RECEIVED

FEB 26 2001

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

DOCKET FILE COPY ORIGINAL

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

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

AT&T COMMENTS ON MAG NPRM

Mark C. Rosenblum
Judy Sello

Its Attorneys

Room 1135L2
295 North Maple Avenue
Basking Ridge, New Jersey 07920
(908) 221-8984

February 26, 2001

TABLE OF CONTENTS

INTRODUCTION AND SUMMARY. 1

I. THE PROPOSED ACCESS RATE LEVELS UNDER MAG NEED TO BE ADJUSTED TO CALLS LEVELS. 3

Subscriber Line Charges. 5

Remaining Non-Traffic Sensitive Cost Recovery 5

Traffic Sensitive Rates 6

USF Flowback 8

II. THE MAG PORPOSAL WOULD ALLOW FOR USF SUBSIDY GROWTH WITHOUT REQUIRED INVESTMENT IN THE NETWORK 8

Elimination of Caps on High-Cost Loop Fund and Corporate Operations Expense Limitation 9

Portability of Universal Service Support 9

RAS and Size of USF 10

Advanced Services 11

III. THE MAG PROPOSAL FAILS TO INCORPORATE THE PROPER INCENTIVES FOR EFFICIENCY AND WOULD ALLOW LECS OPTING FOR INCENTIVE REGULATION GREATER REVENUE RECOVERY THAN UNDER ROR REGULATION 13

Two-Tier Approach. 13

All or Nothing. 14

No Pooling Under Incentive Regulation 15

Revenue Growth Should Be Constrained Under Incentive Regulation 15

Low-End Adjustment 17

Other Needed Access Reforms 17

IV. THE COMMISSION SHOULD NOT ADOPT VARIOUS OTHER ASPECTS OF THE MAG PROPOSAL RELATED TO MERGERS AND ACQUISITIONS, JURISDCITIONAL SEPARATIONS, PRICING FLEXIBILITY AND IXC REGULATION. 18

Mergers and Acquisitions 18

Separations Freeze 19

Pricing Flexibility 19

Geographic Rate Averaging and Rate Integration 19

V. THE USF LAG MUST BE ELIMINATED BEFORE THE FCC ADOPTS ANY MODIFICATIONS THAT WOULD INCREASE THE SIZE OF THE USF, AND THE CONTRIBUTION BASE SHOULD BE BROADENED. 21

CONCLUSION. 23

APPENDIX A: ANALYSIS OF MAG PLAN FOR INCENTIVE REGULATION

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

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	CC Docket No. 00-256
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation	)	CC Docket No. 98-77
	)	
Prescribing the Authorized Rate of Return For Interstate Services of Local Exchange Carriers	)	CC Docket No. 98-166

AT&T COMMENTS ON MAG NPRM

Pursuant to the Commission's Notice of Proposed Rulemaking, FCC 00-448, released January 5, 2001, and published in 66 Fed. Reg. 7725 (January 25, 2001) ("NPRM"), and Section 1.415 of the Commission's rules, 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these comments on the petition for rulemaking submitted by the Multi-Association Group ("MAG") for interstate access reform and universal service support for incumbent local exchange carriers ("LECs") subject to rate-of-return ("ROR" or "non-price cap") regulation. MAG has submitted its proposal to the Commission as an integrated package designed to be implemented over a five-year period commencing July 1, 2001.

INTRODUCTION AND SUMMARY

The MAG plan contains a number of features that, with certain modifications, could be incorporated into a much-needed plan for access reform for ROR carriers by

July 1, 2001. Most importantly, MAG recognizes that implicit subsidies need to be removed from the access charges of ROR carriers and recovered in an explicit manner through the Universal Service Fund ("USF") in the form of a RAS (rate averaging support). However, unlike under MAG's proposal, the RAS should be required for *all* ROR carriers and ROR carriers opting for incentive regulation, irrespective of their Path A or B status or NECA pool participation. MAG also recognizes the need to increase subscriber line charge ("SLC") caps to allow for recovery of loop costs from the end user and to reduce traffic sensitive rates. AT&T suggests that SLC caps should be increased to CALLS levels and the traffic sensitive rate should be reduced to the CALLS rate for rural carriers of $0.0095. And, the NPRM identifies the need to remove recovery of ROR carriers' USF obligation from carrier-paid access charges. The Commission can and should act quickly to adopt these modifications as soon as possible, in conjunction with the universal service reforms proposed by the Rural Task Force ("RTF").[1]

Under MAG's USF proposal, additional universal service support is not linked to increased infrastructure investment by the carrier. Accordingly, AT&T instead urges the Commission to adopt the comprehensive package for universal service and access reform submitted by the RTF. In addition to constraining the size of the USF, the RTF proposal recognizes the need for access reform by establishing a High-Cost Fund III for recovery of universal service support currently implicit in rural LECs' interstate access charges. Using the RTF framework, the Commission could selectively incorporate those portions of the MAG proposal that would allow for efficient access rate level reform through a High-Cost Fund III

[1] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Further Notice of Proposed Rulemaking, FCC 01-8, released January 12, 2001, and published in 66 Fed. Reg.

(footnote continued on following page)

(or RAS) to be implemented by July 1, 2001, while it proceeds to develop a more effective plan of incentive regulation for the non-price cap LECs.

With respect to the MAG's proposed incentive regulation plan, AT&T is concerned that allowing traffic sensitive revenues to grow based on line growth plus inflation and without any productivity offset would allow unbounded revenue growth for companies electing incentive regulation. Given the complexity of productivity issues, the Commission should consider incentive regulation in a separate phase of this proceeding.

In short, rate-of-return regulation should continue for the non-price carriers for the July 1, 2001 annual filing, by which time proposed SLC increases and a High-Cost Fund III/RAS should be in place to support a traffic sensitive rate of $0.0095. These are critical modifications necessary to sustain local competition, universal service and nationwide geographic rate averaging of long distance services. At the same time, given that these changes will increase the size of the USF, it is critical that the FCC eliminate the competitive inequity caused by the prior-year assessment mechanism of the USF ("USF lag") *prior* to adoption of the plan. The Commission should then proceed to develop a properly constructed incentive plan in the next phase of this proceeding that would ensure that revenue growth tracks underlying cost growth and that consumers benefit from carriers' increased efficiencies.

I. THE PROPOSED ACCESS RATE LEVELS UNDER MAG NEED TO BE ADJUSTED TO CALLS LEVELS.

MAG makes a number of proposals related to access rate level issues. To the extent that these proposals would rationalize access cost recovery, the Commission should use

---

(footnote continued from previous page)

7867 (January 26, 2001) ("RTF FNPRM").

them to fill in the RTF proposal for access reform predicated on removal of implicit subsidies and establishment of a High-Cost Fund III. These changes should be fully implemented by July 1, 2001.

At the outset, it should be noted that the access reform/High-Cost Fund III changes are required by the 1996 Act. As the Fifth Circuit explained in *Alenco Communications Inc. v. FCC,* 201 F3d 608, 615-616 (5th Cir. 2000) (citations omitted): "The FCC must see to it that both universal service and local competition are realized; one cannot be sacrificed in favor of the other. The Commission therefore is responsible for making the changes necessary to its universal service program to ensure that it survives in the new world of competition." . . . ."[T]he old regime of implicit subsidies – that is, 'the manipulation of rates for some customer to subsidize more affordable rates for others' – must be phased out and replaced with explicit universal service subsidies – government grants that cause no distortion to market prices – because a competitive market can bear only the latter." . . . "Indeed, the Act requires that all universal service support be explicit. *See* 47 U.S.C. § 254(e). Finally, the program must treat all market participants equally – for example, subsidies must be portable – so that the market, and not local or federal government regulators, determines who shall compete for and deliver services to customers. Again, this principle is made necessary not only by the economic realities of competitive markets but also by statute." *See* 47 U.S.C. § 214(e)(1). As described with greater specificity below, to implement these statutory directives, the Commission needs to adjust access rates to reflect removal of implicit subsidies, convert such subsidies into explicit support and establish a competitively neutral High-Cost Fund III for their recovery.

Subscriber Line Charges. MAG proposes that SLC caps be raised to mirror those under CALLS, provided that the caps are "reasonably comparable" to SLCs charged by the LECs subject to CALLS.[2] To rationalize loop cost recovery, AT&T suggests that SLC caps be increased to CALLS levels – irrespective of the amount the CALLS LECs actually charge end users – to maximize efficient loop cost recovery from the cost causer of the loop, namely, the end user. For the same reason, the multiline business SLC cap should be increased from $6.00 to $9.20 immediately rather than over a two-year transition period, as MAG proposes. A PBX trunk equivalency approach should not be applied to Centrex SLC charges because, unlike a PBX, each Centrex line is a common line to which a full SLC should apply.

Remaining Non-Traffic Sensitive Cost Recovery. The MAG Plan does not specify which rates are to be reduced in order to achieve its target composite access rate of $0.0160 per minute. This will depend to a large extent on how revenues from the RAS are applied in reducing rates. Although the MAG plan stipulates that the RAS consists of common line and traffic sensitive components, it is not clear how these components are to be

---

[2] *See Access Charge Reform, etc.,* CC Docket No. 96-262, FCC 00-193, released May 31, 2000 ("CALLS Order"). As part of CALLS, the cap on subscriber line charges for primary residential and single-line business lines was raised from $3.50 to $4.35 on July 1, 2000 and will be further increased to $5.00 on July 1, 2001, to $6.00 on July 1, 2002, and to $6.50 on July 1, 2003. For non-primary residential lines, the cap was raised to $7.00 on July 1, 2000. *See* 47 C.F.R. § 69.152(d)-(e). For multi-line business customers, the cap had already been raised to $9.00 on July 1, 1997 per the Commission's *Access Reform Order*, which also included an inflation adjustment that raised the cap to $9.20 on January 1, 1999. *Access Charge Reform,* CC Docket No. 96-262, First Report and Order, FCC 97-158, ¶ 78, released May 16, 1997 ("Access Reform Order").

determined.[3] AT&T recommends that the common line component of RAS be established at a level sufficient to eliminate the CCL charge by the end of the transition to a residential SLC cap of $6.50 on July 1, 2003. To the extent there is a CCL charge, the costs embodied therein should be recovered predominantly on the originating CCL minutes.[4] Moreover, as noted above, the RAS should be available to *all* ROR carriers and ROR carriers opting for incentive regulation, irrespective of their Path A or Path B status or NECA pool participation. *See Part II below "Portability of Universal Service Support."*

Traffic Sensitive Rates. Under the MAG proposal, other NECA switched access rates are reduced to a point where the average rate per minute, known as the "composite access rate" ("CAR"), is $0.0160 on July 1, 2003. AT&T believes that this figure is too high relative to the CALLS rate for rural price cap carriers, and thus would threaten the ability of long distance carriers to sustain nationwide averaged pricing. Rather all ROR carriers should reduce their average traffic sensitive rate to $0.0095 on July 1, 2001, equivalent to that of the smaller price cap companies under CALLS. Under CALLS, the $0.0095 rate is available to "primarily rural" LECs, which is defined as a holding company

---

[3] Proposed rule 54.319(b)(1) defines the common line component of RAS as the difference between the projected common line revenue requirement for Path A LECs and their revenues from SLC and CCL charges and long term support. However, neither the common line revenue requirement nor the mechanism for setting CCL charges is specified in the proposed rules. It is therefore not clear how much of the RAS is to be directed toward reducing the CCL charge and whether the CCL charge is to be eliminated.

[4] *Access Reform Order* ¶¶ 349-357. This is a change that the Commission has already adopted for the price cap LECs.

that has less than 19 end user common lines per square mile served.[5] Because ROR LECs are also primarily rural, the $0.0095 rate is a reasonable rate for them as well. As the Commission noted in the *CALLS Order* (¶¶ 176-77), this rate is within the range of economic costs that have been presented and is reasonable for primarily rural LECs who, due to the nature of their service areas, have costs that are significantly higher than other LECs.

By contrast, retaining implicit subsidies in carrier access rates is incompatible with a competitive environment and the continuing disparity between rural and non-rural carriers' access rates creates significant pressure on interexchange carriers to geographically deaverage toll rates, in a manner that conflicts with the requirements of Section 254(g) of the Act. First, by definition, implicit subsidies are inherent in any access charge system predicated on pooling and rate averaging where the averaged rates charged to customers in lower cost areas subsidize the below-cost averaged rates charged to customers in higher cost areas. These subsidies must be eliminated, per the Act's directives. Second, a long distance carrier with nationally averaged rates will rapidly lose customers in low-cost areas (where its averaged rates are significantly higher than the regional carrier's) if it is required to continue to serve customers in high-cost areas (where its rates are significantly below costs). Not only will local entry be stymied into high-cost areas absent a portable subsidy, but interexchange carriers cannot hope to compete in a national long distance market when pitted against carriers with lower overall access costs because formidable regional competitors, namely the RBOCs, will take advantage of this easy arbitrage opportunity. Indeed, ROR companies would obtain benefits in the retail long distance market from reduced access charges because their long distance services would need only to cover an access cost of $0.0095 per minute

[5] *See CALLS Order* ¶ 162.

instead of the much higher $0.0394 per minute which would make it prohibitive for them to compete against a nationwide long distance carrier that recovers an average access rate that is significantly lower than $0.0394. *Cf. CALLS Order* ¶ 55.

USF Flowback. Unlike CALLS, MAG does not include a proposal to eliminate non-price cap carriers' flowback of their USF contribution obligations to long distance carriers. The Commission asks whether it should adopt a provision similar to that in CALLS for recovery of non-price cap carriers' USF contributions. NPRM ¶ 18. Clearly, it must. As the Fifth Circuit has ruled, recovery of LECs' USF contributions through carrier-paid access charges constitutes an impermissible implicit subsidy. *Texas Office of Public Utility Counsel v. FCC.*[6] Accordingly, the Commission should ensure that all non-price cap carriers recover their USF obligations from their end user customers either in the form of an increment to the SLC or an additional line-item on the customer bill. Inclusion of USF contribution obligations in carrier-paid access charges, RAS or High-Cost Fund III would violate the competitive neutrality requirements of Section 254.

II. THE MAG USF PROPOSAL WOULD ALLOW FOR USF SUBSIDY GROWTH WITHOUT REQUIRED INVESTMENT IN THE NETWORK.

MAG contains a number of features that could result in significantly increased USF support for both Path A and Path B carriers. Accordingly, AT&T urges the Commission

---

[6] 183 F.3d 393, 425 (5th Cir.1999), *cert. denied sub nom AT&T Corp. and MCI WorldCom Corp. v. Cincinnati Bell Telephone Company*, 120 S.Ct. 2237 (June 5, 2000), as implemented by the Commission, *Federal-State Joint Board on Universal Service and Access Charge Reform*, Sixteenth Order on Reconsideration in CC Docket No. 96-45, Eighth Report and Order in CC Docket No. 96-45, Sixth Report and Order in CC Docket No. 96-262, FCC 99-290 (Oct. 8, 1999) ("Implementation Order"), *appeal pending sub nom. Comsat Corporation v. FCC,* No. 00-60044 (5th Cir.).

to adopt the RTF proposal, which is a comprehensive USF plan, based on a consensus among varied constituents and has several cost-containment features. By contrast, MAG is a plan developed exclusively by the LECs and thus does not include some of the restraints in the RTF proposal.

Elimination of Caps on High-Cost Loop Fund and Corporate Operations Expense Limitation. Unlike RTF, under the MAG proposal, there would be unconstrained growth in the USF because of a totally uncapped high-cost loop fund and elimination of the corporate operation expense limitation. Moreover, once a study area opts for incentive regulation, its high-cost loop fund would be converted to an inflation-adjusted support per line and would no longer be based on a LEC's investment in loop facilities. Thus, LECs would be guaranteed increased loop support without having to invest in any facilities. This spiraling support, without network investment, simply increases LECs' profitability without any public interest benefit.

Portability of Universal Service Support. Under the MAG proposal, the RAS (rate averaging support) is restricted to those Path A LECs that elect to participate in the NECA pool.[7] The NPRM (¶ 17) inquires whether this restriction is appropriate. Restricting the RAS is *inappropriate*. The RAS (or High-Cost Fund III under RTF) should be available

[7] MAG classifies ROR LECs into two categories. Path A companies could elect incentive regulation for individual study areas at the start of the transition but would not be required to convert all study areas to incentive regulation until the end of the 5-year transition period. Under Path B, the LEC would remain under ROR regulation with the option to move to Path A at any time during the 5-year transition. Both Path A and Path B companies would have the option of participating on a study area basis in the NECA common line and/or traffic sensitive pool, which would be combined. Depending on the form of regulation, pooling LECs would recover interstate access settlements from the pool through use of average schedules, on a cost basis or through incentive regulation based on revenue per line.

to all non-price cap LECs, both to keep their traffic sensitive rates low and to allow new entrants to obtain the same subsidy amount as the incumbent. Restricting the RAS puts pressure on LECs that leave the pool to charge higher traffic sensitive rates. Moreover, absent portability of the subsidy, competitive entry into rural areas will occur only for high volume customers who are in the lower cost areas served by these LECs. As such, broader competitive entry will be thwarted, thereby limiting consumer choice. Moreover, if as MAG posits, the RAS permits long distance carriers to maintain geographically averaged toll rates, then it should apply to both pooling and non-pooling LECs.

RAS and Size of USF. The NPRM (¶ 18) asks to what extent is RAS likely to increase the size of the USF and how will RAS support levels increase over time. AT&T estimates that if all ROR carriers receive the RAS, which recovers the difference between LEC revenues derived from rates (SLCs and traffic sensitive rates), long term support and local switching support, the size of the USF would increase by approximately $610 million annually, if SLC caps were increased to their maximum CALLS values and the traffic sensitive access rate were set at $0.0095.[8] This is roughly equivalent to the magnitude of the USF increase for price cap LECs under CALLS and thus appears to be reasonable for the ROR LECs.

---

[8] As discussed in Part I above, AT&T suggests that the non-price cap LECs' traffic sensitive rate be set at $0.0095. The $610 million is predicated on this rate as well as the removal of the USF flowback from common line rates and is based on forecasted demand data for the period July 1, 2000 to June 30, 2001 obtained from the 2000 Annual Filing TRPs for NECA and those few ROR LECs (other than Interstate Telephone Company for which data were not available) that do not participate the NECA CCL pool, namely, ALLTEL Georgia Communications Corp., Georgia ALLTEL Telecom, Inc., CenturyTel of Ohio, Warwick Valley Telephone Company New Jersey and New York, respectively, and Great Plains Communications.

As long as the RAS is a per line support amount, it will grow as the number of lines increase. As shown in Part III below (*see "Revenue Growth Should Be Constrained Under Incentive Regulation"*) and Appendix A, the problem with MAG is that, even under incentive regulation, it fails to constrain LEC revenues, resulting in an ever-increasing RAS based solely on line growth plus inflation. By contrast, under the RTF proposal, High-Cost Fund III would be adjusted annually based on ROR carriers' annual filings to determine whether a LEC needs more or less support to maintain its authorized rate-of-return, while charging a $0.0095 traffic sensitive rate.

Even if the Commission adopts RAS as a residual support mechanism or some other form of High-Cost Fund III, it should still retain long term support, which is an established program used to reduce the LECs' revenue requirements, pending adoption of incentive regulation for the ROR carriers. Contrary to MAG's proposal, RAS should *not* be available to support special access services. USF support for special access would be an unprecedented and unwarranted increase in the size of the fund, and inconsistent the scope of the "core" services that the Commission has defined as eligible to receive universal service support.[9]

Advanced Services. The NPRM (¶ 21) seeks comment on the validity of MAG's premise that USF funding caps and regulatory uncertainty have diminished non-price cap carriers' incentives to invest in new technologies and whether MAG requires the use of USF funding to support advanced services. First, MAG's premise is incorrect. There has

---

[9] *Federal-State Joint Board on Universal Service*, First Report and Order, 12 FCC Rcd 8776, 8807-8825 (1997).

been tremendous growth in advanced service in rural company areas.[10] According to an Economics and Technology, Inc. study on broadband deployment in rural areas, "rural communities and their residents are *not* becoming orphans of the information age, but are full-blown participants with access to the same services and capabilities – and at roughly the same costs – as their urban cousins."[11] While the large incumbent LECs have concentrated their efforts on the low-cost upgrades to urban and suburban distribution networks to accommodate the introduction of DSL, smaller LECs, and cable, wireless and satellite operators have been concentrating on broadband deployment in precisely those communities that the large ILECs have tended to ignore.[12] Thus, the National Rural Telecommunications Association, the National Telephone Cooperative Association, and the Organization for the Promotion and Advancement of Small Telecommunications Companies demonstrated in the

---

[10] *See Communications Daily* (November 10, 1999) (National Telephone Cooperative Association study shows that small rural telcos . . . have infrastructure in place to offer advanced services to those areas . . . [and that] "[t]he so-called 'digital divide' is greatly exaggerated with respect to areas served by small telephone companies"); *see also* Comments of AT&T Corp., filed March 20, 2000, in *Inquiry Concerning Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable And Timely Fashion, and Possible Steps To Accelerate Such Deployment Pursuant To Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-146, at 19-21, 28-30; *id.* Reply Comments, filed April 4, 2000, at 4-6.

[11] Economics and Technology, Inc., *Bringing Broadband to Rural America: Investment and Innovation in the Wake of the Telecom Act* at 43 (Sept. 1999), filed with the Commission in CC Docket 98-147 on September 10, 1999. *See also* John Borland, *Firms Target Rural Communities for Broadband*, CNET News (Feb. 4, 2000) <http://news.cnet.com/news/0-1004-200-1541543.html> (discussing strategies of New Edge Networks, Jato Communications, DSL.Net, and OneMain.com to bring high-speed access to small towns).

[12] *Bringing Broadband to Rural America* at 42.

Commission's Section 706 proceedings that their members are actively deploying advanced telecommunications capability to rural America in a reasonable and timely manner.[13]

Second, MAG does *not* require use of USF funding to support infrastructure capable of providing advanced services but simply permits additional USF funding based on line growth plus inflation. Thus, MAG in no way ensures the deployment of infrastructure needed to support advanced services.

III. THE MAG PROPOSAL FAILS TO INCORPORATE THE PROPER INCENTIVES FOR EFFICIENCY AND WOULD ALLOW LECS OPTING FOR INCENTIVE REGULATION GREATER REVENUE RECOVERY THAN UNDER ROR REGULATION.

The MAG proposal grants the non-price cap LECs far too much flexibility and would not provide the carriers opting for incentive regulation the proper efficiency incentives. In the NPRM (¶ 16), the Commission seeks comment on the potential effects of the MAG plan on competition and the universal service goals of the 1996 Act. AT&T believes that MAG is an overly generous plan without sufficient efficiency incentives for the LECs that would strain the consumer price tag. In the next phase of this proceeding, the Commission should proceed to develop a properly constructed incentive plan that would ensure that revenue growth tracks underlying cost growth. AT&T's positions on specific aspects of the MAG incentive regulation proposal are discussed below.

Two-Tier Approach. AT&T believes that in lieu of the Path A/ Path B approach proposed by MAG, once the Commission adopts a well-designed incentive plan, it should adopt a two-tiered approach that would make incentive regulation *mandatory* for the

[13] *See* Comments, in CC Docket No. 98-146, filed March 20, 2000, by NRTA at 2, 7-9; NTCA at 5-6; OPASTCO at 5-6.

largest ROR LECs.[14] Large non-price cap carriers have the necessary scope to benefit from increased efficiency incentives under incentive (price cap) regulation thereby increasing their profitability, which, under a well-structured plan, would translate into rate reductions that would promote consumer welfare. It would defeat the purpose of incentive regulation if these carriers were afforded the discretion to gold-plate their networks and raise rates before electing price cap regulation. Under the two-tiered approach that AT&T suggests, only smaller carriers should have the *option* of electing incentive regulation on a voluntary basis.

All or Nothing. For both mandatory companies and those smaller companies that could opt for price cap regulation, the Commission should require *all* study areas to convert to price cap regulation at the same time. Absent this requirement (which is not a feature of the MAG plan), carriers with mixed price cap/ incentive regulation could engage in cost-shifting and gaming so as to maximize profitability. As the Commission has explained, in the absence of the "all or nothing" rule, a LEC might attempt to shift costs from its price cap affiliate to its non-price cap affiliate, allowing the non-price cap affiliate to charge higher rates to recover its increased revenue requirement, while increasing the earnings of the price cap affiliate."[15] It is exactly for this reason that the Commission adopted the "all or nothing" rule (Section 61.41(b) & (c)) for price cap regulation, and it should make that rule a feature of any incentive plan.

---

[14] *See* n.7 *supra.*

[15] *ALLTEL Corporation Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control*, CCB/CPD 99-1, Memorandum Opinion and Order, FCC 99-156, ¶ 18, released September 3, 1999 ("ALLTEL Order"), citing *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706 (1991).

No Pooling Under Incentive Regulation. Contrary to MAG's proposal, pooling by companies subject to incentive regulation should not be permitted. As the Commission explained, the "relationship between pooling and price cap regulation is fundamental to the rules defining LEC eligibility for price cap regulation. We have repeatedly emphasized . . . that price cap regulation will increase carriers' incentives to achieve heightened efficiency, which in turn will lead to lower rates. Participation in pools, by its nature, entails risk-sharing, and thus a weakening of incentives to operate efficiently."[16]

Revenue Growth Should Be Constrained Under Incentive Regulation. Under the MAG proposal, the common line and traffic sensitive revenues of LECs opting for Path A incentive regulation, as well as the USF subsidy that such carriers would receive in the form of high-cost loop support, would increase based on growth in lines plus inflation.

In the NPRM (¶ 20), the Commission seeks comment on what effect the MAG plan is likely to have on LEC revenues and whether an inflation factor equal to the Gross Domestic Product Price Index ("GDP-PI") accurately reflects changes in cost per line, or whether an X-factor or consumer productivity dividend should be included in the revenue per line formula. Consistent with its price cap objectives, the Commission should adopt a formula that reasonably reflects the trend in LECs' costs to ensure "that ongoing gains by the LECs in reducing unit costs are passed through to consumers."[17] To accomplish this, the

---

[16] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, 6819 (1990) ("LEC Price Cap Order"). Accordingly, Sections 61.41(a)(3) and 69.3(i)(4) of the Commission's rules bar price cap companies from participation in the NECA CL and TS pools.

[17] Fourth FNPRM in CC Docket 94-1, FCC 95-406, ¶ 16, released September 27, 1995.

Commission has relied on the X-factor component of its price cap formulas and has devoted considerable attention to determining what the X-factor should be.[18]

Examination of the TRP data filed by NECA for its common line and traffic sensitive pools demonstrates that an X-factor is also warranted for the ROR companies that convert to incentive regulation. According to AT&T's analysis, if all ROR LECs had been operating under the MAG incentive plan during 1995-1999, they would have obtained substantially greater traffic sensitive revenues than under ROR regulation, amounting to $424 million in 1999 alone, due primarily to productivity gains in switching and transport. *See* Appendix A.[19] This strongly suggests that the proposed revenue per line mechanism must include a substantial X-factor in order to reflect the trend in the LECs' productivity as to traffic sensitive services to satisfy the FCC's objectives in this proceeding. Accordingly, rather than adopting the MAG approach, which provides only minimal efficiency incentives for the LEC, the Commission should require that a LEC's total revenues under incentive regulation be constrained by an X-factor and a consumer productivity dividend. The FCC

---

[18] During the initial phase of its price cap proceedings, the FCC determined that any form of regulation that is based on the costs of production must take productivity gains into account. *See Further Notice*, 3 FCC Rcd at 3399-3400, ¶ 363, released May 23, 1988. The FCC found that the GNP-PI (the predecessor of GDP-PI) automatically reflects certain productivity gains in the economy, but does not necessarily reflect the productivity gains experienced by carriers, and thus concluded that its price cap formula should include a productivity adjustment. *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, FCC 89-91, ¶ 198, released April 17, 1989. The Commission affirmed this conclusion in the *LEC Price Cap Order* (¶ 75) when it adopted the initial productivity offsets of 3.3% and 4.3% (*id.* ¶¶ 100-101). These offsets were subsequently revised upwards in the Commission's 1995 and 1997 price cap orders. *See First Report and Order*, CC Docket No. 94-1, FCC 95-132, ¶¶ 210-217, released April 7, 1995; *Fourth Report and Order in CC Docket No. 94-1*, FCC 97-159, ¶¶ 133-143, released May 21, 1997.

[19] The $424 million consists of common line and traffic sensitive revenues. It does not include either high-cost loop fund support or special access.

should initiate a further NPRM to establish and X-factor and CPD, as well as address other price cap issues.

Low-End Adjustment. There should be no low-end adjustment ("LEA") unless the incentive plan also contains a provision for sharing earnings above a certain level with ratepayers, which the MAG plan does not. Moreover, the need for a low-end adjustment should be determined at the tariff filing entity level (as is done for LECs operating under price cap regulation), which could be at the holding company level rather than the study area level that MAG proposes. Permitting low-end adjustments at lower than the filing entity level encourages LECs not to consolidate their study areas so as to increase their ability to obtain such an adjustment and to qualify for greater support under the local switching support and high-cost loop support programs. Not only are the proposed 10.25% and 10.75% thresholds for a LEA overly generous because they are well above the LECs' current cost of capital, but there is no reason why a LEC with fewer study areas should have a higher threshold.[20] As under the current price cap plan, a single LEA threshold should apply for all carriers.

Other Needed Access Reforms. The Commission should implement varying access reforms for all non-price cap LECs. First, it should modify Section 69.307 of its rules to ensure that costs supporting nonregulated billing and collection functions are no longer

---

[20] As AT&T has previously shown, the LECs' cost of capital in 1999 was in the 8%-9% range, and the authorized ROR should have been prescribed at the midpoint of that range. *See* Responsive Submission of AT&T Corp. to Prescription Proceeding Direct Case Submissions and Reply Comments on the Notice of Proposed Rulemaking, filed March 16, 1999, in *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, at iv, 28-31. Given the decline of interest rates since then, the LECs' current cost of capital is likely lower.

recovered via access rates but are instead assigned to the billing and collection category.[21] Second, local switch line port costs should be transferred to the common line category and recovered from end users (or the USF) and trunk port costs should be recovered from IXCs on a flat-rate basis.[22] Each of these changes, which the Commission has already adopted for the price cap LECs, is necessary to ensure that costs are recovered in a cost-causative manner.

IV. THE COMMISSION SHOULD NOT ADOPT VARIOUS OTHER ASPECTS OF THE MAG PROPOSAL RELATED TO MERGERS AND ACQUISITIONS, JURISDICTIONAL SEPARATIONS, PRICING FLEXIBILITY AND IXC REGULATION.

Mergers and Acquisitions. The NPRM (¶ 22) asks whether the "all or nothing" rule in connection with mergers and acquisitions between companies under price cap and ROR regulation should be eliminated, as MAG proposes. It also inquires whether MAG's proposal to eliminate the freeze of study areas for non-price cap LECs is warranted and whether MAG adequately addresses gaming concerns if Section 54.305 were eliminated. To avoid cost-shifting and gaming, the "all or nothing" rule should be retained so that a carrier does not operate study areas subject to both incentive and ROR regulation. Moreover, Section 54.305 should be retained. The Commission expressly adopted Rule 54.305 to avoid skewing carriers' decisions regarding the purchase of exchanges. As the Commission explained in the *Universal Service Order* (¶ 308), "[u]ntil support for all carriers is based on a forward-looking economic cost methodology, . . potential universal service support payments

---

[21] The Commission adopted this modification for price cap LECs several years ago. *See Access Charge Reform,* CC Docket No. 96-262, Third Report and Order, FCC 97-401, ¶¶ 33-35, 43-49, released November 26, 1997.

[22] *Access Reform Order* ¶¶ 123-35.

may influence unduly a carrier's decision to purchase exchanges from other carriers. In order to discourage carriers from placing unreasonable reliance upon universal service support in deciding whether to purchase exchanges from other carriers, we conclude that a carrier making a binding commitment on or after May 7, 1997 to purchase a high-cost exchange should receive the same level of support per line as the seller received prior to the sale." *Id.* The study area boundary freeze serves a similar function in that it ensures that carriers will not proliferate study areas for the purpose of increasing USF support based on Part 36 embedded costs. NPRM ¶ 22 and n.43.

Separation Freeze. The MAG plan proposes a freeze of all Part 36 allocation factors for ROR companies. As AT&T has demonstrated, such a freeze would embed into the separations process various pre-existing flaws that already result in over-assignment of costs to the interstate jurisdiction. Moreover, such a freeze would prevent additional costs from being assigned to the intrastate jurisdiction as a result of rapid growth of Internet traffic which is treated as intrastate for separations purposes.[23]

Pricing Flexibility. MAG proposes that new access services be introduced at prevailing market rates. NPRM ¶ 14. To the contrary, LECs should continue to introduce new services with cost support, and any future pricing flexibility should be linked to a competitive showing.

Geographic Rate Averaging and Rate Integration. MAG proposes that IXCs be required to pass through to consumers any savings realized from lower rates as a result of

---

[23] *See* AT&T Comments on Joint Board Recommended Decision on Jurisdictional Separations, filed September 25, 2000, in *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, at 2 & *im passim.*

implementation of the MAG plan and to offer consumers in rural and urban areas the same optional calling plans. It further proposes to prohibit IXCs from imposing minimum monthly charges on residential consumers. NPRM ¶¶ 13, 23. These requirements are unnecessary.

There is no need for AT&T to commit to flow through the savings from access cost reductions to consumers. As the Commission has found repeatedly, competition in the interexchange market forces all IXCs to pass those savings onto their customers in all events.[24] Moreover, AT&T has a number of optional calling plans available to customers in rural areas and already has committed under CALLS to offer a calling plan with a single per-minute rate with no monthly recurring charge or minimum usage requirement over the life of the CALLS plan.[25] AT&T is fulfilling this commitment by offering such a plan.

---

[24] *See, e.g.*, *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, Fourth Report and Order, 12 FCC Rcd 16642, ¶ 185 (1997) (rejecting proposal that IXCs be required "to flow through to [] end users the reductions in the access charges they pay" on the ground that "there are no longer any dominant carriers in the market for interexchange services, [] long-distance carriers have been passing through access charge reductions in the past, [and there is] nothing to indicate that market forces will not compel IXCs to flow through access charge reductions"); *Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579*, Report to Congress, 13 FCC Rcd 11810, ¶ 28 (1998) ("Because past experience indicates that long distance carriers tend to compete on the basis of per-minute rates, . . . this competition creates strong incentives for carriers to reflect reductions in their costs through lower rates."); *Motion of AT&T Corp. To Be Reclassified As a Non-Dominant Carrier*, Order, 11 FCC Rcd 3271, ¶¶ 58, 63, 65-66, 88 (1995); *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Second Report and Order, 11 FCC Rcd 20730, ¶ 22 (1996); *In re Applications of Teleport Communications Group, Inc., Transferor and AT&T Corp., Transferee*, Memorandum Opinion and Order, 13 FCC Rcd 15236, ¶ 40 (1998).

[25] *CALLS Order*, Appendix D-1 to D-2, Letter, dated March 30, 2000, from Joel E. Lubin, AT&T to Magalie Roman Salas, Secretary, FCC. Specifically, AT&T stated that it "will eliminate the minimum usage requirement on its residential interstate Basic Schedule for 5 years, although AT&T reserves the right to work with the Commission to revise or eliminate this commitment after 3 years if market circumstances warrant." It further indicated that it "will maintain the AT&T One Rate Basic plan rate of 19 cents per minute at all times for domestic interstate calls from home, with no monthly recurring charge and no minimum

(footnote continued on following page)

V. THE USF LAG MUST BE ELIMINATED BEFORE THE FCC ADOPTS ANY MODIFICATIONS THAT WOULD INCREASE THE SIZE OF THE USF, AND THE CONTRIBUTION BASE SHOULD BE BROADENED.

Under the MAG plan, the rural carrier component of the USF will be larger than it is today. In this regard, AT&T notes that USF support should be based the broadest possible assessment base, including intrastate revenues, even if that outcome requires the Commission to seek additional statutory authority from Congress. Broadening of the contribution base is essential to ensure its stability and neutrality, so that all who benefit from universal service contribute to its support.

Moreover, as AT&T has previously shown, the Commission's prior-year assessment methodology for USF contributions systematically disadvantages certain carriers, violates statutory requirements, discourages local competition and should be promptly revised.[26] Section 254(d) of the Telecommunications Act of 1996 requires that all interstate telecommunications service providers make an equitable and nondiscriminatory contribution to universal service support. The Commission's current USF recovery mechanism is profoundly anticompetitive and does not comply with this statutory directive because it means

---

(footnote continued from previous page)

usage requirement, for 1 year from the date it establishes revised Basic Schedule rates. If this plan is successful, AT&T will offer during the five-year life of the CALLS plan a calling plan with a single per-minute rate for domestic interstate calls from home, with no monthly recurring charge, and with no minimum usage requirement."

[26] *See* AT&T Comments on USF Lag FNPRM, filed November 30, 2000, and AT&T Reply Comments on USF Lag FNPRM, filed December 14, 2000, in *Federal-State Joint Board on Universal Service, etc.*, CC Docket No. 96-45, Further Notice of Proposed Rulemaking and Order, FCC 00-359, released October 12, 2000 ("USF Lag FNPRM"). *See also* AT&T Petition for Reconsideration, CC Docket No. 96-45, filed March 1, 2000; AT&T *Ex Partes* filed January 14, 2000, February 10, 2000, and October 10, 2000 in this proceeding.

that carriers with declining interstate revenues will be inordinately disadvantaged as compared to carriers with increasing interstate revenues. Specifically, it will put interexchange carriers, who must compete with RBOCs as they gain entry into the long distance market, at a severe and untenable competitive disadvantage. Alleviating the USF lag is necessary to remove the competitive distortions of the current USF assessment mechanism which penalizes carriers with decreasing revenues and unfairly favors carriers with increasing revenues.

The Commission should immediately address this inequity, as contemplated in its *USF Lag FNPRM*,[27] *prior* to increasing the size of the USF to accommodate any rural carrier concerns. Otherwise increasing the size of the USF to accommodate rural carrier concerns would be intolerable because it would exacerbate the USF lag problem.

---

[27] *See* n.26 *supra*.

CONCLUSION

For the reasons stated above, by July 1, 2001, the Commission should adopt and implement a modified version of the MAG access rate level changes, as described in Part I, in conjunction with the universal service reforms proposed by the RTF, including the establishment of a High-Cost Fund III. Before adopting these changes, it should eliminate the competitive imbalance caused by the USF lag. It should consider MAG's incentive plan, including productivity and other issues, in a further phase of this proceeding.

Respectfully submitted,

AT&T CORP.

By /s/ Judy Sello

Mark C. Rosenblum
Judy Sello

Room 1135L2
295 North Maple Avenue
Basking Ridge, New Jersey 07920
(908) 221-8984

Its Attorneys

February 26, 2001

ANALYSIS OF MAG PLAN FOR INCENTIVE REGULATION

In its NPRM (¶ 20) on the MAG plan, the Commission seeks comment on what effect the MAG plan is likely to have on non-price cap carrier revenues. Comment is requested on whether an inflation factor equal to the GDP Price Index (GDP-PI) accurately reflects changes in costs per line and whether an X-factor or consumer productivity dividend should be included in the RPL (revenue per line). As shown in AT&T's analysis, the simple answer is that the incentive regulation scheme proposed in the MAG plan is likely to provide ROR carriers with a substantial windfall. Growth in the GDP-PI tends to overstate increases in their costs per line and thus, the use of GDP-PI must be accompanied by an X-factor in order for the RPL mechanism to be consistent with the trend in carriers' cost per line.

Data for the NECA common line and traffic sensitive pools presented in this appendix indicate that during the 1990s historical growth in the GDP-PI has exceeded both the growth in pooled revenue per line and growth in embedded costs per line. The likely impact of MAG is estimated by calculating what LEC switched access revenues would have been if the MAG plan for incentive regulation had been in effect historically, with primary emphasis on the period from 1995 to 1999. Using NECA data for the common line and traffic sensitive pools, AT&T demonstrates that if all the ROR carriers had been operating under the MAG plan during those years, they would have received substantially more revenue than was actually obtained.

Analysis

The basic premise of the MAG incentive regulation scheme is fairly simple. A carrier is entitled to receive a certain amount of revenue from the pool for each access line it provides, with the revenue per line (RPL) amount adjusted each year for inflation using the GDP-PI, the same index used for the price cap carriers. Growth in a carrier's common line and traffic sensitive revenue is thus approximately equal to the growth in its lines plus the rate of inflation.[1] Tables 1 and 2 attached show that this growth exceeds the historical growth in revenues and revenue requirements for the NECA common line and traffic sensitive pools. Under the MAG plan, this additional revenue would come mainly from ever-increasing subsidy support, rather than from interstate access charges.

Historical data for the NECA common line pool from 1990 to 1999 are summarized in Table 1. A revenue requirement for the pooling companies is calculated based on their expenses, net investment, an 11.25% rate-of-return, and a 39% marginal income tax rate. In addition, universal service contributions (*i.e.*, "flowback), which amounted to about $40 million in 1998 and 1999 but do not represent a cost of providing service, are removed to obtain the pool's adjusted revenue requirement.

---

[1] More precisely, the rate of growth in revenue can be calculated as:

$$\%\Delta Rev = (1+\%\Delta Lines)*(1+\%\Delta GDP\text{-}PI) - 1.$$

Various growth rates for the 1990-99 and 1995-99 periods are shown in the lower portion of Table 1. The growth in GDP-PI and lines combined represents the growth in revenue that would result from the MAG plan. For the entire 1990 to 1999 period, this growth exceeded that of both common line revenue and common line revenue requirements. For 1995 to 1999, growth in GDP-PI plus lines was somewhat less than growth in common line revenue. However, the pool's rate-of-return increased substantially during this period – from 10.83% in 1995 to 12.68% in 1999. When these revenues are adjusted to provide an 11.25% return, their growth is significantly less than the growth in GDP-PI plus lines.[2]

Historical data for the NECA traffic sensitive (TS) pool are summarized in Table 2, with selected growth rates shown in the lower portion of the table. Because NECA does not report the total number of access lines for companies in the TS pool, the growth in lines was estimated based on access minutes (which NECA does report) and the assumption that minutes per line for the pooling companies grew at the same rate as that for the entire ROR LEC industry. The growth in lines for pooling companies is thus estimated as the growth in pooled access minutes minus the growth in industry minutes per line. As discussed below, there are problems with the TS pool data prior to 1995, presumably as a result of carriers leaving the pool. Focusing on the growth rates for 1995 to 1999, which are shown in the lower portion of Table 2, it is clear that the growth in GDP-PI plus lines far exceeds the growth in either TS revenue or revenue requirements.

The tendency for revenues to grow under MAG by far more than the growth in costs means that over time carriers will enjoy ever increasing amounts of excess revenues and earnings. This is illustrated in Table 3, which shows the trend in switched access revenues (common line plus traffic sensitive) if all ROR carriers had operated under the MAG plan for incentive regulation from 1995 to 1999. The calculations are based on illustrative data whereby data for the NECA pools are used to represent the entire ROR carrier industry.

The shorter historical period of 1995 to 1999 was chosen because it appears that a substantial number of companies exited the NECA traffic sensitive pool during 1993 to 1995, and, as a result, trends in the NECA data for those years cannot be used to represent the industry. Traffic sensitive minutes reported by NECA declined from 1993 to 1995, while total minutes for the ROR carriers increased as they normally do. As a result, the trend in NECA pooled revenues and revenue requirements for those years cannot be considered representative of the entire ROR LEC industry. It is likely that

---

[2] It is also worth noting that the current authorized ROR of 11.25% is exceedingly generous. As AT&T and other parties have demonstrated, most recently in the Commission's X-factor prescription proceeding, the LECs' cost of capital declined substantially during the 1990s to the 8% to 9% range. *See, e.g.,* "Selected Issues in Calculating the X-Factor," AT&T *ex parte* in CC Docket Nos. 94-1 and 96-262, February 24, 2000, pp. 9-11. Today, the cost of capital is likely lower given recent interest rate declines.

those companies leaving the pool had relatively lower costs, causing the pool's overall average cost per unit to rise, even though unit costs may have been declining for individual companies.[3] The situation appears to have stabilized since 1995, with growth in NECA TS minutes similar to that for all ROR carriers in total. Thus, 1995 is an appropriate year to use as the initial year in the analysis.

In the upper portion of Table 3, industry revenues are developed on the basis of revenues reported by NECA for its common line and traffic sensitive pools. For common line revenues, it is assumed that the pool represents 96.7% of the ROR carriers' total common line revenue.[4] This assumption is then used to "gross up" the NECA results to obtain total revenues and revenue requirements for all ROR carriers. Because the vast majority of ROR companies are members of the common line pool, NECA pool data provide a reasonably proxy for the entire industry.

With the traffic sensitive pool, the number of participants is considerably smaller. Data on access minutes reported by the pool were compared with total ROR industry minutes to estimate the percentage of industry TS revenue represented by the pool. To account for the fact that rates within the pool are somewhat higher than those of non-pooling companies, the fraction of pooled minutes to total minutes was multiplied by a factor of 1.0914, the ratio of NECA's composite interstate access rate to that for ROR LECs as a whole.[5] The resulting fraction provides an estimate of the percentage of total ROR LEC TS revenue that resides in the pool. Industry revenues and revenue requirements are then estimated by dividing the pool amounts by this percentage. The key assumptions underlying these calculations are that: (a) the ratio of NECA's composite interstate access rate to that for ROR LECs as a whole can be applied to traffic sensitive rates and has remained constant over the period; and (b) the earnings for the TS category of companies outside the pool has been similar to that of the pool.

It should be emphasized that, because the data on ROR carriers are incomplete, the calculations presented here are intended mainly for illustrative purposes. To the extent that trends in the NECA data are representative of all ROR carriers, these calculations illustrate the impact that implementation of the MAG plan in its current form is likely to have, as well as the type of data and analysis that are needed to formulate a

---

[3] While minutes in the traffic sensitive pool declined from 1993 to 1995, the pool's overall revenue per minute rose. The longer term trend is for minutes to grow while revenue per minute declines over time.

[4] According to the June 2000 TRP filings, revenue requirements for the NECA pool comprised 96.7% to total ROR revenue requirements for the period July 1, 2000 to June 30, 2001.

[5] According to MAG's Petition for Rulemaking (at 11), the existing composite interstate per-minute access rate for ROR LECs is $0.0394, while the comparable NECA per-minute access rate is $0.0430.

better version of the plan. The Commission should require carriers to provide this data in a format that can be readily be analyzed by the Commission and other interested parties.

To simulate the impact of MAG incentive regulation on switched access, the analysis starts with estimated industry revenue requirements per line (RPL) in 1995 and adjusts the RPL at the beginning of each subsequent year by the percentage increase in the GDP-PI.

- The estimated impact of MAG depends critically on how the initial RPL is calculated. In this analysis, it is calculated on the basis of revenue requirements associated with the authorized ROR of 11.25%. This has the effect of reducing annual revenues by about $16 million compared to an initial RPL calculated on the basis of actual revenues for 1995.

- For the inflation adjustments, 4th quarter values of the GDP chained price index were used, with each year's RPL calculated by adjusting the previous year's RPL by the most recent 4th quarter to 4th quarter growth in GDP-PI.

- Total switched access revenue (common line plus traffic sensitive) is then calculated by multiplying each year's RPL by the corresponding number of access lines.

Results

Revenues generated by the MAG plan are shown in the line labeled "Total CL + TS revenue" in the middle of Table 3. Excess revenues resulting from MAG are displayed in the following line, which shows the difference between revenues under MAG and revenue requirements. The amount of excess revenue increases each year, reaching a total of $424 million for the common line and traffic sensitive categories in 1999. For the entire four-year period, the cumulative amount of excess revenue is over $1 billion.

Additional excess revenues would be generated by application of the MAG formula to high-cost loop support. Under the MAG plan, existing caps are removed from high-cost loop support, and the uncapped amount is adjusted each year by the growth in lines plus inflation. High-cost loop support is currently limited under Section 36.601(c) to the existing level of funding increased yearly by the annual growth in supported loops. With the MAG plan, annual growth in the fund would increase by an additional percentage equal to the inflation rate. As with common line and traffic sensitive revenues, the excess revenue associated with high-cost loop support would tend to increase each year.

It is not surprising that the MAG plan generates excess revenues, because it does not contain any type of productivity factor. A reasonable X-factor can be estimated by calculating the X which, when included in the RPL mechanism, results in 1999 revenues

being equal to the revenue requirement.[6] This is essentially the same type of calculation performed by the Commission staff in its Imputed X-Factor Study done for the price cap LECs[7] and results in an imputed X-factor of 3.29% for the common line and traffic sensitive categories. Because this figure does not include a consumer productivity dividend, nor does it reflect any decline in the LECs' cost of capital over the period, it represents a very conservative estimate of what an appropriate X-factor would be.

It should be noted that this X-factor is not directly comparable to the X-factor used for the price cap LECs, because the overall price cap mechanisms differ. Under MAG, each carrier's revenue per line, rather than individual rate elements, is governed by the price cap formula. Because the number of access lines has a tendency to grow by less than usage and those rate elements whose volume is a function of usage, the X-factor associated with MAG will be somewhat lower than that associated with conventional price cap regulation.

Also included in Table 3 are calculations that identify the major sources of revenue under the MAG plan, showing how much of carrier revenues are obtained from interstate access charges and how much are derived from the various subsidy mechanisms. Access revenues are calculated on the basis of the MAG plan being fully phased in, with a $0.0160 per minute composite access rate and SLC rates set at their $6.50 and $9.20 caps. The remaining revenues generated by the RPL mechanism are provided by the various subsidy programs, namely, Long Term Support, Local Switching Support, and the proposed Rate Averaging Support. As shown at the bottom of Table 3, subsidy requirements increase substantially from year-to-year, amounting to nearly 56% of total switched access revenue in 1999 (not counting the high-cost loop support).

---

[6] With an X-factor included in the RPL mechanism, the RPL would be adjusted annually by the percentage change in the GDP-PI minus the X-factor.

[7] *Further Notice of Proposed Rulemaking*, CC Docket Nos. 94-1 and No. 96-262, released November 15, 1999, Appendix C.

TABLE 1 - COMMON LINE POOL DATA

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
NECA CL pool results (1):										
IXC Access revenues	162,356,354	147,717,943	143,844,616	163,458,470	192,870,614	193,505,188	192,583,677	197,284,932	291,480,289	343,638,609
End user revenues	338,015,374	343,606,106	353,842,015	370,889,531	387,503,795	409,871,512	432,953,709	462,837,325	492,650,517	527,554,053
Long term support	262,563,073	271,729,978	305,735,598	322,608,953	346,644,678	382,255,111	425,624,307	469,515,463	472,564,542	472,774,206
Total CL revenues	**762,934,801**	**763,054,027**	**803,422,229**	**856,956,954**	**927,019,087**	**985,631,811**	**1,051,161,693**	**1,129,637,720**	**1,256,695,348**	**1,343,966,868**
Total expenses	632,084,904	627,198,445	648,208,584	691,841,161	754,674,027	810,667,325	864,492,829	919,823,658	1,024,316,159	1,097,327,303
Avg. net investment	1,153,627,221	1,164,165,744	1,186,562,657	1,294,035,335	1,429,478,840	1,616,249,419	1,716,524,139	1,808,320,084	1,888,151,194	1,945,221,547
Return (residue for dist.)	130,849,897	135,855,582	155,213,645	165,115,793	172,345,060	174,964,486	186,668,864	209,814,062	232,379,189	246,639,565
ROR (residue ratio)	11.34%	11.67%	13.08%	12.76%	12.06%	10.83%	10.87%	11.60%	12.31%	12.68%
Return @ 11.25%	129,783,062	130,968,646	133,488,299	145,578,975	160,816,370	181,828,060	193,108,966	203,436,009	212,417,009	218,837,424
Tax adjustment	(682,075)	(3,124,434)	(13,889,975)	(12,490,752)	(7,370,802)	4,388,186	4,117,442	(4,077,771)	(12,762,705)	(17,775,139)
Flowback removal (2)									(39,592,000)	(40,509,000)
Adjusted rev. requirement	**761,185,892**	**755,042,657**	**767,806,908**	**824,929,384**	**908,119,594**	**996,883,571**	**1,061,719,237**	**1,119,181,896**	**1,184,378,463**	**1,257,880,588**
Marginal tax rate	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39	0.39
Access lines (2)	7,511,169	7,635,403	7,998,789	7,990,655	8,582,626	8,951,113	9,584,556	9,933,111	10,502,918	11,064,890
Data on inflation:	4Q89	4Q90	4Q91	4Q92	4Q93	4Q94	4Q95	4Q96	4Q97	4Q98
GDP Price Index	84.24	87.76	90.47	92.56	94.79	96.74	98.79	100.63	102.49	103.69
% increase		4.18%	3.09%	2.31%	2.41%	2.06%	2.12%	1.86%	1.85%	1.17%

Growth rates	**1990-1999**	**1995-1999**
CL revenue	6.49%	8.06%
CL revenue requirement	5.74%	5.99%
Access lines	4.40%	5.44%
GDP Price Index	2.34%	1.75%
GDP-PI & lines combined	6.84%	7.29%

Notes:

(1) Source of NECA pool results: FCC Monitoring Reports (Docket 87-339), Table 7.1 (1990-96), Table 3.3 (1996-98), Table 3.5 (1998-99)

(2) Access lines and flowback (universal service contributions) obtained from NECA TRP filings.

Access lines for 1990, which were not reported in NECA's 1991 TRP, are estimated on the basis of end user revenue, assuming same end user revenue per line as in 1991.

CERTIFICATE OF SERVICE

I, Ann DeGenaro, do hereby certify that on this 26th day of February, 2001, a copy of the foregoing "AT&T Comments on MAG NPRM" was served by U.S. first class mail, postage prepaid, on the parties named on the attached Service List.

/s/ Ann DeGenaro
Ann DeGenaro

SERVICE LIST
UNIVERSAL SERVICE
FEDERAL-STATE JOINT BOARD
CC DOCKET NO. 96-45

The Honorable Susan Ness, Chair
Commissioner
Federal Communications Commission
445 Twelfth Street, SW, Room 8-B115
Washington, DC 20554

Irene Flannery
Acting Ass't. Division Chief
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A426
Washington, DC 20554

The Honorable Harold Furchtgott-Roth
Commissioner
Federal Communications Commission
445 Twelfth Street, SW, Room 8-A302
Washington, DC 20554

Paul Gallant
Federal Communications Commission
Legal Advisor to Commissioner Tristani
445 Twelfth Street, SW, Room 8-C302B
Washington, DC 20554

The Honorable Gloria Tristani
Commissioner
Federal Communications Commission
445 Twelfth Street, SW, Room A-C302
Washington, DC 20554

The Honorable Nanette G. Thompson
Regulatory Commission of Alaska
1016 West Sixth Avenue, Suite 400
Anchorage, AK 99501-1693

Lori Kenyon
Common Carrier Specialist
Alaska Public Utilities Commission
1016 West Sixth Avenue, Suite 400
Anchorage, AK 99501

Mark Long
Economic Analyst
Florida Public Service Commission
Gerald Gunter Bldg.
2540 Shumard Oak Blvd.
Tallahasse, FL 32399-0866

The Honorable Bob Rowe
Montana Public Service Commission
1701 Prospect Avenue
PO Box 20261
Helena, MT 59620-2601

Sandra Makeeff Adams
Accountant
Iowa Utilities Board
350 Maple Street
Des Moines, IA 50319

The Honorable Laska Schoenfelder
Commissioner
South Dakota Public Utilities Commission
State Capitol, 500 East Capitol Street
Pierre, SD 57501-5070

Kevin Martin
Federal Communications Commission
Legal Advisor to Commissioner Furchtgott-Roth
445 Twelfth Street, SW, Room 8-A302E
Washington, DC 20554

The Honorable Martha S. Hogerty
Public Counsel
Secretary of NASUCA
Truman Building
301 West High Street, Suite 250
P.O. Box 7800
Jefferson City, MO 65102

Philip F. McClelland
Assistant Consumer Advocate
Pennsylvania Office of Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120

Charles Bolle
Public Utilities Commission of Nevada
1150 East William Street
Carson City, NV 89701

Thor Nelson
Rate Analyst/Economist
Colorado Office of Consumer Counsel
1580 Logan Street, Suite 610
Denver, CO 80203

Jordan Goldstein
Federal Communications Commission
Legal Advisor to Commissioner Ness
445 Twelfth Street, SW, Room 5-C441
Washington, DC 20554

Barry Payne
Economist
Indiana Office of the Consumer Counsel
100 North Senate Avenue, Room N501
Indianapolis, IN 46204-2208

Rowland Curry
Policy Consultant
Texas Public Utility Commission
1701 North Congress Avenue
P.O. Box 13326
Austin, TX 78701

Brad Ramsay
Deputy Assistant
General Counsel
National Assoc. of Regulatory Utility
Commissioners
1101 Vermont Avenue, N.W., Suite 200
Washington, D.C. 20005

Jack Leutza
Regulatory Analyst
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Tiane Sommer
Special Assistant
Attorney General
Georgia Public Service Commission
47 Trinity Avenue
Atlanta, GA 30334

Patrick H. Wood, III
Chairman
Texas Public Utility Commission
1701 North Congress Avenue
P.O. Box 13326
Austin, TX 78711-3326

Peter Bluhm
Director of Policy
Vermont Public Service Board
Research Drawer 20
112 State St., 4th Floor
Montpelier, VT 05620-2701

Walter Bolter
Intergovernmental Liaison
Florida Public Service Commission
Gerald Gunter Building, Suite 270
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Carl Johnson
Telecom Policy Analyst
New York Public Service Commission
3 Empire State Plaza
Albany, NY 12223-1350

Doris McCarter
Ohio Public Utilities Commission
180 E. Broad Street
Columbus, OH 43215-3793

Susan Stevens Miller
Assistant General Counsel
Maryland Public Service Commission
6 Paul Street, 16th Floor
Baltimore. MD 21202-6806

Mary E. Newmeyer
Federal Affairs Advisor
Alabama Public Service Commission
100 N. Union Street, Suite 800
Montgomery, AL 36104

Tom Wilson
Economist
Washington Utilities & Transportation Commission
1300 Evergreen Park Drive, S.W.
P.O. Box 47250
Olympia, WA 98504-7250

Linda Armstrong
Attorney
Federal Communications Commission
CCB, Accounting and Audits Division
Universal Service Branch
445 Twelfth Street, SW, Room 5A-663
Washington, DC 20554

Lisa Boehley
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B544
Washington, DC 20554

Katherine Schroder
Deputy Division Chief
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A423
Washington, DC 20554

Steve Burnett
Public Utilities Specialist
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B418
Washington, DC 20554

Bryan Clopton
Public Utilities Specialist
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A465
Washington, DC 20554

Andrew Firth
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A505
Washington, DC 20554

Lisa Gelb
Division Chief
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A520
Washington, DC 20554

Emily Hoffnar
Federal Staff Chair
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A660
Washington, DC 20554

Charles L. Keller
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A664
Washington, DC 20554

Katie King
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B550
Washington, DC 20554

Robert Loube
Telecom. Policy Analyst
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B524
Washington, DC 20554

Brian Millin
Interpreter
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-a525
Washington, DC 20552

Sumita Mukhoty
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A633
Washington, DC 20554

Mark Nadel
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B551
Washington, DC 20554

Gene Fullano
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-A623
Washington, DC 20554

Richard D. Smith
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5B-448
Washington, DC 20554

Matthew Vitale
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B530
Washington, DC 20554

Sharon Webber
Attorney
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B552
Washington, DC 20554

Adrian Wright
Accountant
Federal Communications Commission
CCB, Accounting Policy Division
445 Twelfth Street, SW, Room 5-B510
Washington, DC 20554

Ann Dean
Assistant Director
Maryland Public Service Commission
6 Paul Street, 16th Floor
Baltimore, MD 21202-6806

David Dowds
Public Utilities Supervisor
High Cost Model
Florida Public Service Commission
Gerald Gunter Bldg.
2540 Shumard Oaks Blvd.
Tallahassee, FL 32399-0866

Don Durack
High Cost Model
Staffer for Barry Payne
Indiana Office of Consumer Counsel
100 North Senate Avenue
Indianapolis, IN 46204-2208

Greg Fogleman
Regulatory Analyst
High Cost Model
Florida Public Service Commission
Gerald Gunter Bldg.
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0866

Anthony Myers
Technical Advisor
High Cost Model
Maryland Public Service Commission
6 St. Paul Street, 19th Floor
Baltimore, MD 21202-6806

Diana Zake
Texas Public Utility Commission
1701 North Congress Avenue
P.O. Box 13326
Austin, TX 78711-3326

Tim Zakriski
NYS Department of Public Service
3 Empire State Plaza
Albany, NY 12223

Barbara Meisenheimer
Consumer Advocate
Missouri Office of Public Counsel
301 West Madison St., Suite 250
Truman Building
P.O. Box 7800
Jefferson City, MO 65102

Earl Poucher
Legislative Analyst
Office of the Public Counsel
111 West Madison, Rm. 812
Tallahassee, FL 32399-1400