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

REPLY COMMENTS OF THE INDEPENDENT TELEPHONE & TELECOMMUNICATIONS ALLIANCE

I. INTRODUCTION AND SUMMARY

In its initial comments in this proceeding,[1] ITTA urged the Commission to: (1) eliminate immediately the price cap all-or-nothing and one-way door rules, (2) make incentive-based rate regulation optional for rate-of-return carriers not only by operating company but by study area, and (3) grant pricing flexibility tailored to small and midsize carriers. The record developed in this proceeding strongly supports these proposals and demonstrates that Commission action to implement them would serve the public interest. Those commenters opposing ITTA's positions have provided no convincing evidence to the contrary.

II. THE COMMISSION SHOULD IMMEDIATELY REPEAL THE PRICE CAP ALL-OR-NOTHING RULE

The record in this proceeding strongly supports the Commission's immediate repeal of the price cap all-or-nothing and one-way-door rules contained in the Commission's rules, 47 C.F.R. § 61.41(b-d). ITTA urges the Commission to take this action as soon as possible so rate-of-return carriers may make price cap elections for any affiliates that could operate successfully under price caps before the next annual access tariff filings are due, in June 2002.

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1 Comments in this proceeding were due on February 14, 2002. *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, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166, FCC 01-304, 16 FCC Rcd 19613 (2001).

As Verizon, ICORE, the Joint Commenters[2] and NTCA, OPASTCO, and USTA point out, by eliminating the price cap all-or-nothing rule, the Commission would serve the public interest by:

(1) eliminating unnecessary layers of costly front-end regulatory scrutiny in favor of vigorous enforcement action if the Commission or competitors detect rule violations;[3]

(2) protecting universal service by eliminating a rule that, if vigorously enforced, would undermine universal service support provided to price cap carriers by the Interstate Access Universal Service Support fund, which is capped at $650 million;[4]

(3) benefiting consumers by facilitating transactions that improve service quality by promoting ownership of rural exchanges by rural service specialists;[5]

(4) allowing the Bell Operating Companies to divest their least profitable and most isolated exchanges;[6] and

(5) permitting all carriers that could operate successfully under price caps to do so, without regard to whether price cap regulation would be appropriate for their affiliates.[7]

The Commission, in tacit recognition of the public interest benefits that would flow from the elimination of this rule, has routinely granted waivers of the one-way door rule in the context of acquisitions over the past decade,[8] and granted repeated extensions of time for some carriers to bring their operations into compliance with the price cap all-or-nothing rule.[9]

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2 ALLTEL Corp., CenturyTel, Inc., Madison River Communications, and TDS Telecom.

3 *See, e.g.*, NTCA Comments at 8 (noting high transaction cost associated with seeking all-or-nothing rule waivers); ICORE Comments at 15 (same); *see also* Testimony of Michael K. Powell, Chairman, Federal Communications Commission, Before the Subcommittee on Commerce, Justice, State, and the Judiciary of the Committee on Appropriations, United States Senate, March 7, 2002 (calling enforcement "the cornerstone of [the FCC's] competition policy."

4 Verizon Comments at 3-4.

5 *See, e.g.,* ICORE Comments at 14.

6 *Id.*

7 Joint Commenters Comments at 32.

8 ITTA attached an extensive list of these waivers to its initial comments in this proceeding.

9 *E.g., ALLTEL Corp. Petition for Waiver of Section 61.41. of the Commission's Rules*, Order, 16 FCC Rcd 12407 (2001) (permitting ALLTEL, a rate-of-return carrier, to operate its affiliate, Aliant, under price caps following acquisition); *Puerto Rico Tel. Co. Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's*

Those commenters that oppose the elimination of the price cap all-or-nothing rule provide no convincing evidence of harm that would justify retention of this rule. While AT&T, Sprint, and the CUSC, for example, raise the spectre of cost-shifting from price cap carriers to affiliated rate-of-return carriers, they fail to identify at the state or federal level even an allegation of such cost-shifting by any carrier operating under dual modes of regulation.[10] Nor do those parties seriously challenge the sufficiency of existing safeguards to prevent such abuse.

The Commission's great body of experience (including over two years of real-world experience with holding companies that operate partly under price cap regulation and partly under rate-of-return regulation)[11] should carry far more weight than the conjecture, fears, and non-sequiturs that these opposing commenters offer. Real-world experience confirms that existing FCC rules and oversight authority provide an effective deterrent by making such activity both illegal and readily detectable.[12] Therefore, the Commission should immediately repeal the price cap all-or-nothing and one-way door rules without imposing additional safeguards.

First, the Commission's existing rules specify in detail the process for allocating costs, both between affiliated ILECs, and between regulated and non-regulated affiliates.[13] These rules already prohibit improper cost-shifting and deter such activity by exposing a carrier to stiff enforcement penalties for violations. Labor, plant, and other costs incurred by one ILEC

Rules, Order, 16 FCC Rcd 12343 (2001) (permitting Puerto Rico Telephone Company to continue to operate under rate-of-return regulation following acquisition by price cap carrier); *see also ALLTEL Corp. Petition for Waiver of Section 61.41. of the Commission's Rules*, CCB/CPD No. 99-01, Order, DA 00-1307 (rel. June 16, 2000) ("*ALLTEL/Aliant Waiver Order*"); *Puerto Rico Tel. Co. Petition for Waiver of Section 61.41 or Section 54.303(a) of the Commission's* Rules, Order, 15 FCC Rcd 9680 (2000); *Puerto Rico Telephone Authority, Transferor, and GTE Holdings (Puerto Rico) LLC, Transferee, For Consent to Transfer Control of Licenses and Authorization Held by Puerto Rico Telephone Company and Celulares Telefónica, Inc.*, Memorandum Opinion and Order, 14 FCC Rcd 3122 (1999).

10 As pointed out by the Joint Commenters, multiple carriers operate under different plans at the state level, and at least two currently do so at the interstate level. Joint Commenters Comments at 8.

11 *See supra* note 9.

12 Verizon Comments at 5.

13 47 C.F.R. § 64.901.

cannot simply be "shifted" to another, not just because such action would violate the Commission's cost allocation rules,[14] but also because it would violate fundamental principles of corporate governance and accounting. Commission rules also already govern the allocation of overhead expenses, including common overheads that cannot be directly or indirectly assigned or attributed to any particular service.[15] These rules already require LECs to allocate common overhead expenses on the basis of a general allocator reflecting the proportion of expenses directly assigned or attributed to regulated and non-regulated activities.[16] In addition, the Commission's affiliate transactions rules specify in great detail the manner in which affiliate transactions must be accounted for.[17]

Similarly, the Part 36 rules strictly govern jurisdictional separation of costs and prohibit improper assignment of costs to the wrong jurisdiction.[18] Overhead expenses allocated to regulated activities, in general, must be separated between the state and federal jurisdictions "on the basis of the separation of the cost of the combined Big Three Expenses," namely plant specific expenses, plant non-specific expenses, and customer operations expenses.[19]

Indeed, AT&T's comment that state-level accounting regulation "is neither designed nor able to detect such cost shifts *within the interstate jurisdiction*" is telling.[20] AT&T apparently does not dispute that such measures can and do prevent cost-shifting between affiliates at the state level, and between the state and federal jurisdictions within a single affiliate.[21] AT&T

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[14] Verizon Comments at 5 n.7.

[15] 47 C.F.R. § 64.901(b)(3)(i-iii).

[16] *Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Telephone Service*, Report and Order, 2 FCC Rcd 1298, ¶¶ 156, 161 (1987).

[17] 47 C.F.R. §§ 32.27, 64.902.

[18] 47 C.F.R. Part 36; *accord*, Verizon Comments at 5.

[19] 47 C.F.R. § 36.392.

[20] AT&T Comments at 17 (emphasis added), *citing LEC Price Cap Order*, 5 FCC Rcd 6786, ¶ 272.

[21] *Id*.

fails to appreciate, however, the federal accounting and separations which amply protect against misallocation of costs, as discussed above, apply to the same underlying *costs* as the state accounting rules; thus, any attempt to shift costs between affiliates only at the federal level would be readily apparent because of the resulting mismatch with data reported at the state level.

Second, AT&T and the CUSC[22] ignore the fact that the possibility of competitive entry diminishes both incentives and opportunities to engage in cost-shifting. Competition for telecommunications customers is many-faceted and growing. Inter-modal competition, in particular, has made dramatic inroads even in rural markets. For example, CMRS carriers today have widespread coverage, and ITTA members typically face multiple unaffiliated CMRS competitors. As is documented in the record, CMRS carriers have been capturing a large and increasing share of access minutes of use in rural areas.[23] Moreover, CLECs, cable broadband providers, and other Internet access providers all have been draining voice traffic off of the PSTN at an increasing rate.[24] These competitors also are becoming certified as eligible telecommunications carriers ("ETCs") and receiving support based on the ILEC's costs, despite the fact that their costs are often lower than those of the ILEC against which they compete.[25]

Given such real-world constraints, it would be impossible for ILECs to "lower costs through cost-shifting strategies in order to foreclose competitive entry."[26] The competitors already exist and can easily enter any market where prices exceed costs, making cost-shifting unsustainable. Opposing commenters' references to rural competition evolving slowly and unevenly fundamentally mischaracterize the many ways in which competition is taking hold in

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22 AT&T Comments at 16; CUSC Comments at 6.

23 Joint Commenters Comments at 19-22.

24 *Id.*

25 *See, e.g., Federal-State Joint Board on Universal Service*, Memorandum Opinion and Order and Further Notice of Proposed Rulemaking, 13 FCC Rcd 21252, ¶ 45 (1998) (asking whether the Commission's implementation of its "competitive neutrality" universal service principle "favor[s] unfairly one technology over another.").

rural America. Inter-modal competitors, such as CMRS, satellite, and cable operators, often have large-footprint facilities that allow them to launch competitive services across large portions of a rural ILEC's service territory extraordinarily quickly, and without regard to whether the ILEC is subject to the rural exemption in Section 251(f)(1) of the Communications Act.[27]

Third, in the course of the tariff-filing process, the Commission, local exchange competitors, interexchange carriers, consumer groups, and other interested parties all have the opportunity to examine in detail the results of a carrier's application of the cost allocation and jurisdictional separations rules. Any large year-over-year changes that could signal illegal cost-shifting would become readily apparent in the cost support for these tariffs. Cost-shifting from a holding company's (presumably) larger price cap carriers to its (presumably) smaller rate-of-return affiliates would be especially apparent because the smaller affiliates generally have smaller revenue requirements and thus any significant additional costs would be particularly noticeable. If the Commission were to suspect illegal cost-shifting as a result of year-over-year changes in individual costs or revenue requirements, it has ample authority to suspend and investigate the tariff of the carrier involved.[28]

III. ANY ALTERNATIVE REGULATORY METHOD SHOULD BE OPTIONAL BY STUDY AREA

For the same reasons that the Commission should eliminate its price cap all-or-nothing rule, the Commission should make any new form of alternative regulation it develops optional by study area. ITTA concurs with NRTA that one regulatory "size" cannot fit all midsize and smaller ILECs.[29] As is amply demonstrated in the record, the diversity that exists

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[26] AT&T Comments at 16.

[27] *See, e.g., Smith Bagley, Inc. for Designation as an Eligible Telecommunications Carrier Under 47 U.S.C. 214(e)(2)*, Final Order, Utility Case No. 3026 (NM Com. Feb. 19, 2002) (designating CMRS carrier as an ETC within the rural New Mexico service territory of CenturyTel of the Southwest, Inc.).

[28] 47 U.S.C. § 204(a)(1).

[29] NRTA, OPASTCO, and USTA Comments at 5.

among rate-of-return carriers – even those under common ownership – makes it impossible for the Commission to design any form of alternative regulation that would be suitable on either a mandatory or an all-or-nothing basis.[30]

Against this backdrop, AT&T, WorldCom, and Sprint fail to demonstrate how mandatory conversion to price cap regulation or any other form of incentive regulation the Commission develops would benefit consumers, rural America, the public interest, or, indeed, anyone other than themselves.[31] While railing against the inefficiencies they allege are induced by rate-of-return regulation, none of the three have offered any convincing evidence of inefficiency or year-over-year productivity gains as support for their calls for "instant price caps." Further, notably absent from any of these comments is any commitment from the nation's largest long-distance carriers either to make their best rate plans available to rural Americans or to share with consumers any reduction in access charges that alternative regulation produces.

It is now widely agreed that price cap regulation had unintended consequences in high-cost areas, creating incentives for carriers serving large study areas with divergent cost characteristics to allow the deterioration of the network in the highest cost areas.[32] Under price caps, many BOCs were understandably unwilling to invest in their highest-cost exchanges if they could not recover these expenses, under the declining, averaged, rates they were permitted to charge, without compromising profitability of the overall study areas. The Commission should not compound the resulting rural network decay problems by mandating price cap regulation for a whole new set of companies that cannot achieve the expected performance level.

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[30] *Id.*; ICORE Comments at 12-13; NTCA Comments at 2-6; Western Alliance Comments at 2-10; GVNW Comments at 2-3; ITTA Comments at 6-7; Joint Commenters Comments at 3-6.

[31] AT&T Comments at 13-15; WorldCom Comments at 2; Sprint Comments at 4.

[32] Joint Commenters Comments at 8-12.

Rather, the Commission should seek a form of alternative regulation that creates incentives for carriers to meet service quality and advanced services deployment goals. One essential component of such a regulatory framework is optionality – a carrier that is struggling to survive under an inappropriate form of regulation simply cannot make the types of service quality and investment commitments as one that is operating under a form of regulation well-matched to its needs and those of its customers.

IV. THE RECORD SUPPORTS A GRANT OF IMMEDIATE PRICING FLEXIBILITY

As the Commission has long recognized, pricing flexibility serves the public interest in a variety of ways. Contract-based pricing, for example, serves important policy goals which the Commission has acknowledged, namely: increasing competition; enabling users to purchase services that match their specific needs; facilitating planning by carriers and customers; and allowing carriers and users to share in cost savings.[33] Geographic rate deaveraging allows prices to track costs more closely, promoting efficient competition.[34] Volume and term discounts permit pricing that reflects the cost savings LECs experience when a customer is willing to make a long-term or volume commitment.[35] Thus, the CUSC's argument that competition must precede pricing flexibility ignores the many pro-competitive public interest benefits such flexibility brings. Further, and contrary to the arguments of GCI, AT&T, and the CUSC, these benefits can be realized without any particular level of competition.[36] Pricing flexibility moves rates closer to cost and promotes efficient competition in all areas, not just in the lowest-cost portions of an ILEC's service territory typically targeted by CLECs. The

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[33] *Competition in the Interstate, Interexchange Marketplace*, Report and Order, 6 FCC Rcd 5880, ¶¶ 102-106 (1991).

[34] *E.g., MAG Order*, at paras. 57-60.

[35] *See Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221,14289 (1999), *aff'd sub nom. WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

[36] GCI Comments at 12-13; CUSC Comments at 7-8; AT&T Comments at 19-23.

opponents of pricing flexibility desire simply to maintain the economically inefficient pricing umbrella created under the current rules.[37]

ITTA therefore supports pricing flexibility that is triggered *either* by a particular level of competition, *or* by ILEC market-opening commitments.[38] While ITTA agrees that actual levels of competition, as measured by lost revenues or lines, for example, should justify pricing flexibility, pricing flexibility should not be tied exclusively to this prerequisite. Moreover, competition from providers opportunistically taking advantage of arbitrage opportunities under the ILEC price umbrella is of questionable public interest value.

Given the elimination of barriers to entry and increase in inter-modal competition, ITTA agrees with the Joint Commenters and NRTA that actual competition should not be the only trigger for pricing flexibility.[39] As discussed above and elsewhere in the record, inter-modal competitors such as CMRS providers and cable television system operators, make inroads in ILEC markets without challenging the rural exemption, without purchasing UNEs, without collocating one piece of equipment in an ILEC central office, and without seeking or obtaining ETC status or even CLEC certification. Therefore, ITTA agrees with AT&T that "[t]the existing pricing flexibility rules, based on levels of competition within an MSA, would be inappropriate for the smaller rate-of-return LECs . . . ."[40] Rather, the Commission should create triggers based on ILEC market-opening commitments. Such triggers should be voluntary and could include the filing of a collocation or interconnection tariff *or* the ILEC's renunciation of the rural exemption

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[37] AT&T, for example, argues, not just against pricing flexibility, but also against establishing triggers for pricing flexibility for non-price cap carriers. AT&T Comments at 22. AT&T, by refusing even to engage in the debate, demonstrates with uncommon candor its true intention simply to hamstring the ILEC community for as long as possible.

[38] The House of Representatives has twice endorsed a trigger based on the presence of actual facilities-based competition. *See* H.R. 3850, 106th Cong., § 2(a)(4) (2000); H.R. 496, 107th Cong., § 2(a)(4) (2001). Similar legislation has been introduced in the U.S. Senate as S. 1359, 107th Cong. (2001).

[39] Joint Commenters Comments at 48-49; NRTA, OPASTCO, and USTA Comments at 20.

under Section 251(f)(1).[41] Commitments such as these would serve the public interest by encouraging voluntary market-opening steps by ILECs, ensuring that ILEC markets are open to competition before the ILEC receives pricing flexibility, and reducing dependence on decisions made by the ILEC's competitors.

V. CONCLUSION

For the forgoing reasons, the Commission should (1) immediately eliminate the price cap all-or-nothing and one-way door rules, (2) make incentive-based rate regulation optional for rate-of-return carriers not only by operating company but by study area, and (3) grant pricing flexibility that is tailored to small and midsize carriers.

Respectfully submitted,

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[40] AT&T Comments at 22.

[41] Joint Commenters Comments at 48.