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

REPLY COMMENTS OF AT&T CORP.

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GLOSSARY

Commenter	Abbreviation
Alltel Communications	ALLTEL
Association of Communications Enterprises	ASCENT
Competitive Universal Service Coalition	CUSC
GVNW Consulting	GVNW
General Communication, Inc.	GCI
ICORE Companies	ICORE
Independent Telephone & Telecommunications Alliance	ITTA
NRTA, Opastco and USTA	MAG
National Exchange Carrier Association	NECA
National Telephone Cooperative Association	NTCA
Nebraska Rural Independent Companies	NRIC
Puerto Rico Telephone Company, Inc.	PRTC
Sprint Corporation	Sprint
TCA, Inc.	TCA
Verizon	Verizon
Western Alliance	Western Alliance
WorldCom	WorldCom

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Pursuant to the Commission's Further Notice of Proposed Rulemaking ("*Notice*"), FCC 01-304, released November 8, 2001, and Section 1.415 of the Commission's rules, 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these reply comments on the establishment of an appropriate incentive regulation mechanism for rate-of-return carriers.

INTRODUCTION AND SUMMARY

The comments amply confirm that the Commission correctly rejected MAG's one-sided incentive regulation proposal, which would have given rate-of-return carriers all of the benefits of incentive regulation (*i.e.*, the opportunity for higher rates of return in excess of the Commission's current authorized rate of return) without any of the risks or responsibilities, and without sharing any of the increased efficiencies with its customers in lower rates. Many commenters agree that any incentive regulation plan for these LECs must be more balanced and must better protect the interests of consumers.

Accordingly, as shown in Section I, the comments support AT&T's proposals that (1) the Commission should adopt the revenue-per-line (RPL) approach only for common line services, and it should adopt conventional price caps for traffic sensitive and special access services; (2) a LEC should be required to leave the NECA pool when it becomes subject to incentive regulation; and (3) the Commission should apply an X-Factor to the traffic sensitive and special access baskets of services. Indeed, as explained below, the rate-of-return LECs make little attempt to defend any contrary proposals in their comments.

As shown in Section II, the comments also confirm that the Commission should make incentive regulation mandatory for the largest rate-of-return LECs (*e.g.*, those with 50,000 or more lines at the holding company level). Experience with similarly-sized price cap LECs suggests that the larger rate-of-return LECs can operate successfully under incentive regulation and achieve significant efficiency gains, and the rate-of-return LECs offer no evidence to the contrary. Moreover, the comments also confirm that the Commission should both retain and enforce the all-or-nothing rule, because the rule is still needed to protect against the dangers of cross-subsidization and other anticompetitive harms.

Finally, as shown in Section III, the commenters agree that pricing flexibility for the rate-of-return LECs would be premature. Rate-of-return LECs already have substantial pricing flexibility today. The rate-of-return LECs offer no compelling evidence that they face any significant competition that would warrant additional flexibility.

I. THE COMMENTS CONFIRM THAT INCENTIVE REGULATION FOR RATE-OF-RETURN CARRIERS SHOULD CONTAIN APPROPRIATE PROTECTIONS FOR CONSUMERS.

A. The Comments Confirm That The Commission Should Adopt The RPL Approach For Common Line Services, But It Should Adopt Conventional Price Caps For Traffic Sensitive And Special Access Services.

The comments overwhelmingly confirm that the Commission should apply traditional price caps, rather than the revenue-per-line (RPL) approach, to traffic sensitive and special access rates. Indeed, MAG has never offered any justification for applying the RPL mechanism to traffic sensitive and special access rates, and despite the fact that the Commission sought comment on the obvious flaws of the RPL approach (*see Notice* ¶ 231), none of the rate-of-return carriers has sought to defend the RPL mechanism in its comments. That silence should be taken as a concession that the RPL would in fact be anticompetitive if applied to traffic sensitive and special access rates. As AT&T explained (at 5-6), when competition is emerging and competitors provide some components of access, a guaranteed RPL would allow a LEC to offset competitive losses by raising other rates. *See also Notice* ¶ 231 ("it appears that in some cases, as when competition exists, a carrier could lose lines and thus revenues, while under a pure revenue cap structure, it could increase prices to recover any shortfall").

Accordingly, an RPL mechanism would be inconsistent with the Commission's pro-competitive goals if applied to all services. The Commission should apply the RPL mechanism only to common line rates (with no annual adjustments, *see* AT&T at 4-5), but it should cap traffic sensitive and special access rates directly, as in a conventional price cap system, and apply annual GDPPI-X adjustments to those rates (*see id.* at 6). *See also* Sprint at 3 ("[p]roductivity reductions should be targeted to the same traffic sensitive services defined in the CALLS plan," because most efficiencies "have accrued to switching and transport services");

GCI at 8-10 (same); WorldCom at 2-3 (Commission should adapt the existing price cap regime rather than adopt the RPL approach).

B. The Comments Confirm That LECs Should Be Required To Leave The NECA Pool When They Become Subject To Incentive Regulation.

The comments also confirm that the Commission should require rate-of-return carriers to leave the NECA pool when they become subject to incentive regulation. The commenters agree with the Commission's longstanding conclusion that "[p]articipation in pools, by its nature, entails risk-sharing, and thus a weakening of incentives to operate efficiently." *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd. 6786, ¶ 266 (1990) ("*LEC Price Cap Order*"); Sprint at 4. Any attempt to retain pooling would therefore directly undermine the entire purpose of adopting an incentive regulation plan for rate-of-return LECs, and should be rejected.

The rate-of-return LECs have no answer to these concerns. MAG asserts that, even after the adoption of incentive regulation, small carriers will still want to continue to "share risks" by participating in the NECA pool. *See* MAG at 17. MAG's comments, however, do not address the real issue, which is that "sharing risks" fundamentally undermines the incentives that incentive regulation is intended to foster. This is simply another instance in which the proponents of the MAG plan want the benefits of incentive regulation (*i.e.*, the possibility of higher returns) without any of the risks or responsibilities of incentive regulation (which entail the possibility of lower returns).[1]

[1] It should be noted that, under AT&T's proposal, only those LECs with 50,000 lines or more at the holding company level would be required to switch to incentive regulation (and thus to leave the NECA pool). The vast majority of rate-of-return LECs, which have fewer than 50,000 lines,

Similarly, NECA does not attempt to explain why risk-sharing would be appropriate in the context of incentive regulation. *See* NECA at 5-9. Moreover, NECA's actual proposal for how incentive regulation could be implemented in a pooling arrangement raises more questions than it answers. For example, the NECA proposal does not address how various price cap adjustments, such as sharing, lower formula adjustments, and other exogenous cost changes would be implemented in a pooled environment. Would such adjustments be performed for each LEC individually or for the pool as a whole? Would sharing and low-end adjustments be implemented for all incentive regulation companies in the pools taken as a whole, based on their combined earnings? Or would they be implemented for each LEC individually, based on its own earnings? Similarly, would each LEC determine and apply its own exogenous costs or would all the exogenous costs be pooled and a common exogenous percentage be applied to each LEC's RPL? Is it feasible to have both incentive regulation LECs and rate-of-return LECs in the same pool or should separate pools be established?

Marrying incentive regulation with pooling would require fundamental changes in the nature of the pools, and the Commission would have to resolve many implementation issues before such a scheme could be adopted. NECA's brief proposal only begins to address those issues. Since pooling and risk sharing would undermine the entire incentive regulation regime, however, the Commission should simply require carriers to leave the NECA pool when they become subject to incentive regulation.

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could elect to remain in the NECA pool and receive the benefits of risk sharing and administrative convenience.

C. The Comments Confirm That The Commission Should Establish An X-Factor For Carriers Subject To Incentive Regulation.

The commenters also agree that the Commission should establish a productivity offset within its incentive regulation plan for rate-of-return carriers. As the commenters recognize, the main shortcoming in MAG's proposal was that it contained no annual productivity offset, which meant that its plan did not properly balance carrier and consumer interests. *See, e.g.*, Sprint at 3; GCI at 4; *see also Notice* ¶¶ 217-18. Indeed, as Sprint explains, the principal benefit of adopting incentive regulation for today's rate-of-return carriers is that it promises increased efficiency and substantial rate reductions for consumers. *See* Sprint at 2 (noting that since the adoption of price caps, the largest LECs have reduced access charges, which has been passed on to end users in lower toll rates, and that minutes of use have increased 70%, the BOCs' average net investment has increased, and the BOCs' rates of returns have remained high); WorldCom at 2.

Despite the Commission's request for comment on a proposed X-Factor, the rate-of-return LECs are again almost silent. ALLTEL asserts that independent price cap LECs, such as Cincinnati Bell, Citizens and Frontier, have experienced lower year-over-year productivity gains than the BOCs, and follows that with the *non sequitur* that today's rate-of-return carriers cannot achieve *any* productivity gains. ALLTEL at 51. That is simply nonsense. Indeed, AT&T's proposed X-Factor is based on the observed performance of smaller LECs over the last several years. *See* AT&T at 9-10 & Appendix A. As AT&T also showed, the smaller price cap LECs have reduced their switched access rates far more than similarly-sized rate-of-return carriers during the last five years, which suggests that the larger rate-of-return carriers can achieve productivity gains. AT&T at 10. In addition, because AT&T's proposed X-Factor is targeted to traffic sensitive and special access services, the reductions would likely be equivalent to an annual across the board decrease of only about 2.8 percent (assuming that the GDDPI continue to increase at a 2% annual rate). *Id.* at 11.

In opposing the adoption of any X-Factor, the LEC commenters simply make general assertions that rate-of-return carriers have higher costs than the large price cap LECs. *See, e.g.*, Western Alliance at 7-8; PRTC at 9. The absolute level of the rate-of-return carriers' costs, however, has nothing to do with the *trend* in those costs, which is what is captured by the X-Factor. AT&T provided substantial evidence that smaller price cap LECs flourish under the price cap regime's X-Factor, and that similarly-sized rate-of-return carriers (*i.e.*, those with more than 50,000 lines) can do so as well. To the extent that smaller LECs (those with less than 50,000 lines) cannot achieve such gains – and there is no evidence in this record that that is the case – incentive regulation would not be mandatory for such LECs under AT&T's proposal. The Commission should therefore adopt AT&T's proposed X-Factor.

II. THE COMMENTS CONFIRM THAT THE COMMISSION SHOULD REQUIRE LARGER RATE-OF-RETURN LECS TO ADOPT INCENTIVE REGULATION, AND IT SHOULD ENFORCE THE "ALL-OR-NOTHING" RULE.

The comments confirm that incentive regulation should be mandatory for the larger rate-of-return LECs (*e.g.*, those with more than 50,000 lines). Furthermore, the comments confirm that a decision to opt-in to incentive regulation should be irreversible. As discussed below, these rules ensure that consumers can immediately enjoy the full benefits associated with incentive regulation, while at the same time ensuring that those rate-of-return carriers that might not thrive under incentive regulation are afforded the opportunity to continue operating under the rate-of-return mechanism. The comments further confirm that the Commission should maintain and strictly enforce its existing all-or-nothing rules. Those rules are critical to protect CLECs and ratepayers from the substantial incentives that LECs would have to engage in anticompetitive behavior under a dual-regulation regime.

A. The Comments Confirm That Incentive Regulation Should Be Mandatory For Larger Rate-of-Return LECs, And Optional For All Other LECs.

Multiple commenters confirm that incentive regulation should be mandatory for larger rate-of-return LECs. *See* NRIC at 2; Sprint at 4; WorldCom at 2; AT&T at 13. As demonstrated by these commenters, larger rate-of-return LECs have the scale to benefit from the efficiency incentives inherent in the Commission's incentive regulation rules. *See id.* Moreover, mandatory participation for larger rate-of-return LECs eliminates LEC incentives to game the system by opting into incentive regulation only when their costs are at a cyclical peak, and by engaging in inefficient "gold-plating" of their networks prior to opt-in in order to ensure maximum possible revenue requirements under the incentive regulation plan. *See, e.g.,* AT&T at 13 (citing *LEC Price Cap Order* ¶ 335 n.450).

The benefits of mandatory incentive regulation cannot be overstated. Mandatory incentive regulation would substantially improve the competitive environment and benefit consumers. For example, as demonstrated by AT&T, from 1996 through 2001, a representative sample of small price cap (*i.e.,* incentive regulation) carriers have reduced switched access rates from between 62% to 84%. *See* AT&T, Appendix B-2 (also attached hereto as Att. 1). By contrast, similarly-sized carriers that currently operate under rate-of-return regulation have decreased access rates by only 8% to 16%. *See id.; see also* WorldCom at 2 (showing similar statistics). Thus, ratepayers have experienced substantial benefits from increased rate reductions that result from LEC participation in incentive regulation programs.

Some LEC commenters, however, urge the Commission to make participation in incentive regulation optional for *all* carriers. *See* ALLTEL at 3-5; MAG at 5-8; NTCA at 2; TCA at 2-3; ITTA at 6-7; Western Alliance at 3-5. These LECs assert that, unlike price cap carriers, the universe of rate-of-return carriers is extremely diverse and, therefore, the Commission should not adopt a "one size fits all" approach. *See id.* According to these commenters, each rate-of-return LEC is in the best position to determine when and whether to participate in the incentive regulation plan. *See id.* This argument does not withstand scrutiny.

Indeed, the LEC commenters rely almost entirely on generalized assertions that mandatory incentive regulation would be inappropriate for small rate-of-return LECs. *See, e.g.*, ALLTEL at 4; TCA at 2; Western Alliance at 4. By "small LECs," however, these commenters appear to mean very small LECs – *i.e.*, those with fewer than 20,000 lines. *See id.* Although the record in this proceeding contains no evidence that such LECs cannot succeed under an incentive regulation plan,[2] AT&T's proposal would not require such LECs to become subject to incentive regulation. As demonstrated by AT&T and other commenters, the available data show that LECs with 50,000 or more lines can and do perform very well under incentive regulation. *See* AT&T at 14 & Appendix B-1. Thus, the record fully supports mandatory participation in an incentive regulation regime for rate-of-return carriers with greater than 50,000 lines. The Commission should not make the plan optional for all carriers simply because the plan may not

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[2] The only commenter that even attempts to provide evidence that small rate-of-return carriers could not profitably operate under incentive regulation is NTCA. NTCA asserts that Qwest sold many of its rural affiliates in order to avoid having to operate them as price cap carriers, which NTCA takes to be evidence that small carriers could not be profitably operated under incentive regulation. But NTCA is simply wrong. There are numerous factors that have led the RBOCs to divest their rural properties in recent years, but there is no evidence that price cap regulation has been a significant factor. *See, e.g.*, Legg Mason Research, *Reshaping Rural Telephone Markets*, pp. 13-16, 109-40 (Fall 2001).

be appropriate for a subset of those carriers (*i.e.* the smallest rate-of-return carriers). *See* NRIC at 2; Sprint at 4; WorldCom at 2; AT&T at 13.

A few LEC commenters also claim – again with no empirical evidence – that participation in an incentive regulation plan should be optional because mandatory participation might result in reduced deployment of advanced services in those markets. *See, e.g.,* TCA at 3-4; Western Alliance at 6-7. To the contrary, mandatory incentive regulation will *spur* investment in high value services in rural areas. Under rate-of-return regulation, carriers' returns on investment are capped. As a result, rate-of-return carriers are indifferent about the types of investments they make, and have no real incentive to ensure that any new investments are the most beneficial to consumers.[3] By contrast, incentive regulation provides carriers with the opportunity to obtain substantially higher returns by operating more efficiently and by making investments in the infrastructure necessary to bring new high-value services to their customers. Thus, contrary to LEC claims, incentive regulation will encourage investment in new innovative services in rural areas, whereas continued rate-of-return regulation ensures the status quo of lagging investment in new innovative services in rural areas.

The comments further demonstrate that, to the extent a small LEC opts into incentive regulation, that decision should be permanent. *See* AT&T at 14-15; Verizon at 5. That is because allowing LECs to move in and out of incentive regulation substantially undermines the incentive to succeed within the incentive regulation environment. Indeed, a revolving

[3] *See, e.g.,* Third Report, *Inquiry Concerning the 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, FCC 02-33, ¶¶ 108-115 (released February 6, 2002) (noting that although investment rural areas finally appears to be improving, investment in those areas lags far behind that of non-rural areas).

regulatory door provides LECs with the opportunity to "game" the system. *See, e.g., ALLTEL Corporation; Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control,* Memorandum Opinion and Order, 14 FCC Rcd. 14191, ¶ 18 (1999) ("*ALLTEL Waiver Order*"); *NRTA* v. *FCC*, 988 F.2d 174, 179 (D.C. Cir. 1993) ("permanent-choice [rules] aimed at preserving cost incentives . . . are central to price cap [*i.e.*, incentive] regulation"). Accordingly, a decision to opt-in to incentive regulation should be, as a general rule, permanent. *See also* ALLTEL at 7 (acknowledging that opt-in cannot be revoked for at least the life of the plan); Western Alliance at 10 (Commission should limit switching back and forth between incentive and rate-of-return regulation).

Only ITTA claims (at 2) that LECs should be allowed to opt-in and out of incentive regulation on a whim, but it does not address any of the serious concerns with such a revolving door policy raised by the Commission and by the D.C. Circuit. Rather, ITTA can support its claim only by citing proposed legislation language that has never been enacted into law. *See* ITTA at 2. But it is axiomatic that *proposed* (and in this case failed) legislation cannot trump *existing* legislation and precedent. *See, e.g., Bradley* v. *Richmond School Board,* 416 U.S. 696, 712 (1974) ("the court must decide according to *existing* law") (emphasis added). Thus, the proposed legislation cited by ITTA is irrelevant, and the Commission should reaffirm both its previous findings and those of the D.C. Circuit that a revolving door policy with respect to incentive regulation would contravene the public interest.

The bottom line is that incentive regulation should be mandatory for all larger rate-of-return LECs, *e.g.,* those with more than 50,000 lines. Incentive regulation may be optional for smaller rate-of-return LECs, but a decision to opt into the plan by a smaller rate-of-return LEC should be irreversible.

B. The Comments Confirm That The Commission Should Retain – And Enforce – The "All Or Nothing" Rule.

The comments also confirm that the Commission should retain its all-or-nothing rule. *See* CUSC at 6; Sprint at 6-7; WorldCom at 4; AT&T at 4. The D.C. Circuit has warned that "it seems quite obvious that dual regulation . . . has a key feature in common with regulated-unregulated dual status: a firm can escape the burden of costs incurred in its unregulated *or* price cap business by shifting them to the rate-of-return affiliate, which can pass them on to ratepayers." *NRTA*, 988 F.2d at 179-180; *see also id.* at 179 (under dual regulation LECs could engage in "successive mergers or acquisitions [that] enable [the LEC] to shift back and forth between rate-of-return and price cap [and would create] . . . a risk of . . . sequential cost shifting"). The Court affirmed the Commission's all-or-nothing rule on that basis. *See id.* at 181.

Contrary to LEC claims,[4] these competitive concerns have become only more serious because of changes in the telecommunications business since 1990. As a result of competitive entry, LECs now have additional incentives to lower costs in competitive areas through cost-shifting strategies in order to foreclose such competitive entry. As explained by this Commission when it first adopted the all-or-nothing rule, "LEC holding companies have both the means and the motive to shift costs improperly from affiliates under one regulatory system to affiliates under another system, to the detriment of ratepayers." *LEC Price Cap Order* ¶ 272. And given the size and complex ownership structures of today's LECs, it would be virtually impossible to detect this type of anticompetitive behavior.

[4] *See, e.g.,* ALLTEL at 25-26; NTCA at 3; Western Alliance at 8.

In this regard, LEC claims that the all-or-nothing rule should be abolished because LECs and the Commission could detect cost-shifting and other gaming behavior based on disparate LEC filings does not withstand scrutiny. *See* ALLTEL at 29-32; ITTA at 5; PRTC at 10-12; Verizon at 5. Eliminating the all-or-nothing rule – or failing to enforce it – would place the burden of monitoring LEC anticompetitive behavior squarely on CLECs, ratepayers and the Commission. That would be inappropriate, and bad policy, because the LECs, rather than their competitors and customers, have full access to the accounting records and other relevant information necessary to determine whether cost-shifting or other anticompetitive behavior has occurred. Moreover, placing the burden of monitoring LEC behavior on CLECs, ratepayers and the Commission would create unnecessary administrative burdens on CLECs and the Commission. *Compare ALLTEL Waiver Order* ¶ 38 (noting that the Commission does "not wish to create new administrative burdens for the Commission associated with monitoring affiliate transactions and taking appropriate enforcement action, if necessary").

In addition, contrary to the LECs' claims, interested parties cannot rely on LEC jurisdictional accounting and tariff filings to monitor whether LECs are engaged in cost-shifting or other gaming strategies. *See* ALLTEL at 29-32; ITTA at 5; PRTC at 10-12; Verizon at 5. As explained by the Commission, "[w]hile state regulation may be adequate to detect and prevent improper inter-affiliate and intra-affiliate cost shifts from the interstate category to the intrastate category, it is neither designed nor able to detect such cost shifts within the interstate jurisdiction." *LEC Price Cap Order* ¶ 274; *see also NRTA,* 988 F.2d at 180 (noting that such jurisdictional separation rules are "of little relevance for cost shifting entirely within the federal domain"). Furthermore, because LEC tariff filings are generally based on their jurisdictional accounting submissions, the tariff filings also are insufficient to allow the Commission and interested parties to monitor cost-shifting or other gaming strategies.

There are also other obvious deficiencies in the LEC jurisdictional separations and tariff submissions that make them useless for monitoring whether LECs are engaged in anticompetitive behavior. Those submissions are not based on independent audits, but reflect only LEC "self-reported" values. Consequently, those submissions contain only final numbers and do not include any detailed work papers or other information that could allow third parties to determine whether the reported values reflect improper cost-shifting or other gaming strategies. Only a full audit by an independent party possibly could match LEC purported costs to actual equipment and labor. Without such an audit, identifying cost-shifting and other gaming activities from the LECs' FCC submissions would be virtually impossible.

Moreover, even if (contrary to fact) the Commission and interested parties could identify anticompetitive LEC conduct by looking at LEC jurisdictional accounting and tariff submissions, any cost-shifting or other gaming strategies would be detected only several months or years after the anticompetitive strategy had been implemented. Many LECs, for example, file tariffs on a biannual basis, and the cost information in those filings is up to two and a half years old. Therefore, LECs could implement a cost-shifting strategy that could not be detected (if at all) for over two-years. Even worse, ratepayers that are harmed by the implementation of the cost-shifting strategies would not be eligible for damages, but could seek only prospective relief. *See Implementation of Section 402(b)(1)(A) of the Telecommunications Act of 1996*, CC Docket No. 96-187, Report and Order, 12 FCC Rcd. 2170, ¶¶ 20-21 (1997). In short, even if LEC filings could be used to detect anticompetitive behavior (which they cannot), that information could not be used as a *preventative* tool.

Some LEC commenters also claim that the fact that the Commission has granted waivers from its all-or-nothing rules in the past shows that the all-or-nothing rules are obsolete. *See* ALLTEL at 23-25; ITTA at 2-3; Verizon at 2-4. That argument plainly lacks merit. The fact that the Commission has granted waivers does not remotely mean that the purpose of the all-or-nothing rule – *i.e.*, to protect against LEC incentives to engage in cost-shifting and other gaming strategies – no longer exists. Indeed, by the LECs' "logic" any general rule that allows regulated entities to seek waivers becomes obsolete once a threshold number of waivers are granted. That, of course, is wrong.

As pointed out by multiple commenters, rather than repealing the all-or-nothing rule, the Commission should fully enforce it. *See* AT&T at 15-19; CUSC at 6. The Commission's waivers in the context of mergers have allowed numerous rate-of-return carriers to remain under rate-of-return regulation, which has undoubtedly cost consumers millions of dollars in lost access charge reductions. These larger rate-of-return LECs that have been parties to these mergers are of sufficient scale to respond effectively to incentive regulation, and it is no longer in the public interest to shelter these LECs from full application of the all-or-nothing rule. The Commission should promptly apply incentive regulation to larger rate-of-return LECs, and it should not shield LECs from the all-or-nothing rule in future mergers.[5]

Lastly, some commenters suggest that the all-or-nothing rule should be abolished on the grounds that the rule limits a LEC's ability to choose between the most appropriate form

[5] ITTA (at 2-3) suggests that, of the firms that have obtained waivers, there is no evidence of cost-shifting or other anticompetitive behavior, and MAG (at 8-9) claims that cost-shifting strategies are purely hypothetical. Those claims are not true. As explained by AT&T, there is evidence that Verizon may have engaged in cost-shifting strategies with PRTC (a rate-of-return affiliate). *See* AT&T Opposition To PRTC Supplement To Petition For Waiver, *PRTC Petition*

of regulation. *See, e.g.*, PRTC at 9. That argument makes no sense. As explained on numerous occasions by this Commission and the D.C. Circuit, incentive regulation is always preferable to rate-of-return regulation for ensuring efficient provision of access services. *See, e.g., LEC Price Cap Order*, ¶¶ 271-279; *NRTA,* 988 F.2d at 178-181. The only circumstances where incentive regulation would not be "appropriate" are those where a LEC could not obtain sufficient cost savings under incentive regulation to make continued operations sufficiently profitable. But empirical evidence shows that this situation will arise, if ever, only very infrequently. An analysis of a representative sample of carriers illustrates that fact. From 1996 through 2001 a representative sample of small price cap (*i.e.*, incentive regulation) carriers have reduced switched access rates from between 62% to 84%, while at the same time enjoying high interstate rates of return, in most cases far higher than the 11.25% return authorized for rate-of-return carriers. *See* AT&T at Appendix B-2 (also attached hereto as Att. 2). By contrast, similarly-sized carriers that currently operate under rate-of-return regulation have decreased access rates by only 8% to 16%, *see id.*, indicating that there is substantial room for additional savings on the part of rate-of-return LECs. There is thus no merit to LEC claims that the Commission's all-or-nothing rule deters them from choosing the "appropriate" form of regulation.[6] In all events, in the few instances where incentive regulation would contravene the public interest, the Commission may, as discussed above, approve a waiver of the all-or-nothing rules.

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for Waiver of Section 61.41 or Section 54.303(a) of the Commission's Rules, CCB/CPD 99-36, at 8-10 (filed March 9, 2001).

[6] Similarly, LEC claims that the all-or-nothing rule prohibits cost-saving mergers are also baseless. As described above, there are substantial opportunities for cost savings and increased profitability in mergers between rate-of-return and incentive regulation carriers. Moreover, in the context of large mergers, a LEC holding company's risks are reduced because they can be spread out over all of the LEC holding companies' affiliates.

III. THE COMMENTS CONFIRM THAT THE COMMISSION SHOULD NOT ADOPT ADDITIONAL PRICING FLEXIBILITY RULES FOR RATE-OF-RETURN CARRIERS AT THIS TIME.

The comments amply confirm that pricing flexibility for the rate-of-return carriers would be grossly premature at this time. Rate-of-return LECs already have substantial pricing flexibility, and these carriers face no competition that would warrant any additional flexibility.

No party disputes that rate-of-return carriers are still dominant carriers that have market power. As several commenters correctly note, granting pricing flexibility to rate-of-return carriers before actual competition has developed would simply facilitate a broad range of anticompetitive behavior that would inhibit competition. *See, e.g.*, CUSC at 7 ("[i]n the absence of actual competition, there is no justification for pricing flexibility," and if "granted *prior* to competitive entry," rural ILECs would use that flexibility "to preclude entry"); WorldCom at 4 ("premature grant of contract tariff authority would only allow the incumbent LECs to erect a barrier to competitive entry"); GCI at 10-11. Moreover, the commenters recognize that the rate-of-return carriers' markets are not remotely competitive today. *See, e.g.*, Sprint at 5 ("competition in regions served by rate of return LECs is generally quite limited today").

The ILECs assert that there is competition in their markets, but they provide no evidence to support their claims. For example, MAG and ALLTEL assert that competition from wireless carriers is increasing in their service areas, but they provide no evidence that wireless carriers provide services competing with the special access and dedicated transport services that would be subject to pricing flexibility under the MAG proposal. Indeed, MAG admits that wireless carriers target residential customers. MAG at 19 ("[w]hile wireless competition targets residential users, multi-line high-volume business customers are the prime targets of any *other* new market entrant" (emphasis added), whom MAG does not identify).[7]

Equally important, as Sprint notes, the rate-of-return carriers generally have not used the substantial pricing flexibility that they have already been awarded. *See* Sprint at 5. This simply underscores the fact that there is little competitive entry in the rate-of-return carriers' markets that would warrant a grant of additional pricing flexibility. This is also consistent with the Commission's experience in granting essentially unfettered pricing flexibility to the price cap carriers. Price cap LECs generally have not used pricing flexibility to respond to "competition" by lowering rates. To the contrary, as AT&T showed (at 20-21), price cap LECs that have been granted pricing flexibility have in fact increased their special access and dedicated transport rates. The rate-of-return LECs expressly oppose "downward only" pricing flexibility, which suggests that these LECs may engage in the same pricing behavior if granted additional flexibility. *See* ALLTEL at 48-50. The Commission should not make the same mistake with the rate-of-return carriers that it made with the price cap carriers; LECs do not need to raise rates to respond to competitive entry, and ALLTEL provides no other reason why such "flexibility" would be in the public interest.

The commenters also agree that the Commission should not grant the rate-of-return carriers pricing flexibility on the basis of simplistic "triggers," like the Commission's collocation-based triggers for the price cap companies. Indeed, although pricing flexibility would be grossly premature at this time, the commenters echo AT&T's suggestions concerning

[7] ALLTEL's additional claims that cable and satellite services compete with rural carriers are also fanciful at present. *See* ALLTEL at 15-19. Cable telephony is still years away, and even where it currently exists it generally does not serve business customers. Significant satellite

factors that might be usefully included in a future pricing flexibility test. *See, e.g.*, CUSC at 7-8 (no pricing flexibility until there is at least one competitor that has not only received ETC designation, but also has reported a non-trivial number of lines in service to USAC and begun to receive a non-trivial amount of support, and the carrier has renounced Section 251(f)(1) exemptions); GCI at 16 (must be "actual competitive alternative to the ILEC services").[8]

In addition, pricing flexibility would be incompatible with pooling, and NECA's explanation of how pricing flexibility could be accommodated in the context of pooling is wholly inadequate. NECA simply asserts (at 9-10), without elaboration, that the "existing pool mechanism can easily be modified to encompass pricing flexibility proposals" by modifying "its settlement and rate setting mechanisms on a more targeted basis to narrower groups of companies." These bare assertions leave a number of basic questions unanswered. For example, NECA does not explain whether pricing flexibility would be implemented through the pool or by individual LECs, nor does it explain how a carrier's settlement rate would be affected if that carrier's rates deviate from the pool rates.

In short, the Commission has already provided rate-of-return LECs substantial additional pricing flexibility in the *MAG Order*, and the adoption of incentive regulation would provide even more flexibility. *See* WorldCom at 4. The pricing flexibility that rate-of-return carriers already have is fully sufficient to respond to the extremely limited competition that exists today in their service areas.

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competition is also years away, as ALLTEL itself acknowledges. *See id.* at 19 (satellite providers "project" that they will offer business services "over the next several years").

[8] Indeed, even ALLTEL recognizes that there must be some test that indicates competition before additional pricing flexibility can be awarded. ALLTEL at 49.

CONCLUSION

For the foregoing reasons, and those in AT&T's initial comments, the Commission should adopt an incentive regulation plan for rate-of-return carriers with appropriate consumer protections.

Respectfully submitted,

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March 18, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 18th day of March, 2002, I caused true and correct copies of the forgoing Reply Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: March 18, 2002
Washington, D.C.

/s/ Peter M. Andros

Peter M. Andros

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Attachment 1

Price Cap-- Small Entity Rates of Return 1994 to 2000.

REPORTING ENTITY	LEC LOOPS	INTERSTATE RATE OF RETURN* 2000	INTERSTATE RATE OF RETURN* 1999	INTERSTATE RATE OF RETURN* 1998	INTERSTATE RATE OF RETURN* 1997	INTERSTATE RATE OF RETURN* 1996	INTERSTATE RATE OF RETURN* 1995	INTERSTATE RATE OF RETURN* 1994
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
GTE Midwest Inc. (COMO+COCM+COEM); See: Note M.	331,534	17.86%	15.29%	12.56%	12.39%	11.97%	9.57%	10.79%
Citizens Telecommunications Cos. (Tariff 4); See: Note L.	312,681	30.94%	"na"	"na"	"na"	"na"	"na"	"na"
Frontier-Tier 2 Concurring Companies; See: Note K.	272,138	38.95%	43.42%	45.45%	31.93%	26.91%	19.32%	17.69%
GTE Southwest Inc. (Texas - COTX)	237,202	12.87%	17.13%	14.96%	18.10%	22.42%	14.62%	8.29%
GTE South Inc. (N. Carolina - GTNC)	220,661	26.43%	24.85%	27.92%	24.48%	23.83%	14.99%	19.02%
GTE South Inc. (GTSC+COSC=GTST); See Note D.	217,451	31.70%	30.70%	"na"	"na"	"na"	"na"	"na"
GTE North Inc. (COIN); See: Note J.	204,183	47.41%	41.40%	34.61%	33.26%	29.02%	23.27%	22.44%
GTE North Inc. (COIL)	200,856	44.39%	41.03%	14.11%	41.14%	36.34%	24.21%	26.48%
GTE South Inc. (S. Carolina - GTSC); See Note D.	191,963	"na"	"na"	30.62%	24.06%	25.70%	18.93%	17.60%
Frontier Communications of Minnesota & Iowa; See: Note I.	188,263	33.16%	35.40%	29.28%	28.26%	23.71%	21.90%	19.65%
GTE South Inc. (Alabama - GTAL)	171,112	20.48%	22.23%	17.59%	23.49%	17.68%	11.39%	11.83%
Sprint Local Telephone Cos. - Northwest; See: Note H.	164,568	32.77%	31.86%	32.54%	30.59%	34.55%	34.17%	29.32%
Citizens Telecommunications Cos. (Tariff 2) ; See: Note G.	135,896	24.05%	15.74%	14.29%	13.25%	13.58%	"na"	"na"
GTE South Inc. (N. Carolina - CONC)	135,438	17.77%	19.87%	12.78%	16.63%	11.98%	14.16%	10.75%
GTE Northwest Inc. (Idaho - GTID)	135,283	34.26%	32.24%	30.89%	30.52%	23.94%	20.78%	19.60%
GTE Midwest Inc. (Missouri - GTMO)	132,854	19.32%	11.82%	16.08%	17.88%	19.84%	17.18%	18.20%
Valor Oklahoma; See: Note G.	124,033	11.17%	"na"	"na"	"na"	"na"	"na"	"na"
GTE Systems of The South (Alabama - COAL)	123,095	14.96%	10.88%	7.97%	15.31%	9.69%	11.88%	12.58%
GTE North Inc. (COPA+COQS=COPT) ; See: Note F.	113,741	40.98%	39.58%	45.97%	36.83%	40.55%	36.38%	32.60%
GTE South Inc. (Kentucky - COKY)	99,432	32.50%	9.55%	5.97%	6.62%	4.49%	4.79%	5.56%
GTE Northwest Inc. (Washington - COWA)	95,250	39.42%	39.17%	30.41%	31.85%	29.43%	22.24%	18.07%
GTE North/Contel Systems of South(GTMI+GLMI=GAMI)	55,474	16.50%	15.75%	13.17%	15.33%	14.85%	11.45%	11.10%
Valor New Mexico #1193; See: Note E.	48,645	13.41%	"na"	"na"	"na"	"na"	"na"	"na"
Valor New Mexico #1164; See: Note E.	47,574	20.57%	"na"	"na"	"na"	"na"	"na"	"na"
GTE California, Inc. (Nevada - CONV)	37,040	28.79%	20.57%	24.01%	31.44%	25.50%	19.15%	27.39%
GTE South Inc. (Virginia - GTVA)	36,528	6.44%	9.94%	20.56%	23.76%	11.07%	10.91%	9.29%
GTE South Inc. (COSC); See Note D.	25,488	"na"	"na"	26.14%	25.09%	17.40%	12.32%	9.77%
Micronesian Telecomm Corp (N. Mariana Islands - GTMC	24,945	1.87%	29.24%	34.45%	21.17%	15.49%	7.49%	2.53%
GTE Alaska (GTAK); See: Note C.	23,493	"na"	13.34%	26.89%	29.58%	19.44%	22.48%	24.78%
Citizens Telecommunications Cos. (Tariff 3); See: Note B.	23,250	16.12%	15.56%	"na"	"na"	"na"	"na"	"na"
Citizens Telecommunications Cos. (Tariff 5) ; See: Note A.	16,313	-11.23%	"na"	"na"	"na"	"na"	"na"	"na"
GTE Northwest Inc. (West Coast - GNCA)	13,990	-8.40%	-9.93%	-6.85%	-25.83%	-24.03%	-16.99%	-15.37%
GTE California, Inc. (Arizona - COAZ)	8,558	12.17%	15.57%	13.80%	14.17%	4.15%	2.95%	6.24%

(*) Unless noted the line data is per the FCC Monitoring Report, October 2001, Table 3.30. Rates of return are as reported on the Interstate Rate of Return Summary, January 1, 2000 - December 31, 2000. Price-Cap Carriers.

Notes:

A. Citizens acquired these assets from Qwest on November 1, 2000. The line data is per the January 18, 2001. the sum of the line data reported by Verizon N-IN(CONTEL) and Verizon N-IN(ALLTEL).
B. Citizens acquired these assets from Ogden on January 1, 1998. The line data is per the January 18, 2001. the sum of the line data reported by Verizon N-IN(CONTEL) and Verizon N-IN(ALLTEL).
C. Property was sold
D. COSC was combined with GTSC in 1999 to form a new entity operating as GTST.
E. Valor New Mexico line data is taken from its June 18, 2001 TRP's for 1164 &1193.
F. Line Data equals the sum of Verizon N-PA(Quaker and Verizon N-PA(Contel).
G. Valor Oklahoma line data is taken from its June 18, 2001 TRP.
H. Sprint Northwest loop count equals the sum of UTC of the NW-Wa and UTC of the NW-OR.
I. Frontier of Minnesota and Iowa loop count equals the sum of Frontier of Iowa and Frontier of Minnesota.
J. The GTE North Indiana line data is the sum of consists of the line data reported by Verizon N-IN(CONTEL) and Verizon N-IN(ALLTEL).
K. The Frontier concurring carriers consist of a number of small study areas.
L. Citizens Tariff (4) loop data is taken from its June 18, 2001 TRP.
M. Loop Count equals the sum of KS ST DBA Verizon MW and GTE-MW Verizon-MO.

Attachment 2

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
Price Cap Carriers									
Citizens (Tariff 1)	No. of Access Lines	782,875	815,475	844,363	876,837				
	Sw Access Unit Price@	$ 0.057604	$ 0.051157	$ 0.053603	$ 0.045440	$ 0.030175	$ 0.026671	-53.70%	-10.74%
	Interstate Rate Return	**15.42%**	**9.77%**	**17.87%**	**16.71%**	**19.68%**			
Citizens (Tariff 2)	No. of Access Lines	120,198	126,278	129,400	135,896				
	Sw Access Unit Price@	$ 0.089386	$ 0.088300	$ 0.068127	$ 0.061595	$ 0.029855	$ 0.025649	-71.31%	-14.26%
	Interstate Rate Return	**13.58%**	**13.25%**	**14.29%**	**15.74%**	**24.05%**			
Citizens (Tariff 3)*	No. of Access Lines				23,250				
	Sw Access Unit Price@					$ 0.013523	$ 0.012246	-9.45%	-9.45%
	Interstate Rate Return				**15.56%**	**16.12%**			
Froniter-Tier 2 Concurring Companies	No. of Access Lines	234,647	244,557	256,206	272,138				
	Sw Access Unit Price@	$ 0.059349	$ 0.058059	$ 0.043039	$ 0.035596	$ 0.022597	$ 0.017291	-70.87%	-14.17%
	Interstate Rate Return	**26.91%**	**31.93%**	**45.45%**	**43.42%**	**38.95%**			
Froniter-Minnesota & Iowa	No. of Access Lines	161,116	166,813	182,992	188,263				
	Sw Access Unit Price@	$ 0.041036	$ 0.043487	$ 0.040741	$ 0.032458	$ 0.018536	$ 0.015020	-63.40%	-12.68%
	Interstate Rate Return	**23.71%**	**28.26%**	**29.28%**	**35.40%**	**33.16%**			
GTE South Inc. (Alabama-GTAL)	No. of Access Lines	150,302	156,996	162,410	171,112				
	Sw Access Unit Price@	$ 0.050037	$ 0.047795	$ 0.043093	$ 0.034249	$ 0.016254	$ 0.012886	-74.25%	-14.85%
	Interstate Rate Return	**17.68%**	**23.49%**	**17.59%**	**22.23%**	**20.48%**			
GTE Sys of the South (Alabama-COAL)	No. of Access Lines	108,771	113,792	118,660	123,095				
	Sw Access Unit Price@	$ 0.036440	$ 0.036616	$ 0.031432	$ 0.031432	$ 0.013082	$ 0.012099	-66.80%	-13.36%
	Interstate Rate Return	**9.69%**	**15.31%**	**7.97%**	**10.88%**	**14.96%**			
GTE California, Inc. (Arizona-COAZ)	No. of Access Lines	7,645	8,037	8,170	8,558				
	Sw Access Unit Price@	$ 0.072142	$ 0.070722	$ 0.036831	$ 0.041515	$ 0.021560	$ 0.018322	-74.60%	-14.92%
	Interstate Rate Return	**4.15%**	**14.17%**	**13.80%**	**15.57%**	**12.17%**			
GTE-Alaska (GTAK)^	No. of Access Lines	18,978	20,455	22,258	23,493				
	Sw Access Unit Price@	$ 0.054570	$ 0.059840	$ 0.043792	$ 0.027974	$ 0.020454		-48.74%	-12.18%
	Interstate Rate Return	**19.44%**	**29.58%**	**26.89%**	**13.34%**				
GTE Northwest Inc. (Westcoast-GNCA)	No. of Access Lines	13,190	13,268	13,450	13,990				
	Sw Access Unit Price@	$ 0.077878	$ 0.049977	$ 0.013610	$ 0.037777	$ -	$ -	-100.00%	-20.00%
	Interstate Rate Return	**-24.03%**	**-25.83%**	**-6.85%**	**-9.93%**	**-8.40%**			
GTE Northwest Inc. (Idaho-GTID)	No. of Access Lines	121,733	128,068	131,106	135,283				
	Sw Access Unit Price@	$ 0.053730	$ 0.064952	$ 0.059819	$ 0.051644	$ 0.020333	$ 0.015576	-71.01%	-14.20%
	Interstate Rate Return	**23.94%**	**30.52%**	**30.89%**	**32.24%**	**34.26%**			
GTE North Inc. (Indiana Contel-COIN)	No. of Access Lines	172,594	179,777	187,153	193,226				
	Sw Access Unit Price@	$ 0.040333	$ 0.041642	$ 0.048843	$ 0.037885	$ 0.017676	$ 0.013674	-66.10%	-13.22%

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
	Interstate Rate Return	**29.02%**	**33.26%**	**34.61%**	**41.40%**	**47.71%**			
GTE North Inc. (Indiana Alltel-COIN)	No. of Access Lines	9,967	10,342	10,835	10,957				
	Sw Access Unit Price@	$ 0.040333	$ 0.041642	$ 0.048843	$ 0.037885	$ 0.017676	$ 0.013674	-66.10%	-13.22%
	Interstate Rate Return	**29.02%**	**33.26%**	**34.61%**	**41.40%**	**47.71%**			
GTE South Inc. (Kentucky-COKY)	No. of Access Lines	88,473	92,569	95,776	99,432				
	Sw Access Unit Price@	$ 0.044296	$ 0.043138	$ 0.038220	$ 0.035954	$ 0.016441	$ 0.014242	-67.85%	-13.57%
	Interstate Rate Return	**4.49%**	**6.62%**	**5.97%**	**9.55%**	**32.50%**			
GTE Midwest Inc. (Missouri-GTMO)	No. of Access Lines	119,487	124,607	128,032	132,854				
	Sw Access Unit Price@	$ 0.040983	$ 0.043061	$ 0.036487	$ 0.025428	$ 0.013133	$ 0.006853	-83.28%	-16.66%
	Interstate Rate Return	**19.84%**	**17.88%**	**16.08%**	**11.82%**	**19.32%**			
GTE Midwest Inc.-KS ST (Missouri-COMT)	No. of Access Lines	3,943	4,099	4,283	4,484				
	Sw Access Unit Price@	$ 0.040983	$ 0.043061	$ 0.036487	$ 0.025428	$ 0.013133	$ 0.006853	-83.28%	-16.66%
	Interstate Rate Return	**11.97%**	**12.39%**	**12.56%**	**15.29%**	**17.86%**			
GTE Midwest Inc. (Missouri-COMT)	No. of Access Lines	52,162	54,779	54,202	56,774				
	Sw Access Unit Price@	$ 0.049773	$ 0.045873	$ 0.042716	$ 0.031790	$ 0.014554	$ 0.006490	-86.96%	-17.39%
	Interstate Rate Return	**11.97%**	**12.39%**	**12.56%**	**15.29%**	**17.86%**			
GTE California, Inc. (Nevada-CONV)	No. of Access Lines	30,458	32,905	34,880	37,040				
	Sw Access Unit Price@	$ 0.040381	$ 0.052874	$ 0.037976	$ 0.028627	$ 0.012154	$ 0.010376	-74.30%	-14.86%
	Interstate Rate Return	**25.50%**	**31.44%**	**24.01%**	**20.57%**	**28.79%**			
GTE South Inc. (N Carolina-CONC)	No. of Access Lines	117,749	124,874	128,838	135,438				
	Sw Access Unit Price@	$ 0.044342	$ 0.039627	$ 0.035407	$ 0.031332	$ 0.015108	$ 0.012551	-71.69%	-14.34%
	Interstate Rate Return	**11.98%**	**16.63%**	**12.78%**	**19.87%**	**17.77%**			
Micronesian Telecomm Corp (GTMC)	No. of Access Lines	18,837	20,639	20,639	24,945				
	Sw Access Unit Price@	$ 0.147447	$ 0.130564	$ 0.059950	$ 0.046119	$ 0.029991	$ 0.018616	-87.37%	-17.47%
	Interstate Rate Return	**15.49%**	**21.17%**	**34.45%**	**29.24%**	**1.87%**			
GTE North Inc. PA (Contel-COPA)	No. of Access Lines	62,032	65,018	65,374	66,903				
	Sw Access Unit Price@	$ 0.030114	$ 0.050225	$ 0.031191	$ 0.033277	$ 0.014901	$ 0.012406	-58.80%	-11.76%
	Interstate Rate Return	**40.55%**	**36.83%**	**45.97%**	**39.58%**	**40.98%**			
GTE North Inc. Quaker State (Contel-COQS)	No. of Access Lines	40,773	42,632	44,547	46,838				
	Sw Access Unit Price@	$ 0.030114	$ 0.050225	$ 0.031191	$ 0.033277	$ 0.014901	$ 0.012406	-58.80%	-11.76%
	Interstate Rate Return	**40.55%**	**36.83%**	**45.97%**	**39.58%**	**40.98%**			
GTE South Inc. (S. Carolina-GTSC)	No. of Access Lines	169,753	177,720	187,219	191,963				
	Sw Access Unit Price@	$ 0.042665	$ 0.044124	$ 0.038512	$ 0.030934	$ 0.013624	$ 0.011621	-72.76%	-14.55%
	Interstate Rate Return	**25.70%**	**24.06%**	**30.62%**	**30.70%**	**31.70%**			
GTE South Inc. (S. Carolina-COSC)	No. of Access Lines	20,934	22,610	24,225	25,488				
	Sw Access Unit Price@	$ 0.041969	$ 0.043852	$ 0.031752	$ 0.030934	$ 0.013624	$ 0.011621	-72.31%	-14.46%

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
	Interstate Rate Return	**17.40%**	**25.09%**	**26.14%**	**30.70%**	**31.70%**			
GTE South Inc. (Virginia-GTVA)	No. of Access Lines	33,940	35,140	36,367	36,528				
	Sw Access Unit Price@	$ 0.050335	$ 0.046501	$ 0.031080	$ 0.018197	$ 0.012980	$ 0.011252	-77.65%	-15.53%
	Interstate Rate Return	**11.07%**	**23.76%**	**20.56%**	**9.94%**	**6.44%**			
GTE Northwest Inc. (Washington-COWA)	No. of Access Lines	79,420	83,753	91,428	95,250				
	Sw Access Unit Price@	$ 0.053976	$ 0.060710	$ 0.053069	$ 0.045296	$ 0.017985	$ 0.015477	-71.33%	-14.27%
	Interstate Rate Return	**29.43%**	**31.85%**	**30.41%**	**39.17%**	**39.42%**			
GTE Southwest Inc. (Texas-GTTX)	No. of Access Lines	1,511,422	1,610,872	1,688,954	1,777,873				
	Sw Access Unit Price@	$ 0.048549	$ 0.042149	$ 0.034368	$ 0.026471	$ 0.012257	$ 0.010579	-78.21%	-15.64%
	Interstate Rate Return	**11.53%**	**14.81%**	**16.43%**	**21.42%**	**21.74%**			
GTE Florida (GTFL)	No. of Access Lines	2,082,160	2,199,225	2,272,117	2,320,241				
	Sw Access Unit Price@	$ 0.038965	$ 0.030768	$ 0.025483	$ 0.019673	$ 0.011708	$ 0.010913	-71.99%	-14.40%
	Interstate Rate Return	**15.17%**	**19.14%**	**14.58%**	**18.93%**	**21.81%**			
Sprint-MW (MO, KS, MN, NE, WY, TX)	No. of Access Lines	862,260	901,105	938,896	996,917				
	Sw Access Unit Price@	$ 0.057574	$ 0.050676	$ 0.046673	$ 0.035544	$ 0.015787	$ 0.011656	-79.75%	-15.95%
	Interstate Rate Return	**21.53%**	**19.97%**	**19.66%**	**17.69%**	**18.88%**			
Sprint-NW (OR & WA)	No. of Access Lines	146,473	152,997	158,962	164,568				
	Sw Access Unit Price@	$ 0.066993	$ 0.062586	$ 0.059983	$ 0.043954	$ 0.025109	$ 0.019183	-71.37%	-14.27%
	Interstate Rate Return	**34.56%**	**30.59%**	**32.54%**	**31.86%**	**32.77%**			
Sprint-SE (TN, VA & SC)	No. of Access Lines	705,178	734,779	764,831	763,234				
	Sw Access Unit Price@	$ 0.036248	$ 0.031592	$ 0.028120	$ 0.019152	$ 0.009030	$ 0.008137	-77.55%	-15.51%
	Interstate Rate Return	**19.30%**	**17.62%**	**15.87%**	**17.50%**	**23.32%**			
Sprint-Indiana	No. of Access Lines	225,592	233,235	239,321	256,398				
	Sw Access Unit Price@	$ 0.051051	$ 0.046323	$ 0.043401	$ 0.041331	$ 0.016719	$ 0.012327	-75.85%	-15.17%
	Interstate Rate Return	**24.30%**	**26.13%**	**24.19%**	**28.98%**	**38.21%**			
Cincinnati Bell	No. of Access Lines	941,316	976,922	987,374	998,991				
	Sw Access Unit Price@		$ 0.026605	$ 0.025069	$ 0.013717	$ 0.007777	$ 0.007282	-72.63%	-18.16%
	Interstate Rate Return		**20.04%**	**17.81%**	**25.45%**	**28.95%**			
Southern New England Telephone	No. of Access Lines	1,990,248	2,130,708	2,188,763	2,411,062				
	Sw Access Unit Price@	$ 0.034171	$ 0.030090	$ 0.027095	$ 0.018113	$ 0.010539	$ 0.009497	-72.21%	-14.44%
	Interstate Rate Return	**11.64%**	**12.70%**	**10.99%**	**12.12%**	**23.91%**			
Nevada Bell	No. of Access Lines	313,150	330,523	348,674	358,700				
	Sw Access Unit Price@	$ 0.035316	$ 0.034173	$ 0.032548	$ 0.021744	$ 0.014325	$ 0.010741	-69.59%	-13.92%
	Interstate Rate Return	**17.75%**	**19.47%**	**16.02%**	**19.26%**	**22.07%**			
Aliant	No. of Access Lines	269,410	279,581	290,596	294,397				
	Sw Access Unit Price@	$ 0.033774	$ 0.032397	$ 0.029330	$ 0.020841	$ 0.014317	$ 0.012703	-62.39%	-12.48%

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
	Interstate Rate Return	**14.95%**	**12.27%**	**15.02%**	**19.27%**	**12.00%**			

Sources:

October 2001 FCC Monitoring Report, Table 3.30, USF Loops are reported up to 1999

1996, 1997, 1998, 1999, 2000 and 2001 Annual Access Tariff Filings, SUM-1 TRP and RTE-1 TRP

1996, 1997, 1998, 1999 and 2000 FCC Form 492 Summary

@ The Sw Access Unit Price is the sum of the Carrier Common Line including PICC Revenues, Traffic Sensitive and Trunking Basket Revenues obtained from the Carriers' Annual Access Tariff Filing SUM-1 TRP divided by the Local Switching Demand from the Annual Access Tariff Filing RTE-1 TRP.

* Odgen Telephone Company acquired by Citizens in 1999

^ GTE-Alaska was sold to ATEAC in 2000

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
Rate-of-Return Carriers/Holding Companies									
ALLTEL Communications Service Corp.%+#	No. of Access Lines	1,701,506	1,794,101	1,884,338	1,977,248				
(excludes Aliant)	Sw Access Unit Price@	$ 0.033950	$ 0.033679	$ 0.035243	$ 0.029824	$ 0.027361	$ 0.029389	-13.43%	-2.69%
	Interstate Rate Return	**11.94%**		**13.42%**		**11.43%**			
ACS-Anchorage	No. of Access Lines	157,299	163,729	157,658	190,013				
	Sw Access Unit Price@	$ 0.025416	$ 0.024816	$ 0.034841	$ 0.035645	$ 0.034080	$ 0.035857	41.08%	8.22%
	Interstate Rate Return	**12.96%**		**11.40%**		**17.09%**			
CenturyTel-Ohio#	No. of Access Lines	72,911	75,717	78,282	81,571				
	Sw Access Unit Price@	$ 0.037255	$ 0.034836	$ 0.034044	$ 0.034044	$ 0.031679	$ 0.031166	-16.34%	-3.27%
	Interstate Rate Return	**21.33%**		**19.57%**		**18.96%**			
CenturyTel-Wisconsin	No. of Access Lines	51,601	53,831	56,199	59,264				
	Sw Access Unit Price@	$ 0.030993	$ 0.030393	$ 0.032231	$ 0.033035	$ 0.028938	$ 0.030716	-0.89%	-0.18%
	Interstate Rate Return	**15.82%**		**16.62%**		**19.68%**			
CenturyTel-Midwest & Michigan>	No. of Access Lines	80,753	84,231	87,888	91,123				
	Sw Access Unit Price@	$ 0.066810	$ 0.065604	$ 0.040615	$ 0.041419	$ 0.038515	$ 0.040293	-39.69%	-7.94%
	Interstate Rate Return	**n/a**		**16.30%**		**16.63%**			
CenturyTel-Other (concur with NECA)	No. of Access Lines	289,047	316,636	332,603	350,690				
	Sw Access Unit Price@	$ 0.066810	$ 0.065604	$ 0.047766	$ 0.045299	$ 0.042404	$ 0.044022	-34.11%	-6.82%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
CenturyTel-TUECA^	No. of Access Lines	475,833	527,349	631,571	660,708				
	Sw Access Unit Price@	$ 0.034148	$ 0.033707	$ 0.033498	$ 0.034303	$ 0.033192	$ 0.034969	2.41%	0.48%
	Interstate Rate Return	**11.31%**		**12.39%**		**11.97%**			
Commonwealth Telephone Ent*	No. of Access Lines	239,060	256,674	276,778	297,405				
	Sw Access Unit Price@	$ 0.066810	$ 0.065604	$ 0.047766	$ 0.045299	$ 0.042404	$ 0.044022	-34.11%	-6.82%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
Concord Telephone	No. of Access Lines	97,866	103,380	110,525	118,218				
	Sw Access Unit Price@	$ 0.022928	$ 0.021277	$ 0.025723	$ 0.024231	$ 0.024124	$ 0.025901	12.97%	2.59%
	Interstate Rate Return	**12.61%**		**14.05%**		**15.58%**			
Farmers Telephone Coop	No. of Access Lines	49,172	52,017	54,080	57,255				
	Sw Access Unit Price@	$ 0.035206	$ 0.024727	$ 0.028093	$ 0.027736	$ 0.025345	$ 0.027123	-22.96%	-4.59%
	Interstate Rate Return	**n/a**		**n/a**		**13.26%**			
Horry Telephone Coop	No. of Access Lines	66,130	72,893	75,821	86,423				
	Sw Access Unit Price@	$ 0.027346	$ 0.025289	$ 0.028861	$ 0.032273	$ 0.030863	$ 0.032640	19.36%	3.87%
	Interstate Rate Return	**11.93%**		**12.91%**		**11.88%**			
Illinois Consolidated	No. of Access Lines	74,904	85,594	87,210	88,953				
	Sw Access Unit Price@	$ 0.033396	$ 0.032796	$ 0.042299	$ 0.043103	$ 0.041520	$ 0.043297	29.65%	5.93%
	Interstate Rate Return	**9.48%**		**10.34%**		**11.77%**			
Low Country Telephone Company%	No. of Access Lines	52,923	57,945	60,141	67,645				

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period
	Sw Access Unit Price@	$ 0.058930	$ 0.056681	$ 0.056651	$ 0.039528	$ 0.039304	$ 0.031776	-46.08%	-9.22%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
Matanuska Telephone	No. of Access Lines	41,908	45,508	51,760	56,575				
	Sw Access Unit Price@	$ 0.066810	$ 0.065604	$ 0.047766	$ 0.045299	$ 0.042404	$ 0.044022	-34.11%	-6.82%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
Pioneer Telephone Coop	No. of Access Lines	47,485	48,926	50,640	50,282				
	Sw Access Unit Price@	$ 0.066810	$ 0.065604	$ 0.047766	$ 0.045299	$ 0.042404	$ 0.044022	-34.11%	-6.82%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
Puerto Rico Telephone Company	No. of Access Lines	1,188,082	1,256,646	1,261,733	1,294,704				
	Sw Access Unit Price@	$ 0.048404	$ 0.042615	$ 0.355096	$ 0.043615	$ 0.041477	$ 0.040416	-16.50%	-3.30%
	Interstate Rate Return	**10.89%**		**11.95%**		**9.63%**			
Rock Hill Telephone Company%~	No. of Access Lines	101,032	107,240	114,819	123,806				
	Sw Access Unit Price@	$ 0.066810	$ 0.025463	$ 0.021017	$ 0.019733	$ 0.020859	$ 0.022649	-66.10%	-13.22%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
Roseville Telephone Company	No. of Access Lines	103,468	111,074	117,860	123,520				
	Sw Access Unit Price@	$ 0.032070	$ 0.031385	$ 0.040700	$ 0.042142	$ 0.041848	$ 0.026429	-17.59%	-3.52%
	Interstate Rate Return	**9.38%**		**9.97%**		**18.42%**			
Telephone And Data Systems, Inc.%+	No. of Access Lines	501,070	529,281	557,755	588,355				
	Sw Access Unit Price@	$ 0.066459	$ 0.065297	$ 0.047766	$ 0.045283	$ 0.042340	$ 0.043950	-33.87%	-6.77%
	Interstate Rate Return	**n/a**		**n/a**		**n/a**			
TXU Communications%	No. of Access Lines	93,559	101,217	109,385	117,268				
	Sw Access Unit Price@	$ 0.034208	$ 0.028887	$ 0.026140	$ 0.023057	$ 0.021768	$ 0.024415	-28.63%	-5.73%
	Interstate Rate Return	**10.90%**		**13.84%**		**11.67%**			
Virgin Islands Telephone	No. of Access Lines	58,315	60,902	63,234	67,229				
	Sw Access Unit Price@	$ 0.030512	$ 0.033609	$ 0.029563	$ 0.030367	$ 0.024036	$ 0.025813	-15.40%	-3.08%
	Interstate Rate Return	**11.08%**		**15.29%**		**11.48%**			

Sources:

October 2001 FCC Monitoring Report, Table 3.30, USF Loops are reported up to 1999

1995, 1996, 1997, 1998, 1999, 2000 and 2001 Annual Access Tariff Filings and Access Reform Tariff Filings made in 1997, 1998 and 1999

1996, 1997, 1998, 1999 and 2000 FCC Form 492 Summary

Footnotes:

@ The Sw Access Unit Price is the sum of the Carrier Common Line Rate and theTraffic Sensitive Revenue Requirements divided by the Local Switching Demand obtained from the Carriers' Cost Support provided in their Annual Access Tariff Filings and Access Reform Tariff Filings. Where Local Switching Demand was not available, AMOUS from the October 2001 FCC Monitoring Report was used. TS MOU Tariff Rates were used for Winterhaven Telephone Company, a TDS carrier, for 1999 and 2000.

Comparisons of Switched Access Unit Price and ROR for Price Cap Carriers vs Rate-of-Return Carriers

		1996	1997	1998	1999	2000	2001	1996 to 2001 % Change	Av Annual % Reduction over 5-Yr Period

% Sw Access Unit Price developed on a Holding Company Level.

~ Rock Hill Telephone Company was a member of the NECA CL and TS Pools in 1996 and withdrew from the TS Pool in 1997.

+ some study areas are average schedule companies

recent acquisitions from Verizon will allow Alltel to grow to approximately 3.2M access lines and for CenturyTel to grow to approximately 2.5M accessn lines.

> prior to 1997, CenturyTel-Midwest & Michigan concurred with NECA.

^ does not include Alaska study areas that were purchased from Pacific Telecom, Inc. and then sold to Alaska Communications Systems.

* Conestoga Enterprises, Inc., Denver & Ephrata, North Pittsburgh Telephone and North State are average schedule carriers with greater than 50K access lines and, like Commonwealth Telephone (also an average schedule carrier), concur with NECA.

Madison River Telephone Company, FairPoint Communications, Inc, Guam Telephone Authorities are Holding Companies with greater than 50K access lines where cost support data were not available to perform a comparison.