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

In the Matter of	)	
Improved Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers And Interexchange Carriers	)	RM No. _______

PETITION FOR RULEMAKING OF THE LEC MULTI-ASSOCIATION GROUP

FILING ASSOCIATIONS:

National Rural Telecom Association

National Telephone Cooperative Association

Organization for the Promotion and Advancement of Small Telecommunications Companies

United States Telecom Association

October 20, 2000

SUMMARY

The Multi-Association Group (NRTA, NTCA, OPASTCO, and USTA) presents this holistic plan for the Commission's regulation of those incumbent local exchange carriers ("LECs") not subject to price cap regulation. These non-price cap LECs include most of the small and mid-sized LECs that serve U.S. rural and insular areas.

The plan seeks to address in a comprehensive manner the numerous issues that face non-price cap LECs. The plan would create more efficient cost recovery under the Commission's access charge system while making universal service support more explicit and enforcing the geographic averaging requirements of the Communications Act. The plan will help ensure that up-to-date broadband infrastructure and advanced services will be widely available to all Americans, consistent with section 706 of the Act. The plan would take effect on July 1, 2001.

The plan moves in the same policy direction as the recent recommendation of the Rural Task Force ("RTF") to the Federal-State Joint Board, although there are differences between the plan and the RTF recommendation. This plan also is compatible with, but not identical to, one for price cap LECs and interexchange carriers ("IXCs") that the Commission adopted based on a proposal of the Coalition for Affordable Local and Long Distance Service ("CALLS").

The plan consists of two regulatory regimes or "paths," Path A and Path B. The plan's features, and the two regulatory paths it adopts, reflect the great diversity of non-price cap LECs. These LECs range in size from those serving a few hundred customers to multiple thousands. They serve the most rural areas of the United States as well as some growing suburban areas.

Each operating company of the non-price cap LECs will elect either Path A or Path B before the start of the plan. Both paths of the plan reform the access charge structure to provide

for more efficient cost recovery. They do so by raising the subscriber line charges ("SLCs") of the non-price cap LECs. The plan also mandates lower long distance rates for residential consumers in the territories of LECs subject to it. With the more economically efficient access charges that will result from the plan, IXCs more readily will be able to satisfy the geographic rate averaging requirements of the Act. IXCs will flow through to consumers the savings from decreases in such charges.

For both paths of the plan, Lifeline support will be increased to be consistent with the Commission's recent CALLS order. Like the RTF recommendation, the plan recognizes that the Commission's current rules do not fully address universal service concerns. The plan moves further than the RTF recommendation by removing the current caps on high cost loop support and other universal service support for both Path A and Path B.

LECs electing Path A will have a period of up to five years from the start of the plan to transition on a per-study-area basis from their existing forms of rate-of-return regulation to a new form of incentive regulation. The length of this period is designed to permit a reasonable, but flexible, transition to incentive regulation. At the end of the transition period, all study areas of Path A LECs that have not already converted to incentive regulation will do so.

In the plan's form of incentive regulation, a LEC's interstate access revenue per line ("RPL") is fixed but adjusted annually for inflation. Under this type of incentive regulation, a Path A LEC's annual interstate access revenues will be calculated as the product of its annual RPL and its line count for that year. Such regulation incorporates major incentives for maximizing efficiency, thus complementing the Commission's price cap regime for the largest LECs. Similar to that regime, the plan includes a low end adjustment mechanism for Path A LECs. This RPL-based form of incentive regulation is designed to be compatible with the pooling system administered by NECA. The plan replaces the current two-pool system that NECA administers with a single pool.

The plan creates a new form of explicit interstate universal service support, known as rate averaging support ("RAS"), to be available to Path A LECs in the NECA pool. The RAS will function similarly to long term support in lowering access charges. The RAS will be portable to eligible telecommunications carriers. The RAS is a major step in moving universal service support for LECs subject to the plan away from implicit mechanisms in a competitively neutral way. By providing for more explicit universal service support, Path A also promotes equitable and efficient competition.

LECs that elect Path B initially will remain under their existing forms of rate-of-return regulation as average schedule or cost companies. Path B serves the public interest because it recognizes the diverse conditions faced by non-price cap LECs. Path B advances the public interest by implementing most of the same access charge and universal service reforms as Path A, with the same types of benefits to consumers. Path B LECs do not receive the RAS. The currently authorized interstate rate of return will remain in place for Path B LECs and Path A LECs with study areas not yet subject to incentive regulation.

The plan encourages Path B LECs to move to the plan's form of incentive regulation by permitting them to choose to become Path A LECs prior to the end of the five-year transition period. From the time that such LECs become Path A LECs through the end of the transition period, they will be able to elect incentive regulation on a per-study area basis, like other Path A LECs. After the end of the transition period, like other Path A LECs, all Path B study areas that have moved to Path A within the transition period must convert to incentive regulation.

The Group asks the Commission to adopt the plan as expeditiously as possible.

GLOSSARY

CALLS	Coalition for Affordable Local and Long Distance Service
CAR	Composite Access Rate
CCL	Carrier Common Line
ETC	Eligible Telecommunications Carrier
IXC	Interexchange Carrier
LEC	Local Exchange Carrier
LSS	Local Switching Support
LTS	Long Term Support
MAG	LEC Multi-Association Group
NRTA	National Rural Telephone Association
NTCA	National Telephone Cooperative Association
NTS	Non Traffic Sensitive
OPASTCO	Organization for the Promotion and Advancement of Small Telecommunication Companies
RAS	Rate Averaging Support
RPL	Revenue Per Line
RTF	Rural Task Force
SLC	Subscriber Line Charge
TS	Traffic Sensitive
USTA	United States Telecom Association

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Exhibit 1: Detailed Description Of The Plan

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PETITION FOR RULEMAKING OF THE LEC MULTI-ASSOCIATION GROUP

I. INTRODUCTION

A. The Group Requests Adoption Of The Plan Presented Here

The LEC Multi-Association Group (the "Group")[1] hereby files this petition for rulemaking pursuant to section 1.401 of the Commission's Rules.[2] In this petition, the Group presents a holistic plan for the Commission's regulation of those incumbent local exchange carriers ("LECs") not subject to price cap regulation (hereinafter "non-price cap LECs"). These carriers, many of which belong to one or more of the associations in the Group, include most of the small and mid-sized LECs that serve the rural and insular areas of the United States. The Group's plan is essential to meeting the Commission's multiple policy goals for rural and insular areas under the Communications Act of 1934, as amended by the Telecommunications Act of 1996 (collectively the "Act").

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1 The Group consists of the National Rural Telecom Association ("NRTA"), the National Telephone Cooperative Association ("NTCA"), the Organization for the Promotion and Advancement of Small Telecommunications Companies ("OPASTCO"), and the United States Telecom Association ("USTA"). The National Exchange Carrier Association ("NECA") provided numerical support for the development of the plan presented in this petition.

2 *See* 47 C.F.R. § 1.401.

The plan presented here moves in the same policy direction as the recommendation to the Federal-State Joint Board that the Rural Task Force ("RTF") recently released, although there are differences between the plan and the RTF recommendation.[3] The RTF recommendation makes a very strong start in addressing the universal service issues that face rural America, and the Group endorses many of the RTF's policy positions. In contrast to the RTF recommendation, this plan provides a comprehensive approach to access reform and incentive regulation as well as universal service. Indeed, the differences between the plan presented here and the RTF recommendation are the result of the Group's consideration of the additional issues facing non-price cap LECs that were not the focus of the RTF recommendation. The Group supports efforts by the RTF for the Joint Board and the Commission to consider promptly the RTF Recommendation and this plan, which are closely linked.

This plan also is compatible with, but not identical to, one for price cap LECs and IXCs that the Commission adopted in May 2000 based on a proposal of the Coalition for Affordable Local and Long Distance Service ("CALLS").[4] When adopted, the plan presented in this petition will result in benefits for consumers and regulation for non-price cap LECs that are consistent with those of the CALLS order. The differences between this plan and that of the CALLS order are necessary to address the high costs and diverse service conditions faced by most non-price

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3 *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service (rel. Sept. 29, 2000) ("RTF Recommendation").

4 *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262 *et al.*, 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, FCC 00-193 (rel. May 31, 2000) (the "CALLS order").

cap LECs in serving their customers.[5]

Section II of this petition discusses the need for a comprehensive approach to the policy issues involving non-price cap LECs and their customers. Section III discusses the consumer benefits of the plan in addressing these issues. Exhibit 1 explains the plan in detail.[6] Exhibit 2 is an affidavit of Dr. James H. Vander Weide, Research Professor of Finance and Economics, Fuqua School of Business, Duke University, that discusses the economic and consumer welfare characteristics of the plan.[7] Proposed rules to implement the plan are attached in Exhibit 3. Because of the plan's comprehensive nature, the Group urges the Commission to issue a notice of proposed rulemaking seeking implementation of the plan as presented here, in a docket that addresses the pending proceedings that apply to non-price cap LECs.[8] Doing so will permit the Commission and the public to consider fully the plan's merits. The Group urges the Commission to adopt the plan expeditiously in the form presented here.

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[5] The RTF has documented the diversity of rural and insular service areas and their differences from urban areas. *See* RTF, *The Rural Difference*, White Paper 2 (Jan. 2000).

[6] The attached exhibits are to be considered part of this petition.

[7] Affidavit of Dr. James H. Vander Weide, Research Professor of Finance and Economics, Fuqua School of Business, Duke University, attached as Exhibit 2 (the "Vander Weide testimony").

[8] The Group respectfully requests the Commission to move speedily to issue a notice of proposed rulemaking regarding this petition as it did in the CALLS proceeding. This petition clearly presents a comprehensive and workable plan to address the issues facing non-price cap LECs and their customers. *See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262 *et al.*, Notice of Proposed Rulemaking, 14 FCC Rcd. 16872 (1999).

The Group recognizes that the Commission will likely refer aspects of this plan involving universal service to the Federal-State Joint Board that is considering such issues, and commits to working closely with the Joint Board to expedite consideration of the plan.

B. Overview Of The Plan

1. General Characteristics

We propose that the plan take effect on July 1, 2001. The plan consists of two regulatory regimes or "paths," Path A and Path B.[9] Each operating company of the non-price cap LECs will elect one of the paths before the start of the plan. Both paths of the plan reform the access charge structure to provide for more efficient cost recovery. They do so by raising subscriber line charges ("SLCs") for non-price cap LECs.[10] The plan also mandates lower long distance rates for residential consumers in the territories of LECs subject to it. With the more economically efficient access charges that will result from Paths A and B under the plan, IXCs more readily will be able to satisfy the geographic rate averaging requirements of the Act.[11] Interexchange carriers ("IXCs") will flow through to consumers the savings from decreases in such charges.

For both paths, the plan increases Lifeline support to be consistent with the CALLS order. Like the RTF recommendation, the plan recognizes that the Commission's current rules do not fully address universal service concerns.[12] The plan moves further than the RTF recommendation by removing the current caps on high cost loop support and other universal service support for both Path A and Path B.

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[9] Because this plan applies to only the interstate access services of certain LECs, it does not affect the states' jurisdiction over those carriers' intrastate services.

[10] *See Deployment of Advanced Telecommunications Capability: Second Report, CC Docket No. 98-146*, (rel. Aug. 21, 2000) para. 267, n. 395.

[11] *See* section 254(g) of the Act, 47 U.S.C. § 254(g).

[12] *See, e.g.*, RTF Recommendation at 21.

2. Path A

The Group anticipates that LECs electing "Path A" will be those serving the majority of access lines of LECs subject to the plan. Path A LECs will have a period of up to five years from the start of the plan to transition on a per-study-area basis from their existing forms of rate-of-return regulation to a new form of incentive regulation.[13] The length of this period is designed to permit a reasonable, but flexible, transition to incentive regulation. At the end of the transition period, all study areas of Path A LECs that have not already converted to incentive regulation will do so.

In the plan's form of incentive regulation, a LEC's interstate access revenue per line ("RPL") is fixed but adjusted annually for inflation. Under this type of incentive regulation, a Path A LEC's annual interstate revenues will be calculated as the product of its annual RPL and its line count for that year. This RPL-based form of incentive regulation is designed to be compatible with the pooling system administered by NECA. The Vander Weide testimony makes clear that such regulation incorporates major incentives for maximizing efficiency.[14] RPL regulation thus complements the Commission's system of price cap regulation of the largest LECs.

The plan also creates a new form of explicit interstate universal service support, known as rate averaging support ("RAS"), that is available to Path A LECs in the NECA pool. The RAS functions similarly to long term support in lowering access charges. The RAS is portable

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[13] Under Path A, non-price cap LECs would elect the plan's form of incentive regulation on a per-study area basis, and also elect whether such study areas would participate in the pool. All study areas of such LECs not on the plan's form of incentive regulation would continue to be subject to their pre-existing form of rate-of-return regulation – that is, regulation on a cost or average schedule basis.

[14] *See* Exhibit 2 at 2-14, 2-18, 2-19.

to eligible telecommunications carriers ("ETCs"). The RAS is a major step in moving universal service support for LECs subject to the plan away from implicit mechanisms in a competitively neutral way.[15] By providing for more explicit universal service support, Path A also promotes equitable and efficient competition. The plan's incentives for efficient operation under RPL regulation, the continued availability of universal service support through the RAS, and removal of the caps on universal service funding will ensure that up-to-date broadband infrastructure and advanced services will be widely available to all Americans, consistent with section 706 of the Act.[16]

3. Path B

Those LECs that elect "Path B" initially will remain under their existing forms of rate-of-return regulation as average schedule or cost companies. Path B serves the public interest because it recognizes the diverse conditions faced by non-price cap LECs.[17] Path B addresses the concerns of those LECs that determine that Path A incentive regulation is not feasible for their demographic, geographic, and operating conditions. Path B advances the public interest by implementing most of the same access charge and universal service reforms as Path A, with the same types of benefits to consumers. Path B LECs do not receive the RAS.

The plan encourages Path B LECs to move to the plan's form of incentive regulation by permitting them to choose to become Path A LECs prior to the end of the five-year transition period. From the time that such LECs become Path A LECs through the end of the transition period, they will be able to elect incentive regulation on a per-study area basis, like other Path A

15 *See* Exhibit 2 at 2-14 through 2-16.

16 *See* Section 706 of the Act, 47 U.S.C. § 706.

17 *See, e.g., The Rural Difference, supra*, at 15-17, 25-26.

LECs. After the end of the transition period, like other Path A LECs, all Path B study areas that have moved to Path A within the transition period must convert to incentive regulation. After the end of the transition period, any LEC that remains on Path B must obtain a waiver of the Commission's rules to be subject to incentive regulation. The currently authorized interstate rate of return will remain in place for Path B LECs and those study areas of Path A LECs not yet subject to incentive regulation.

The plan's features, and particularly the two regulatory paths it adopts, reflect the great diversity of non-price cap LECs. These LECs range in size from those serving a few hundred customers to multiple thousands. They serve the most rural areas of the United States as well as some growing suburban areas. Non-price cap LECs are regulated at the federal level under systems as different as average schedule and cost regulation, although the overwhelming majority participate in the NECA pooling system.[18] As distinguished from the CALLS order, this plan accounts for these differences, and does so in a comprehensive, flexible manner.

II. THE POLICY ISSUES AFFECTING NON-PRICE CAP LECs REQUIRE A COMPREHENSIVE APPROACH

The plan presented in this petition is the best way to address several fundamental issues that are critical to non-price cap LECs and the customers they serve. These issues include access charge reform, universal service, separations reform, and rate of return represcription. The Commission currently has separate dockets pending for all of these matters.[19] Yet these issues

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18 Indeed, 99.4% of all non-price cap LECs now participate in NECA's common line pool.

19 *See, e.g., Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Notice Initiating a Prescription Proceeding and Notice of Proposed Rulemaking, 13 FCC Rcd 20561 (1998) ("Represcription Notice"); *Access Charge Reform For Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation,* CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd 14238 (1998)

are inter-related, and they have major effects on the benefits to consumers and service providers that effective regulation must address. Indeed, the outcome of any one of these proceedings will affect, and could determine, the outcomes of the others.

With these proceedings pending, LECs subject to the plan must address substantial regulatory uncertainty at the federal level. The 1996 amendments to the Act fundamentally changed the structure of the telecommunications industry, most notably by opening to competition those LEC markets that previously were subject to exclusive regulatory franchises.[20] The LECs subject to this plan and their customers have been adjusting to the implications of these fundamental changes. However, the future is anything but certain.[21] Such uncertainty diminishes the incentives of these carriers to invest, and its raises their cost of capital.[22] At the same time, risk increases for all telecommunications service providers in the service areas of these carriers. This unnecessary risk harms, rather than benefits, consumers.

Rather than permitting such uncertainty to continue, the Commission should move to resolve the regulatory issues that confront non-price cap LECs. In light of the numerous competing issues that the associations in the Group and their members have considered in

("Access Notice"); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8889, 8936 (1997) (holding that existing high-cost support mechanisms for rural LECs shall remain in place until at least January 1, 2001); *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Recommended Decision, FCC 00J-2 (Jt. Bd. rel. July 21, 2000).

20 *See, e.g.*, section 253 of the Act, 47 U.S.C. § 253.

21 Certain LECs were either exempted from some provisions of the Act or were expressly permitted to seek suspension or modification of some of those provisions. *See, e.g.*, section 251(f) of the Act, 47 U.S.C. § 251(f).

22 *See* Joint Direct Case and Comments of Local Exchange Carrier Associations, CC Docket No. 98-166 (filed Jan. 19, 1999) at 7-11.

designing the plan, the Group urges the Commission to adopt the plan presented here in its entirety. The plan, with its alternative regulatory paths, resolves these issues in an integrated manner, consistent with the Act. The plan is the product of lengthy discussions and compromises among the associations in the Group and their member LECs. These compromises were necessary because of the great diversity among these LECs, their customers, and the areas that they serve.[23]

III. THE PLAN ADDRESSES THE MAJOR POLICY ISSUES INVOLVING NON-PRICE CAP LECs AND THEIR CUSTOMERS

The Group believes that this plan best meets the needs of customers in the service areas of non-price cap LECs, as well as the LECs themselves. The Group and its members have a strong interest in adoption of this plan, which will improve the ability of these members -- incumbent LECs operating in rural and insular areas throughout the United States -- to serve the public.

The plan will serve the public interest by benefiting consumers in several ways. The plan will set the interstate access charges of non-price cap LECs on a more economically sound basis by increasing SLCs and lowering per-minute access charges. This access charge reform will permit more efficient cost recovery. It will result in lower per-minute charges from IXCs, saving consumers money and stimulating network usage.

Both Paths A and B of the plan benefit consumers by promoting rate and service comparability between rural and urban areas. Moreover, Path A of the plan reduces implicit universal support and makes such support portable, explicit, and competitively neutral. The plan advances the public interest by providing the stable regulatory environment necessary to

[23] *See The Rural Difference*, *supra*, at 24-31.

encourage the deployment of new network technologies, while permitting competition in the lightly populated areas served by many LECs subject to the plan.

A. The Plan Promotes Efficient Cost Recovery

The plan improves the access charge structure for all Path A and Path B LECs, both within and outside the NECA pool system. It benefits consumers by doing so consistently with, but not identically to, the CALLS order. The SLCs of all non-price cap LECs will increase, tracking the SLC caps for carriers subject to the CALLS order (the "CALLS carriers"), so long as those caps are reasonably comparable to the CALLS carriers' actual SLCs.[24] Thus, the SLC for residential and single business lines would change to $5.00 per month on July 1, 2001, and would change consistent with the SLC caps for CALLS carriers thereafter.[25] SLCs for multi-line business lines would change from the current rate of $6.00 per line to $9.20 per line by July 1, 2003. These changes will substantially increase the portion of the common line revenue requirement recovered through flat-rated charges.[26]

For both Path A and Path B LECs, the plan retains existing per-minute switched access rate elements such as those for local switching, transport, the residual interconnection charge, and the carrier common line charge. However, for Path A LECs, the plan establishes a weighted

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24 The CALLS order provides that CALLS carriers' primary residential and single-line business SLC is capped at $4.35 per line beginning July 1, 2000, $5.00 per line as of July 1, 2001, $6.00 per line as of July 1, 2002, and $6.50 per line as of July 1, 2003, subject to Commission review. *See* CALLS order, para 70.

25 There will be no separate SLC for non-primary residence lines.

26 Similarly to the CALLS order, the plan permits limited SLC deaveraging. The Plan provides for SLC deaveraging in up to three geographic zones. However, if pool participants deaverage their SLCs, their revenues from SLCs will be imputed as if they had been set at the maximum amount.

per-minute aggregate target for these rates, known as the Composite Access Rate ("CAR"). Path A pool switched access rates will be adjusted to meet this target composite rate. Under the plan, the Commission will set the CAR to be 1.6 cents per minute on average by July 1, 2003 – two years after the start of the transition period -- for Path A LECs' study areas that participate in the pool. While SLCs increase, NECA will adjust the CAR to reach the 1.6 cents per minute target by July 1, 2003, two years into the transition period. Indeed, the existing composite interstate per-minute access rate for non-price cap LECs is 3.94 cents per-minute.[27] The CAR at the 1.6 cents per minute level thus reflects a percentage reduction in the per-minute switched access rates of non-price cap LECs comparable to that of the CALLS order.

NECA will tariff special access services for Path A and Path B pool participants, and will have the flexibility to develop price structures that align prices for special access more closely with costs as they vary by study area. These LECs also may elect to tariff special access services outside the NECA pool. Current flexibility for individual special access rates would continue to apply.

New services that Path A LECs introduce will be priced at current market rates, either by NECA as part of the pooling process or outside that process. Path A also provides for adjustments to incentive-based RPL pool settlements and streamlining of existing processes when Path A LECs with study areas in the pool acquire lines, exchanges or study areas.[28]

All LECs subject to incentive regulation may leave the NECA pool on a per-study area basis to gain additional pricing flexibility outside the pool. Such LECs must file and maintain

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27 The comparable NECA per-minute access rate is 4.3 cents per-minute.

28 The plan also modifies the Commission's existing rules regarding the application of price cap regulation and study area boundaries in mergers and acquisitions. *See* Exhibit 1 at 1-13; Exhibit 3 at 3-3, 3-8 (discussing the plan's treatment of mergers and acquisitions).

their own access tariffs for non-pooling study areas. The benefits of the plan's access charge reforms continue to apply, since the increased SLCs will result in reduced per-minute charges.[29] Special access rates would be set on a flexible market basis. Path A LECs would set all other access rates using their existing RPL, including universal service funding foregone by exiting the pool. LECs outside the pool do not receive the RAS or LTS. The plan thus provides that Path A LECs that choose not to participate in the NECA pool will bear the greater risks associated with the flexibility that they gain. Path B LECs outside the pool will be subject to existing forms of regulation.

B. The Plan Makes Universal Service Support More Explicit And Advances The Goals Of Rate and Service Comparability

Non-price cap LECs confront unique challenges in providing universal service while addressing the prospect of competition as mandated by the Act. These LECs serve only about seven percent of U.S. access lines. Such LECs are predominantly in the rural and insular areas of the United States with high line costs and low population densities, where universal service and broadband deployment concerns are greatest. As elsewhere, competition in the service areas of LECs subject to the plan focuses on business customers.[30] Because many of these LECs have very limited customer bases, the loss of a few business customers to competitors can place these LECs and their residential customers at risk. Regulatory reform for non-price cap carriers must account for such conditions in order to advance traditional concepts of universal service, as well as to close the "Digital Divide" in under-served areas. As NECA recently concluded, more than

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[29] There will be no non-primary line SLC.

[30] *See, e.g., Federal Communications Commission Takes Steps To Promote Telecommunications on Tribal Lands*, WT Docket No. 99-266, CC Docket No. 96-45, FCC News Release (June 8, 2000).

$10.9 billion is needed to upgrade telephone lines served by rural telephone companies to broadband capability.[31]

At the same time, in many rural, insular, and high-cost areas, IXCs have not provided services and rates comparable to those available in urban areas, contrary to the Act's important national goal of making comparable rates and services available to consumers in rural and urban areas alike.[32] Because some IXCs have refused to offer their discount calling plans to rural and insular customers served by LECs subject to the plan, customers in those areas do not receive the full benefits of access charge reductions by LECs subject to the plan or of competition among IXCs.[33]

The plan addresses these problems by ensuring that IXCs will comply fully with the geographic averaging of section 254(g) of the Act.[34] The plan thus requires IXCs to pass

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[31] *See* Letter from NECA to Magalie Roman Salas, Secretary, FCC (June 21, 2000), transmitting Summary of Results of Broadband Study; *Telephony,* Communications Daily (June 22, 2000) at 2.

[32] *See* sections 254(b)(3) and (g) of the Act, 47 U.S.C. §§ 254(b)(3), (g).

[33] *See* http://www.ATT.com, AT&T One Rate 7¢ Plan; AT&T Communications Tariff FCC No. 27, Optional Calling Plans and Discounts § 4.2 *et. seq.*, listing the companies and their customers to which AT&T offers the optional and discount calling plans. The AT&T list does not include many rural telephone companies and their customers in rural America. *See also* Stephen Labaton, *AT&T Move Means Millions Will Face Higher Phone Bill,* New York Times (June 7, 2000) at A1.

[34] *See* Exhibit 2 at 2-17. Under Section 254(g), the Commission must adopt rules requiring that:

> [T]he rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas. Such rules shall also require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State.

through to long distance customers the savings that IXCs realize from lower access charges in the areas served by LECs subject to it. The plan proposes to continue the elimination of IXCs' minimum monthly charges for long distance service customers in the service areas of LECs subject to it. Similarly, the plan requires IXCs to offer the same optional calling plans to rural and urban customers alike.

The plan provides for portable universal service support, which it defines as the sum of high cost loop support, local switching support, long term support, and a new explicit support component, for Path A pool participants only, known as Rate Averaging Support ("RAS"). The RAS operates like long term support to reduce access charges and bring them closer to cost. The RAS recovers the Path A pool members' residual revenue requirements that are not recovered through SLCs, explicit support, and the rate elements that comprise the CAR.[35] The RAS will be adjusted to reflect the costs of certain regulations, such as those involving number portability and the Communications Assistance for Law Enforcement Act, as applicable to Path A LECs in the pool.

As discussed in detail in Exhibit 1, Path A adjusts existing methods of determining the levels of these support components to the new form of incentive regulation that will be phased in.[36] These forms of support are portable to other ETCs. Because the RAS supports lower access charges in Path A LECs' areas, it will enable IXCs to comply with their nationwide rate

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See also 47 C.F.R. § 64.1801; Exhibit 3 at 3-14.

[35] The RAS includes a component to support a portion of special access designed to preclude rate shock that could result from study areas increasing special access rates. The special access component of the RAS will also help to ensure that small rate-of-return LECs have the incentive to deploy advanced services in their territories.

[36] *See* Exhibit 1 at 1-16 through 1-21.

averaging and rate integration obligations. Indeed, the plan's access charge reforms for Path A LECs and Path B LECs similarly enable IXCs to comply with their nationwide rate averaging and rate integration obligations. The RAS would not apply to Path A study areas outside the pool or to Path B study areas.

Within the pool, when a Path A LEC becomes subject to incentive regulation in a study area, the plan freezes per-line universal service support flows at the level that the LEC is receiving immediately before the effective date of incentive regulation. Analogously to the adjustments applicable to the RPL, such per-line support is subject to annual adjustments for inflation. Per-line support is also subject to adjustment if the definition of supported services changes, and for the costs of complying with other government regulation for which direct cost recovery has not been provided. For both Path A and Path B, the plan broadens the definitions of Lifeline support to be consistent with the CALLS order.

Under Paths A and B, LECs have the ability to disaggregate universal service support per line among up to three zones per wire center.[37] LECs must file these zones and the associated per-line support with the Commission, relevant state regulators, and the Universal Service Administrative Company. Such zoned support will define more closely how much portable support will flow in each zone.[38]

Those non-price cap-LECs not subject to incentive regulation would continue to participate in universal service as they do today, but with the ability to disaggregate support.

[37] If the characteristics of a particular wire center justify more zones, Path A and Path B LECs may seek waivers from the Commission and the state regulator, as needed, to disaggregate support into additional zones.

[38] *See* Exhibit 1 at 1-21.

For both Path A and Path B LECs, the plan immediately removes the "interim" cap on high cost loop support and the corporate operations expense limitation. Although the interim cap had only a minor effect on investment when first imposed, it now has a major annual impact. Indeed, the "interim" cap is expected to reduce such support for rural LECs by about $118.5 million in 2000.[39] This reduction will be a significant disincentive for investment in high cost and under-served areas. The caps now in place limit the universal service support available to all carriers. Even the areas that are most in need of upgrades must make do with less in any given year that the cap operates. Eliminating these caps will provide LECs with a greater incentive to make the investments required to deliver advanced services in high cost areas. To reflect such removal, universal service support for all LECs subject to the plan will be recalculated. Removal of these caps will go far toward assisting all carriers to satisfy the universal service goals of Section 254 of the Act.[40]

C. The Plan's Form Of Incentive Regulation Serves The Public Interest

Path A of the plan provides for a transition period of up to five years, at any time during which Path A LECs may elect to move to RPL-based incentive regulation on a per-study area basis.[41] At the end of this transition period, existing forms of rate-of-return regulation for all study areas of Path A LECs will be replaced by this type of incentive regulation, which will fix

39 *See* RTF Recommendation at 4, 21 n.40, and 24 n. 46 (This figure does not appear to include Puerto Rico).

40 *See* 47 U.S.C. § 254.

41 Once a LEC elects incentive regulation for a study area, that study area cannot return to traditional rate-of-return regulation.

participating carriers' RPL at a base year level subject to adjustments for inflation, regulatory changes, mergers and acquisitions, and certain other costs.

By fixing the RPL, the plan ensures that Path A LECs subject to such regulation have strong incentives to improve their efficiency. As the Vander Weide testimony demonstrates, such LECs can do so by limiting their costs and by increasing the number of lines deployed.[42] The constraints on prices for the LECs' interstate access services in Path A will ensure that these services continue to comply with the fundamental requirements of the Act, including the duty to charge just, reasonable, and non-discriminatory rates for these services.[43] LECs will also have strong incentives to increase the number of lines served, which will advance universal service goals.

During the transition period, Path A LECs may elect to switch to incentive regulation at any time, on a per-study area basis, whether they are pool participants or not. Otherwise, during the transition period, Path A LECs will continue under rate-of-return regulation at the authorized rate of return of 11.25%, and settle on either a cost or average schedule basis. NECA will be able to update average schedule formulas during the five-year period to reflect changes in costs and demand.[44]

Whether in or out of the pool, Path A LECs with study areas subject to incentive regulation that realize unusually low returns may file for a low end adjustment to bring their returns to backstops set below 11.25%. This mechanism, which is similar to that long in place

[42] *See* Exhibit 2 at 2-18 through 2-19.

[43] *See, e.g.,* sections 201, 202 of the Act, 47 U.S.C. §§ 201, 202.

[44] Structural changes to the average schedule formulas also will be permitted during the transition period to reflect changes in network design, the types of service offered, or operating practices.

under Commission price cap regulation, will be available to Path A LECs subject to incentive regulation. As the Vander Weide testimony shows, the adjustment ensures that Path A LECs have an incentive to reduce costs and invest in new infrastructure by providing a backstop that reduces risk.[45] Such LECs with five or fewer study areas that realize study area returns more than 50 basis points less than 11.25% would be entitled to an earnings adjustment to bring their study area return for the relevant year to 10.75%. Path A LECs with more than five study areas subject to incentive regulation that under-earn by more than 100 basis points less than 11.25% in a study area would be eligible for an earnings adjustment to bring their study area return for the relevant year to 10.25%.[46]

As described in Exhibit 1, the plan provides that Path A and Path B LECs participating in the pool may bring into the pool exchanges or study areas that they acquire, with rules for initializing the RPL of the combined or new study areas if the Path A study area is already subject to incentive regulation.

As noted above, Path B LECs may elect to become Path A LECs during the five-year transition period.[47] Otherwise, Path B LECs will continue with their present forms of rate-of-return regulation. After the transition period, a waiver of the Commission's rules would be needed for Path B carriers to move to Path A incentive regulation.

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45 *See* Exhibit 2 at 2-20.

46 Rules for applying for a low end adjustment differ for study areas in or out of the pool. *See* Exhibit 1 at 1-11 through 1-12; 1-15 through 1-16.

47 During the portion of the transition period that remains after such election, these LECs, like other Path A LECs, can become subject to incentive regulation on a per-study area basis. After the last day of the transition period for incentive regulation, all study areas of these LECs, like other Path A LECs, would become subject to incentive regulation.

D. The Plan Reforms Current Pooling Mechanisms

To simplify the administration of Paths A and B, the plan replaces the present two pools administered by NECA with a single pool. NECA will perform appropriate rate banding in the pool. Path A and Path B LECs may decide on a per-study area basis whether to participate in the reformed NECA pool.

During the five-year transition period, Path A pool participants would be permitted to elect separate tariff options on a per-study area basis, for the common line and traffic sensitive elements of switched access, as well as for special access. After the transition period ends, a tariff option for special access will be available to all Path A LECs participating in the pool. The current authorized rate of return would remain in effect for the pool, and jurisdictional separations factors would be frozen consistent with the Joint Board's recent Recommended Decision in CC Docket No. 80-286.[48]

Settlements for the study areas of Path A LECs that are in the pool and subject to incentive regulation would be initialized based on the most recent cost study data or average schedule revenue requirement data available prior to joining the incentive plan. As noted above, the RPL will be adjusted, initially and annually thereafter, for inflation and can be adjusted to account for several additional factors.[49] Settlements for a study area in any year will be calculated as the product of the RPL calculated for that year and the study area's line count for the year. During the transition period, pool settlements will be based on the study area's RPL,

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[48] *See Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Recommended Decision, FCC 00J-2 (Jt. Bd. rel. July 21, 2000).

[49] *See* Exhibit 1 at 1-8 through 1-11.