal on March 8, 2000 (Letter from John T. Nakahata, Counsel to CALLS, to Magalie Roman Salas, Secretary, FCC, March 8, 2000 (Modified Proposal)). CALLS has made some refinements to its proposal since that date. *See* Appendix E. Unless otherwise indicated, the terms "CALLS Proposal" and "proposal" refer to the Modified Proposal, as revised by CALLS in its subsequent filings.

In reviewing the CALLS Proposal, the Commission has twice requested and received comment. Access Charge Reform, CC Docket 96-262, Notice of Proposed Rulemaking, 14 FCC Rcd 16872 (1999) (*CALLS NPRM*); Coalition for Affordable Local and Long Distance Services (CALLS) Modified Proposal, CC Docket No. 96-262, Public Notice, DA-00-533 (Comm. Carr. Bur., rel. Mar. 8, 2000). A comment or reply comment to the *CALLS NPRM* is identified as Comment or Reply, respectively. A comment or reply comment to the supplemental request for comment in the Public Notice is identified as Supp. Comment or Supp. Reply, respectively. Appendix A includes a list of parties filing comments on the CALLS Proposal and Low-Volume Long-Distance Users, CC Docket No. 99-249, Notice of Inquiry, 15 FCC Rcd 6298 (1999) (*Low-Volume Long-Distance Users NOI*).

II. BACKGROUND

4. In passing the Telecommunications Act of 1996 (1996 Act),[2] Congress sought to establish "a pro-competitive, deregulatory national policy framework" for the United States telecommunications industry. In the 1996 Act, Congress also directed that universal service support "should be explicit and sufficient to achieve the purposes" of section 254,[3] which include the purpose that all Americans should have access to telecommunications services at affordable and reasonably comparable rates. Therefore, with this Order, we take action designed to further accelerate the development of competition in the local and long-distance telecommunications markets, and to establish an explicit interstate access universal service support mechanism that will be sustainable in an increasingly competitive marketplace.

A. Access Charges

5. For much of this century, most telephone subscribers obtained both local and long-distance services from the same company, the pre-divestiture Bell System, owned and operated by AT&T. Its provision of local and intrastate long-distance services through its wholly-owned operating companies, the Bell Operating Companies (BOCs), was regulated by state commissions. The Commission regulated AT&T's provision of interstate long-distance service. Much of the telephone plant that is used to provide local telephone service, such as the local loop,[4] is also needed to originate and terminate interstate long-distance calls. Consequently, a portion of the costs of this common plant historically was assigned to the interstate jurisdiction and recovered through the rates that AT&T charged for interstate long-distance calls. The balance of the costs of the common plant was assigned to the intrastate jurisdiction and recovered through the charges for intrastate services regulated by the state commissions. The system of allocating costs between the interstate and intrastate jurisdictions is known as the separations process. The difficulties inherent in allocating the costs of facilities that are used for multiple services between the two jurisdictions are discussed below.

6. At first, there was no formal system of tariffed charges to determine how the BOCs and the hundreds of unaffiliated, independent local exchange carriers (LECs) would recover the costs allocated to the interstate jurisdiction by the separations rules. Instead, AT&T remitted to these companies the amounts necessary to recover their allocated interstate costs, including a return on allocated capital investment.

7. In the 1970s, MCI and other interexchange carriers (IXCs) began to provide switched long-distance service in competition with AT&T. AT&T, however, still maintained monopolies in the local markets served by its local subsidiaries, the BOCs. The BOCs owned

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[2] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151 *et seq.*

[3] 47 U.S.C. § 254(e).

[4] A local loop is the connection between the telephone company's central office building and the customer's premises.

and operated the telephone wires that connected the customers in their local markets. Other independent (non-Bell) LECs held similar monopoly franchises in their local service areas. MCI and the other IXCs were dependent on the BOCs and the independent LECs to complete the long-distance calls to the end user.

8. For much of the 1970s, MCI and AT&T fought over the fees -- the access charges -- that MCI should pay the BOCs for originating and terminating interstate calls placed by or to end users on the BOCs' local networks. That battle took place before federal regulators, as well as in the federal courts. In December 1978, under Commission supervision, AT&T, MCI, and the other long-distance competitors entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), that set rates that AT&T would charge long-distance competitors for originating and terminating interstate traffic over the facilities of its local exchange affiliates.[5] Several years afterwards, AT&T's divestiture was completed, separating the local exchange operations of the BOCs from the rest of AT&T's operations, including AT&T's long distance business. The BOCs maintained monopoly franchises in their local market, but by splitting them off from AT&T's long-distance business, the federal courts removed an incentive for the BOCs to favor AT&T's long distance business over its competitors. Now AT&T competed directly with MCI and the other competitors to provide interstate service, and all of the competitors, including AT&T, paid the BOCs for the service of providing the necessary access to end users.

9. In 1978, the Commission commenced a wide-ranging review of the system by which LECs were compensated for originating and terminating interstate traffic. In 1983, following the decision to break-up AT&T, the Commission adopted uniform access charge rules in lieu of earlier agreements.[6] These rules governed the provision of interstate access services by all incumbent LECs, BOCs as well as independents. The access charge rules provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction by the separations rules.

10. The Commission uses a multi-step process to identify the cost of providing access service. First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations.[7] Second, the rules divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities.[8] Third, the separations rules determine the fraction

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[5] For additional background on the ENFIA agreement, *see, e.g.,* Investigation of Access and Divestiture-Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part 1, FCC 85-100, 57 Rad.Reg.2d 1229, 1241 (rel. March 8, 1985).

[6] MTS and WATS Market Structure, CC Docket No. 78-72, Third Report and Order, Phase 1, 93 FCC 2d 241, *recon.*, 97 FCC 2d 682 (1983), *second recon.*, 97 FCC 2d 834 (1984).

[7] These rules are referred to as the Uniform System of Accounts and are contained in Part 32 of the Commission's Rules. *See* 47 C.F.R. §§ 32.1-.9000.

[8] This is governed by sections 64.901-.904 of our Rules. *See* 47 C.F.R. §§ 64.901-.904.

of the incumbent LEC's regulated expenses and investment that should be allocated to the interstate jurisdiction.[9] After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 of our rules specifies in detail the rate structure for recovering those costs.[10] That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users.

11. Determining the costs that an incumbent LEC incurs to provide interstate access services and that, consequently, should be recovered from those services, is relatively straightforward in some cases and problematic in others. Some facilities, such as private lines, can be used exclusively for interstate services and, in such cases, the entire cost of those facilities is assigned to the interstate jurisdiction by the separations rules. Most facilities, however, are used for both intrastate and interstate services. The costs of some of these facilities vary depending on the amount of telecommunications traffic that they handle. The separations rules typically assign these traffic-sensitive costs on the basis of the relative interstate and intrastate usage of the facilities, as measured, for example, by the relative minutes of interstate and intrastate traffic carried by such facilities. By contrast, the costs of other facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities, *i.e.,* the costs are non-traffic-sensitive. These costs pose particularly difficult problems for the separations process: the costs of such facilities cannot be allocated on the basis of cost-causation principles because all of the facilities would be required even if they were used only to provide local service or only to provide interstate access services. A significant illustration of this problem is allocating the cost of the local loop, which is needed both to provide local telephone service as well as to originate and terminate long-distance calls. The current separations rules allocate 25 percent of the cost of the local loop to the interstate jurisdiction for recovery through interstate charges.[11]

12. In promulgating its access charge rules, the Commission has recognized that, to the extent possible, costs of interstate access should be recovered in the same way that they are incurred. This approach is consistent with principles of cost-causation and promotes economic efficiency. Thus, non-traffic-sensitive costs should be recovered through fixed, flat-rated fees. Similarly, traffic-sensitive costs should be recovered through corresponding per-minute access rates. The Commission's rules, however, are not fully consistent with this goal. In particular, because the Commission has taken a cautious approach in addressing affordability concerns, it has taken measured steps toward this goal by limiting the amount of the allocated interstate cost

[9] This step is governed by Part 36 of the Rules. *See* 47 C.F.R. §§ 36.1-.741.

[10] 47 C.F.R. §§ 69.1-69.731.

[11] The general process of separating these costs between the interstate and intrastate jurisdictions is discussed by the Supreme Court in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

of a local loop that is assessed directly on residential and business customers as a flat monthly charge.[12]

13. Through the end of 1990, access revenues were governed by "rate-of-return" regulation. Under rate-of-return regulation, incumbent LECs calculate the specific access charge rates using projected costs and projected demand for access services.[13] An incumbent LEC is limited to recovering its costs plus a prescribed return on investment, and is potentially obligated to provide refunds if its interstate rate of return exceeds the authorized level. Regulatory structures that base a firm's allowable rates directly on the reported costs of the individual firm can create perverse incentives, because reimbursing the firm's costs removes the incentive to reduce costs and improve productive efficiency.

14. Consequently, in 1991 we implemented a system of price cap regulation that altered the manner in which the largest incumbent LECs establish their interstate access charges. While most rural and small LECs remained subject to rate-of-return rules, generally the largest incumbent LECs[14] are now subject to price cap regulations. The Commission's price cap plan for LECs was intended to avoid the perverse incentives of rate-of-return regulation in part by divorcing the annual rate adjustments from the performance of each individual LEC, and in part by adjusting the cap based on actual experience, only with a considerable lag.

15. Briefly stated, rate-of-return regulation is designed to limit the profits an incumbent LEC may earn from interstate access service, whereas price cap regulation focuses primarily on the prices that an incumbent LEC may charge and the revenues it may generate from interstate access services. Under the Part 69 cost-of-service rules, revenue requirements are based on embedded or accounting costs allocated to individual services. Incumbent LECs are limited to earning a prescribed return on investment and are potentially obligated to provide refunds if their interstate rate of return exceeds the authorized level.

16. By contrast, although the access charges of price cap LECs originally were set at the levels that existed at the time they entered price caps, their prices have been limited ever since by price indices that have been adjusted annually pursuant to formulae set forth in our Part 61 rules. Price cap carriers whose interstate access charges are set by these pricing rules are permitted to earn returns significantly higher, or potentially lower, than the prescribed rate of

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[12] *See, e.g.*, Access Charge Reform, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 16010-11 (1997) (*Access Charge Reform Order*), *aff'd sub. nom.*, *Southwestern Bell V. FCC*, 153 F.3d 523 (8th Cir. 1998).

[13] Since 1981, the Commission has allowed certain smaller incumbent LECs to base their access rates on historic, rather than projected, cost and demand. *See* 47 C.F.R. § 61.39.

[14] The Commission required price cap regulation for the BOCs and GTE, and permitted other LECs to elect price cap regulation voluntarily, provided that all their affiliates also convert to price cap regulation and that they withdraw from the pools administered by the National Exchange Carrier Association (NECA). Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6818-20 (1990) (*LEC Price Cap Order*).

return that incumbent LECs are allowed to earn under rate-of-return rules. Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels.[15] Individual companies retain an incentive to cut costs and to produce efficiently, because in the short run their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs. In this way, price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.[16]

17. Although price cap regulation eliminates the direct link between changes in allocated accounting costs and change in prices, it does not sever the connection between accounting costs and prices entirely. The overall interstate revenue levels still generally reflect the accounting and cost allocation rules used to develop access rates to which the price cap formulae were originally applied. Price cap indices are adjusted upwards if a price cap carrier earns returns below a specified level in a given year. Moreover, a price cap LEC may petition the Commission to set its rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory. In the past, all or some price cap LECs were required to "share," or return to ratepayers, earnings above specified levels. This sharing requirement was eliminated in 1997.[17]

18. With the passage of the 1996 Act, the Commission determined that it was necessary to make substantial revisions to access charges. In the *Access Charge Reform Order*, the Commission instituted reforms that changed the manner in which price cap LECs recover access costs by aligning the rate structure more closely with the manner in which costs are incurred.[18] Prior to such reform, some costs that did not vary with usage, in particular the local

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[15] The price cap regulations also give incumbent LECs greater flexibility in determining the amount of revenues that may be recovered from a given access service. The price cap rules group services together into different baskets, service categories, and service subcategories. The rules then identify the total permitted revenues for each basket or category of services. Within these baskets or categories, incumbent LECs are given some discretion to determine the portion of revenue that may be recovered from specific services. Subject to certain restrictions, this flexibility allows incumbent LECs to alter the access charge rate level associated with a given service. For example, within the category of switching services, an incumbent LEC may choose to recover a greater portion of its switching revenues through access charges assessed to one kind of switching service rather than through charges assessed to another switching service. Although the LEC must still observe the switched-access rate structure that is set forth in Part 69 of our rules (which determines what services may be offered and whether charges may be imposed on a per-minute or flat-rated basis), the rate level of the access charge will vary depending on the amount of revenues that the LEC chooses to recover from a given service.

[16] Price Cap Performance Review for Local Exchange Carriers, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, 862 (1995) (*Price Cap Second FNPRM*).

[17] Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16700 (1997) (*1997 Price Cap Review Order*), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

[18] *Access Charge Reform Order*, 12 FCC Rcd at 16007-33.

loop, were not wholly recovered through flat charges. The SLC, which is a flat charge that recovers the interstate portion of local loop costs from an end user, is subject to a cap that, particularly for residential customers, is often below the level that would enable the LEC to recover the entire interstate cost of the local loop. Prior to the *Access Charge Reform Order*, a price cap LEC recovered the shortfall created by the SLC caps wholly through the carrier common line (CCL) charge, which is a per-minute charge assessed on the end user's IXC whenever the end user placed an interstate long-distance call. The IXC, in turn, passed this charge on to its customers in the form of higher rates. By making the end-user rate for long distance calls more expensive, the CCL charge artificially suppresses demand for interstate long distance services.

19. The *Access Charge Reform Order* also created the PICC, a flat per-line charge imposed by a price cap LEC on an end user's IXC, in order to phase out CCL charges. The Commission sought to establish economically efficient rate structures to encourage the development of efficient competition, thereby enhancing consumer welfare. PICCs have markedly reduced the per-minute recovery of local loop costs and raised flat recovery of non-traffic sensitive costs. Unfortunately, the advent of PICCs has also created market inefficiencies. Because IXCs have recovered the residential PICCs on a per-account basis, residential customers with only one line pay the same as those with two or more lines, and so pay more than the costs IXCs have incurred for providing them service. In addition, because PICCs are not assessed directly on consumers, but instead are subjected to averaging and mark-ups by the IXCs, consumers are prevented from making head-to-head comparisons among local service providers.

20. In the *Access Charge Reform Order*, the Commission also stated that its primary method for bringing about cost-based access charges was by letting competition establish efficient rates.[19] The Commission anticipated creating, in a later stage of access reform, a mechanism whereby rate regulation of services would be lessened, and eventually eliminated, as competition developed.[20] To the extent that competition did not fully achieve the goal of moving access rates toward costs, the Commission reserved the right to adjust rates in the future to bring them into line with forward-looking costs.[21] To assist in that effort, the Commission said it would require price cap LECs to start forward-looking cost studies by no later than February 8, 2001 for all services then remaining under price caps.[22]

B. Universal Service

21. One of the primary purposes of universal service support is to allow LECs and other eligible telecommunications carriers to provide certain basic services to customers in high-

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[19] *Access Charge Reform Order*, 12 FCC Rcd at 16001-02.

[20] *Access Charge Reform Order*, 12 FCC Rcd at 16003.

[21] *Access Charge Reform Order*, 12 FCC Rcd at 16002-03.

[22] *Access Charge Reform Order*, 12 FCC Rcd at 16003.

cost areas without having to charge these customers unaffordable rates.[23] Historically, in the interest of meeting the goal of universal service, LEC services have been subsidized or "supported" to enable high-cost consumers to be served at rates that are reasonably comparable to those in lower cost areas. This universal service support has been both explicit and implicit.

22. *Explicit Support*. Several federal programs have provided explicit universal service support in the form of direct monetary payments to carriers. This support has been provided for both intrastate and interstate services. For example, the Commission's high-cost support mechanism provides support for the costs of the intrastate portion of the local loop that significantly exceed the national average. By providing this federal support for intrastate costs, the Commission assists the states in ensuring that rates for intrastate rates remain affordable and reasonably comparable. Several state universal service programs also provide carriers with explicit support for their intrastate rates so that those carriers can serve customers in high-cost areas without having to charge prohibitively high rates. Carriers have also received explicit federal support for their interstate costs. For example, the Commission's Long Term Support (LTS) mechanism provides certain small carriers with support for the interstate portion of the local loop. This support allows such carriers to reduce the amount of the interstate costs that they would otherwise recover through access charges.

23. *Implicit Support*. In addition to receiving explicit universal service support, LECs also received implicit universal service support from a variety of sources. Some state rate structures have permitted LECs to charge rates for certain services that significantly exceeded the costs of providing those services, thereby enabling those LECs to charge below-cost rates for other services. For example, by charging above-cost rates for vertical services (*e.g.*, caller identification, call waiting), carriers can support the rates for basic local service. The Commission's interstate access charge structure also provided LECs with implicit universal service support. For example, LECs charge business customers interstate access rates that generally exceed those charged to residential customers, even though the costs of providing access to these groups of customers does not differ significantly. In particular, the multi-line business PICC creates a subsidy running from multi-line business subscribers to residential and single-line business subscribers to help LECs recover revenues that they would not otherwise recover from residential and single-line business subscribers due to the lower SLC caps on those lines.[24] In addition, by allowing LECs to recover non-traffic-sensitive (flat) costs through traffic sensitive (per minute) rates, high-volume users bear a greater share of the non-traffic-sensitive

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[23] The "designated" or "core" services a carrier must provide in order to be eligible to receive universal service support include: single-party voice service; voice grade access to the public switched network; DTMF signaling or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation services for qualifying low-income consumers. *See* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8809 (1997) (*Universal Service First Report and Order*), as corrected by Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Errata, FCC 97-157 (rel. June 4, 1997), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393 (5th Cir. 1999) (affirming in relevant part the Commission's decisions regarding implementation of the high-cost universal service support mechanism).

[24] *See Access Charge Reform Order*, 12 FCC Rcd at 16022-26.

costs than low-volume users, thus creating an implicit support flow from high-volume users to low-volume users. Furthermore, the practice of averaging rates over large geographic areas, for both intrastate and interstate services, results in subscribers in low-cost areas subsidizing the rates of subscribers in higher cost areas.

24. *Universal Service in a Competitive Environment.* This "patchwork quilt" of implicit support helped keep rates largely affordable in a monopoly environment where incumbent LECs could be guaranteed an opportunity to earn returns from certain services and customers that are sufficient to support the high cost of providing other services to other customers. The new competitive environment envisioned by the 1996 Act, however, threatens to undermine this implicit support structure over the long run. The 1996 Act removed barriers to entry in the local market, generating competitive pressures that may make it difficult for incumbent LECs to maintain access charges above economic cost. Thus, where existing rules require an incumbent LEC to set access charges above cost for a high-volume user, a competing provider of local service can lease unbundled network elements at cost, or construct new facilities, thereby undercutting the incumbent's access charges. As competition develops, incumbent LECs may be forced to lower their access charges or lose market share, in either case jeopardizing the source of revenue that, in the past, has permitted the incumbent LEC to offer service to other customers, particularly those in high-cost areas, at below-cost prices.[25] Incumbent LECs have been claiming that this process has already made more than trivial inroads on their high-volume customer base.[26]

25. Recognizing the disruptive effects that competition would have on universal service support mechanisms developed in a monopoly environment, Congress instructed the Commission, after consultation with the Federal-State Joint Board on Universal Service (Joint Board), to establish specific, predictable, and sufficient mechanisms to preserve and advance universal service.[27] Congress concluded that the support provided by these mechanisms "should be explicit and sufficient to achieve the purposes" of section 254, which include the purpose that all Americans should have access to telecommunications services at affordable and reasonably comparable rates.[28] In response to this directive, the Commission has taken several actions to put

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[25] *See, e.g.,* H. REP. NO. 204, 104th Cong., 1st Sess. 68 (1995) (The bill "would make such internal subsidies much less viable because deregulation would remove the near-guaranteed returns allowed in a regulated market, and with them the ability of the regulated firm to subsidize high-cost customers.")

[26] *See, e.g.,* U S West Forbearance Petition (Phoenix), CC Docket No. 98-157 (filed Aug. 24, 1998); SBC Communications, Inc. Forbearance Petition, CC Docket No, 98-227 (filed Dec. 7, 1998); U S West Forbearance Petition (Seattle), CC Docket No. 99-1 (filed Dec. 30, 1998); and Ameritech Forbearance Petition, CC Docket No. 99-65 (filed Feb. 5, 1999).

[27] 47 U.S.C. § 254(a), (d). *See also* Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Notice of Proposed Rulemaking and Order Establishing Joint Board, 11 FCC Rcd 18092 (1996) (*Universal Service NPRM*).

[28] 47 U.S.C. § 254(b), (e). According to the Joint Explanatory Statement, the purpose of the 1996 Act is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans (continued....)

in place universal service support mechanisms that will be sustainable in an increasingly competitive marketplace. These actions fall into three general categories: (1) reforming our existing universal service support mechanisms;[29] (2) reforming our interstate access charge regime to identify implicit universal service support and to remove such implicit support from our interstate access charges,[30] and (3) establishing new universal service mechanisms.[31] In this Order, we focus our efforts in these last two categories.

C. The Current Situation

26. Undoing the Gordian knot of determining the appropriate level of interstate access charges and converting implicit subsidies in interstate access charges into explicit, portable, and sufficient universal service support cannot be accomplished with one stroke of the sword. Determining the cost of providing service in every area of the country is a difficult, time-consuming task that regulators cannot perform with exactitude. The particular method that should be used for determining the cost of providing service is itself a contentious issue as are the results achieved from various proposed methods. The incumbent LECs have traditionally argued that they must maintain their current revenue streams to support universal service, while IXCs and consumer groups have argued that access charges should be reduced by amounts in excess of the amount that is converted into explicit universal service support. The subsidies implicit in geographic averaging must be reduced if competition is to develop outside of urban areas; but these subsidies can never be entirely eliminated, without pricing service on a line-by-line-by-line basis. Affordability concerns deter us from allowing end-user charges in higher cost areas to increase to the point where they recover the cost of providing service in those areas, whether cost is determined on a forward-looking or historic basis. These disputes and concerns have dragged on for years and could do so indefinitely.

27. As we devise a transition to a more economically rational approach to access charges and universal service, we need to balance various and sometimes conflicting interests – including promotion of competition, deregulation, maintaining affordability for all, and avoiding rate shock to consumers. It is important, however, that the Commission not permit itself to be gridlocked into inactivity by endeavoring to find precise solutions to each component of this

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by opening all telecommunications markets to competition . . . ." Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113 (Joint Explanatory Statement).

[29] Federal-State Joint Board on Universal Service, Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, and Fourth Report and Order in CC Docket No. 96-262 and Further Notice of Proposed Rulemaking, 14 FCC Rcd 8078 (1999), petition for review filed *sub. nom. Vermont Department of Public Service v. FCC*, No. 99-60530 (5th Cir., filed June 23, 1999) (*Universal Service Seventh Report and Order*); Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999) (*Universal Service Ninth Report and Order*).

[30] *Universal Service First Report and Order*, 12 FCC Rcd at 9162; *Access Charge Reform Order*, 12 FCC Rcd at 16144-50 .

[31] *See, e.g., Universal Service First Report and Order*, 12 FCC Rcd at 9007.

complex set of problems. It is preferable and more reasonable to take several steps in the right direction, even if incomplete, than to remain frozen with indecision because a perfect, ultimate solution remains outside our grasp.

28. Against this background, certain segments of the industry have developed a comprehensive consensus approach to resolve outstanding issues concerning access charges and universal service. The Order we adopt today will result in lower rates for both low-volume and high-volume long-distance consumers, more competition, fewer line items on consumers' phone bills, greater flexibility for price cap LECs to meet competition, and an explicit, portable interstate access universal support mechanism. It is this comprehensive solution of historically contentious issues that allows us to take these actions while ensuring that consumers in high-cost areas will continue to have affordable service.

III. EXECUTIVE SUMMARY

29. CALLS has presented us with an integrated and cohesive proposal that aims to resolve major outstanding issues concerning access charges: the pending NPRM to address implicit universal service support in access charges,[32] the X-factor remand,[33] the Low-Volume Long-Distance Users NOI,[34] the pending NPRM on geographically deaveraging SLCs[35] and the next scheduled price cap performance review.[36] In addressing these issues, the CALLS Proposal reduces, and in most instances eliminates, implicit subsidies among end-user classes; makes implicit universal service funding in access charges explicit and portable; provides significant benefits to consumers who make few or no long distance calls; and sets carrier charges at reasonable levels. Because we find that the CALLS Proposal resolves these issues in a way that benefits consumers and is pro-competitive and economically efficient, we adopt certain parts of the plan, largely rate structure components, as mandatory for all price cap LECs for the full five-years of the plan. As discussed in more detail below, for certain rate-level components of the plan, we adopt it as mandatory on an interim basis. Price cap LECs will be able to choose between having these interim rate-level components apply for the full five years or having their rates reinitialized based on forward-looking economic cost.

30. The proposal provides for the following:

1) Elimination of the residential PICC;

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[32] *Universal Service Seventh Report and Order*, 14 FCC Rcd at 8078.

[33] Price Cap Performance Review For Local Exchange Carriers, CC Docket No. 94-1, Notice of Proposed Rulemaking, 14 FCC Rcd 19717 (1999) (*1999 Price Cap FNPRM*).

[34] *Low-Volume Long-Distance Users NOI*, 15 FCC Rcd 6298.

[35] Access Charge Reform, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, 14320-23 (1999) (*Pricing Flexibility Order*).

[36] *1997 Price Cap Review Order*, 12 FCC Rcd at 16707.

2) Increases to the primary residential and single-line business SLC caps, beginning at $4.35 on July 1, 2000, and gradually increasing to $6.50 on July 1, 2003, provided that LECs can justify any increase beyond $5.00;

3) A review of the SLC rates prior to the increase scheduled for July 1, 2002, including evaluation of forward looking cost information;

4) Targeting of an X-factor[37] for switched access to switching and switched transport elements;

5) Creation of a separate X-factor for special access services;

6) $2.1 billion in reductions to switched access usage rates effective July 1, 2000;

7) Reduction of the switched access X-factor to the Gross Domestic Product-Price Index (GDP-PI) once specific target rate levels are achieved;

8) Removal of $650 million in implicit universal service support from access charges, and the creation of an explicit, portable interstate access universal service support mechanism at the same level;

9) Recovery of LEC universal service contributions directly from end users;

10) Elimination of MUCs by participating long-distance carriers;

11) A commitment by participating long distance carriers to flow through reductions in access rates to residential and business customers over the life of the plan; and

12) Adjustment of the Lifeline Assistance universal service support mechanism to shield low-income customers from increases in the residential SLC.

31. As an initial point, the CALLS Proposal reduces, and in many cases eliminates, implicit subsidies among customer classes through two means. First, by permitting a greater proportion of the local loop costs of primary residential and single line business customers to be recovered through the SLC, rather than through the CCL charge and the multi-line business PICC, the CALLS Proposal reduces, and in most instances removes, the subsidies associated with both of the latter charges. Second, by permitting participating LECs to deaverage their SLCs once the CCL charge and multi-line business PICCs are eliminated, the CALLS Proposal reduces the subsidy that subscribers in low-cost areas provide those in higher cost areas.

32. The CALLS Proposal reduces these subsidies, and keeps rates affordable in high-cost areas, by replacing the subsidies with explicit interstate access universal service support. In

[37] The X-factor is a mechanism used to reduce access rates. *See* Section IV.B. *infra* for a full discussion.

section 254(e), Congress stated that federal universal service support should be made explicit.[38] The CALLS Proposal identifies and removes $650 million of implicit universal service support in interstate access charges, creates an explicit interstate access universal service support mechanism in this amount to replace the implicit support, and makes interstate access universal service support fully portable among eligible telecommunications carriers.[39] The CALLS Proposal conforms with our tentative conclusion in the *Universal Service Seventh Report and Order* that price cap LECs should reduce their interstate access rates to reflect any increase in explicit high-cost support.[40] In addition, we conclude that this interstate access universal support mechanism is specific, predictable and sufficient. Moreover, by making universal service support explicit and portable, the interstate access universal support mechanism should also encourage competitive entry into high-cost areas.

33. We note that even as the CALLS Proposal phases out these subsidies, it maintains several safeguards that ensure that the rates consumers pay for the SLC remain well within a zone of reasonableness. The CALLS Proposal maintains an overall cap on the SLC assessed on primary residential and single-line business lines at $6.50, and could set the cap even lower if price cap LECs cannot justify higher increases. Thus, as explained below, CALLS ensures that basic telephone service does not become too expensive. The CALLS Proposal also asks the Commission to examine the appropriateness of setting the SLC caps for primary residential and single-line business lines above $5.00 before doing so.[41] In addition, the CALLS Proposal provides for additional Lifeline support so that low-income subscribers will not be hurt by increases to the primary residential SLC cap. LEC signatories to the CALLS Proposal have also agreed not to assess universal service charges on Lifeline customers.[42]

34. Low-volume long-distance users also benefit from the CALLS proposal. First, AT&T and Sprint both commit to having no monthly minimum charge on their Basic Schedule for at least three years. Second, both carriers agree to eliminate their PICC pass-through charges for residential and single-line business subscribers in light of the elimination of the PICCs for those customers. Third, in a move that benefits all subscribers, both carriers have agreed to flow through to residential and business customers the savings they realize from the CALLS-related reductions in access charges. We find that these commitments are in the public interest and adopt them as requirements of this Order.

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[38] 47 U.S.C. § 254(e).

[39] The interstate access universal service support is distinct from the intrastate high-cost support already in place for local rates. *See, e.g., Universal Service Ninth Report and Order*, 14 FCC Rcd at 20436.

[40] *Universal Service Seventh Report and Order*, 14 FCC Rcd at 8139.

[41] As revised, the CALLS Proposal acknowledges that at the time of the cost proceeding, parties can argue that certain revenues, rather than be incorporated into the SLC, should be disallowed. *See Wallman March 30 Letter* at 2.

[42] *Wallman March 30 Letter* at 3.

35. Today, we adopt the CALLS Proposal because it accomplishes many objectives that the Commission to date has been unable to achieve in the absence of an industry consensus plan, while providing significant consumer benefits that we would not otherwise be able to ensure on such a wide-scale basis and in such a timely manner. We therefore find the CALLS Proposal to be in the public interest. Certainly there is no guarantee that, at the end of the CALLS Proposal's five-year term, competition will exist to such a degree that deregulation of access charges for price cap LECs is the next logical step. Nevertheless, the CALLS Proposal provides stability during its term and addresses several issues that have served as major obstacles to access charge reform and universal service. We also find the CALLS Proposal to be consistent with our market-based approach to regulation.

IV. DISCUSSION

36. We approve and adopt the CALLS Proposal because it resolves in a manner consistent with the public interest a number of complex, contentious and interrelated issues that stand as a roadblock to a competitive marketplace.[43] The CALLS Proposal is a reasonable approach for moving toward the Commission's goals of using competition to bring about cost-based rates, and removing implicit subsidies without jeopardizing universal service. The CALLS proposal is not designed as a permanent solution to all of the issues it addresses; instead, it is a transitional plan that moves the marketplace closer to economically rational competition, and it will enable us, once such competition develops, to adjust our rules in light of relevant market developments.[44] Consequently, as the term of the CALLS Proposal nears its end, we envision that the Commission will conduct a proceeding to determine whether and to what degree it can deregulate price cap LECs to reflect the existence of competition.[45] At that time, the Commission can also examine whether the interstate access universal service support mechanism remains sufficient.

37. The CALLS Proposal provides relative certainty in the marketplace during its five-year term. All parties will have a much clearer blueprint for developing their business plans and attracting capital than they would in the absence of CALLS. As the Massachusetts Department observes, "Resolving so many contentious issues . . . as the CALLS plan does, reduces this uncertainty to the point that it should not be a significant factor in capital investment."[46]

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[43] Indeed, in a similar context, the D.C. Circuit has admonished the Commission that "[t]he best must not become the enemy of the good, as it does when the FCC delays making any determination while pursuing the perfect tariff." *MCI v. FCC*, 627 F.2d 322, 341-42 (D.C. Cir. 1980).

[44] As explained below, price cap LECs that do not elect the rate level components of the CALLS Proposal will be subject to a forward-looking costs proceeding for those rates.

[45] We note that the Commission has the authority to modify the rules we adopt today before the end of the five-year term of the CALLS Proposal. This Order addresses a marketplace that is dynamic and evolving, and the Commission may exercise its authority should the need arise.

[46] Mass. DTE Comments at 8.