

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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MAR 18 2002

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Multi-Association Group Plan for
Regulation of Interstate Services of
Non-Price Cap Incumbent Local Exchange
Carriers and Interexchange Carriers

Federal-State Joint Board on
Universal Service

Access Charge Reform for Incumbent
Local Exchange Carriers Subject to
Rate-of-Return Regulation

Prescribing the Authorized Rate of Return for
Interstate Services of Local Exchange Carriers

CC Docket No. 00-256

CC Docket No. 96-45

CC Docket No. 98-77 /

CC Docket No. 98-166

REPLY COMMENTS
of the
GENERAL SERVICES ADMINISTRATION

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Summary

With appropriate safeguards, price caps can significantly benefit carriers and their subscribers. The threshold issue is whether carriers under rate-of-return regulation — mid-size or small carriers primarily serving rural areas — can operate efficiently under price caps.

Although many LECs contend that price caps is not a practical alternative for them, others point to successful experiences of mid-size companies that have selected this form of regulation. On balance, GSA urges the Commission to permit any carrier under rate-of-regulation to transition to price caps. However, any plan that the Commission prescribes for mandatory transition to price caps should not apply to the smallest LECs.

Consumer safeguards are a vital concern for end users. When it initiated price cap regulation for the larger LECs some years ago, the Commission adopted a number of important safeguards for consumers. Contrary to claims by several LECs, the Commission should similarly adopt consumer protection mechanisms for carriers that move to price caps at the present time.

For one, a productivity offset is an essential element of price caps. Comments provide evidence that LECs much smaller than the Bell operating companies can achieve productivity levels that support an “X-factor” in the price cap formula. Also, GSA urges the Commission to continue the “all-or-nothing” rule as a vital safeguard, in spite of claims by both large and small LECs that the Commission’s tariffing and other review processes are adequate to detect cost-shifting.

Finally, GSA urges the Commission to continue surveillance over service quality if carriers move to price caps. Parties explain that carriers under a price cap regime may be motivated to compromise service quality, and competition among LECs has not reached the point where it can replace regulatory surveillance. Moreover, as competition increases, it is even more important for consumers to have the information needed to make informed choices among alternative suppliers.

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REPLY COMMENTS
of the
GENERAL SERVICES ADMINISTRATION

The General Services Administration ("GSA") submits these Comments on behalf of the customer interests of all Federal Executive Agencies ("FEAs") in response to the Further Notice of Proposed Rulemaking ("Further Notice") in CC Docket No. 00-256 released on November 8, 2001. The Further Notice was adopted concurrently with the Second Report and Order in CC Docket No. 00-256, the Fifteenth Report and Order in CC Docket No. 96-45, and the Report and Order in CC Docket Nos. 98-77 and 98-166 ("MAG Orders").

In the MAG Orders, the Commission addressed a Petition for Rulemaking ("Petition") submitted in October 2000 by the Multi-Association Group ("MAG"). The Commission described a comprehensive analysis of MAG's proposed plan, but did not address several facets of the plan because it wanted to obtain additional inputs from

carriers and other parties before making additional findings. The Further Notice seeks comments and replies on several of these open issues.

I. INTRODUCTION

As contemplated by the Telecommunications Act, the Commission has taken strides to extend the benefits of competition by reforming access rate structures and bringing per-minute access charges to more cost-based levels.¹ For local exchange carriers (“LECs”) under price cap regulation, this process began in 1997 and continued through the *CALLS Order*.² In the MAG Orders, the Commission implemented several parallel reforms for LECs under rate-of-return regulation.³ The Commission prescribed those changes as a selective response to the comprehensive set of regulatory reforms proposed by MAG.⁴

MAG includes the National Rural Telephone Association (“NRTA”), the National Telephone Cooperative Association (“NTCA”), the Organization for the Promotion and Advancement of Small Telephone Companies (“OPASTCO”) and the United States Telecom Association (“USTA”).⁵ Together, these organizations represent a diverse group of incumbent local exchange carriers. Their Petition described a comprehensive approach to regulatory issues facing non-price cap carriers — the

¹ MAG Orders, para. 1, citing Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. § 151 *et seq.* (“Telecommunications Act”).

² *In the Matter of Access Charge Reform and Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order, *Low-Volume Long-Distance Users*, CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962 (“*CALLS Order*”), *aff’d in part, rev’d in part, and remanded in part*, *Texas Office of Public Util. Counsel et al. v. FCC*, 5th Cir. Nos. 00-60434 (5th Cir. September 10, 2001).

³ MAG Orders, para. 1.

⁴ *Id.*, para. 10.

⁵ MAG Petition, p. 1.

mid-size and smaller LECs serving most of the nation's rural and insular areas. MAG asked the Commission to adopt its proposed plan as a complete regulatory package.⁶

GSA submitted Comments and Reply Comments on the Petition in response to the Notice of Proposed Rulemaking released on January 5, 2001.⁷ On December 31, 2001, GSA submitted Comments in response to the Further Notice. In that submission, GSA urged the Commission to allow rate-of-return carriers to transition to price caps. In addition, GSA asked the Commission to prescribe safeguards for consumers, including a productivity offset, continuation of the "all-or-nothing" rule, and surveillance over service quality levels.

Besides GSA, about 15 carriers and carrier associations submitted comments in response to the Further Notice. In these Reply Comments, GSA responds to the positions and recommendations by those parties.

II. PRICE CAPS WILL BENEFIT MANY CARRIERS, BUT THE SMALLEST LECs SHOULD NOT BE REQUIRED TO LEAVE RATE-OF-RETURN REGULATION.

In their submissions, many mid-size and smaller LECs assert that price cap regulation is not a practical regulatory framework. For example, the National Telephone Cooperative Association ("NTCA"), which represents 550 rural incumbent LECs, points to the varying operating conditions and the lack of economies of scale available to its members.⁸

In addition, the Western Alliance ("Alliance"), a consortium of 250 rural telephone companies serving sparsely populated areas west of the Mississippi River, states that incentive regulation is not feasible for its members because of a number of

⁶ MAG Orders, para. 3.

⁷ Comments of GSA, February 26, 2001; and Reply Comments of GSA, March 12, 2001.

⁸ Comments of NTCA., p. 2.

factors, including: (1) small size; (2) diversity of environmental conditions under which the companies operate; (3) high equipment and operating costs; (4) lack of significant economies of scale; and (5) "lumpy" investment and expenditure patterns.⁹

A third organization, principally representing mid-size LECs, addresses issues concerning the benefits of price caps for various carriers.¹⁰ While acknowledging that price caps may be inappropriate for some LECs, the Independent Telephone and Telecommunications Alliance ("ITTA") asks the Commission to adopt regulations that will permit small and mid-size carriers to elect an appropriate form of regulation to match the needs of their members and respective markets.¹¹

As a paramount consideration, GSA recognizes the significant benefits of price caps for many LECs and their subscribers. Indeed, the Commission has acknowledged that this form of regulation is pro-competitive and economically efficient, and offers numerous benefits for consumers.¹²

Comments in response to the Further Notice point to the benefits of price cap regulation for the more diversified LECs. For example, WorldCom states that as a general proposition, rate-of-return regulation provides few incentives for carriers to operate efficiently.¹³ WorldCom also explains that the incentives for efficient operation under traditional regulation are attenuated because the Commission is able to scrutinize rate-of-return carriers' costs only to a limited extent.¹⁴

⁹ Comments of the Western Alliance, pp. 2-9.

¹⁰ Comments of ITTA, pp. 1-22.

¹¹ *Id.*, p. 2.

¹² *CALLS Order*, para. 29.

¹³ Comments of WorldCom, p. 1.

¹⁴ *Id.*

Moreover, WorldCom states there is clear evidence that incumbent LEC holding companies with more than 200,000 lines can operate successfully under an incentive regulation plan.¹⁵ To demonstrate that price caps are suitable for some LECs previously under rate-of-return surveillance, WorldCom cites the experiences of several smaller carriers such as Iowa Telecom that voluntarily elected price cap regulation, and operated successfully under this form of regulation for several years.

Considering all the comments submitted on this issue, GSA is convinced that price cap regulation is impractical for most small LECs. However, GSA believes that the benefits of price caps should be available to as many carriers as possible.

To extend the benefits of price caps, GSA urges the Commission to allow any carrier under rate-of-return regulation to transition to price caps. However, any plan that the Commission prescribes for mandatory price caps should apply only to carriers meeting a certain size threshold, such as 200,000 access lines. As an alternative size criterion, GSA suggests that the Commission may wish to use the definition for a "rural telephone company" specified in the Telecommunications Act.¹⁶ Since this definition recognizes both the total number of access lines provided and the number of inhabitants of the places served, it may offer a more accurate standard for assessing whether price caps would be appropriate for a carrier and its markets.

¹⁵ *Id.*, p. 2.

¹⁶ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§ 151 *et seq.* ("Telecommunications Act"), section 3.

III. CONTRARY TO CLAIMS BY SEVERAL LECs, THE COMMISSION SHOULD ADOPT CONSUMER SAFEGUARDS FOR CARRIERS MOVING TO PRICE CAPS.

A. A productivity offset is an essential element of price caps.

In its Comments, GSA noted that when price cap regulation was initiated for the larger LECs, the Commission adopted a number of important consumer protection mechanisms.¹⁷ One of the most important devices was an “X-factor” in the price cap formula to account for the fact that productivity gains in the telecommunications industry have averaged well above those in the national economy as measured by the Gross Domestic Product Price Index (“GDP-PI”).¹⁸

In their joint comments, ALLTEL Communications and other LECs assert that such consumer protection mechanisms are unnecessary.¹⁹ The carriers contend that consumers will see little or no benefit from the application of a productivity offset or “X-factor.”²⁰ They claim that such incentives have “disserved rural America” in the past, and that small rate-of-return LECs cannot experience the type of year-to-year productivity gains that the Bell companies achieve.²¹

GSA recommends that the Commission not heed these claims. WorldCom explains that smaller LECs can achieve productivity gains.²² For example, Citizens Communications, Valor Telecommunications, and Iowa Telecom have operated with

¹⁷ Comments of GSA, p. 6.

¹⁸ Comments of General Communications, Inc. (“GCI”), February 16, 2001, p. 5.

¹⁹ Comments of ALLTEL Communications, Inc.; CenturyTel, Inc.; Madison River Communications, LLC; and TDS Telecommunications Corp.

²⁰ *Id.*, p. 50.

²¹ *Id.*, pp. 50-51.

²² Comments of WorldCom, p. 3.

X-factors of 5.3 percent and 6.5 percent.²³ Consequently, WorldCom suggests a productivity offset of at least 5.3 percent, as well as a 0.5 percent consumer productivity dividend for all carriers electing price cap regulation.²⁴

In the same vein, Sprint recommends that the Commission employ a productivity offset for LECs going to price caps. Sprint describes two potential plans, with offsets of 3.3 percent or 4.3 percent respectively, and a 0.5 percent consumer productivity dividend.²⁵ Although these offsets are lower than WorldCom suggests, Sprint additionally recommends that the Commission require 50 percent earnings sharing with consumers if the carrier's overall rate of return is above an established threshold.²⁶

GSA concurs with the views of WorldCom and Sprint on the need for a productivity offset. With optional price caps for the smallest LECs, a productivity offset is a reasonable balance between the interests of consumers and the interests of carriers that elect alternative regulation.

B. The “all-or-nothing” rule will benefit consumers.

Section 61.41 of the Commission's rules concerns mergers and acquisitions, as well as procedures for transitions to and from price caps. The section states that if a carrier (or study area) converts to price cap regulation, all of its affiliates (or study areas) must make this transition.²⁷ In addition, if a carrier under price caps is involved in a merger, acquisition, or similar transaction, it must continue to operate under the

²³ *Id.*

²⁴ *Id.*

²⁵ Comments of Sprint, p. 3.

²⁶ *Id.*

²⁷ Further Notice, para. 260.

price cap regime after the re-organization.²⁸ Also, when rate-of-return and price cap carriers merge or acquire one another, the rate-of-return carrier must convert to price caps within one year.²⁹ Moreover, LECs coming under price caps are not permitted to withdraw from alternative regulation, or to participate in National Exchange Carrier Association (“NECA”) tariffs without a waiver.³⁰ Collectively, these regulations are referred to as the Commission’s “all-or-nothing” rule.

Several carriers contend that the “all-or-nothing” rule should be discarded. For example, Verizon asserts that there are other effective means to address issues of cost shifting and regulatory gaming.³¹ According to Verizon, the rule should not be applied to LECs moving to price caps or even to the largest LECs that have been under this type of regulation for years.³²

Similarly, the ITTA asserts that the Commission should abolish the “all-or-nothing” rule and several other regulations because of the substantive costs and opportunity costs that they place on the industry and the general public.³³ According to the ITTA, the Commission should depend on the tariff review process that allegedly gives the Commission, interexchange carriers (“IXCs”) and consumer groups an opportunity to see any evidence of cost-shifting on an annual basis.³⁴

28 *Id.*

29 *Id.*

30 *Id.*

31 Comments of Verizon, p. 2.

32 *Id.*, pp. 1-2.

33 Comments of ITTA, pp. 5-6.

34 *Id.*, p. 5.

GSA urges the Commission not to heed requests to abandon the “all-or-nothing” rule. The review process mentioned by ITTA does not provide an adequate check, particularly now that carriers are transitioning to a regime without public tariffs.

Competitive carriers also ask the Commission to continue this consumer protection. The Competitive Universal Service Coalition (“CUSC”) includes a number of wireless and wireline competitive carriers and their associations.³⁵ CUSC explains that the “all-or-nothing” rule is indispensable if open competition is to have any chance of taking root and surviving in rural areas.³⁶ In this regard, CUSC states that competitive entry will make the “all-or-nothing” rule more — not less — relevant as a check against incumbents gaming the system to the detriment of consumers and new entrants as well.³⁷ CUSC explains that the Commission should keep the rule, enforce the rule, and limit the availability of waivers that have been granted too frequently in the past.³⁸

In its comments, AT&T explains that competitive concerns with the dangers of eliminating the “all-or-nothing” rule are not speculative.³⁹ Parent organizations have the means and motive to shift costs from affiliates under one regulatory regime to affiliates under another regime to the detriment of ratepayers.⁴⁰ AT&T continues by urging the Commission to reject claims to the effect that new accounting separations

35 Comments of CUSC, p. 1.

36 *Id.*, p. 6.

37 *Id.*

38 *Id.*

39 Comments of AT&T Corp. (“AT&T”), p. 16.

40 *Id.*, p. 17

rules could be used to avoid anti-competitive behavior by LECs that operate under dual regulation.⁴¹

From its perspective as an end user, GSA concurs with parties recommending that the Commission continue the “all-or-nothing” rule. Competitors have demonstrated that the Commission’s accounting and reporting requirements alone are insufficient to guard against cost-shifting.⁴² The Commission should continue these rules as well as the requirements in Section 61.41 of its rules for all carriers under or coming under price caps.

IV. PARTIES EXPLAIN THE NEED TO CONTINUE SURVEILLANCE OVER SERVICE QUALITY IF CARRIERS MOVE TO PRICE CAPS.

The Commission seeks comments on surveillance over service quality levels of rate-of-return LECs as they transition to price caps.⁴³ The Further Notice suggests that the Commission might choose to rely on state programs to ensure that adequate investment and service quality levels are maintained.⁴⁴

In its Comments addressing this issue, GSA urged the Commission to play a significant role in maintaining high service quality and not rely on other regulatory authorities.⁴⁵ Indeed, GSA believes that the Commission should monitor service quality levels for incumbent LECs under any regulatory regime.

GVNW, a management consulting firm providing regulatory support for communications carriers primarily serving rural areas, discusses service quality issues in its comments. GVNW states that an important consideration in deciding whether

41 *Id.*

42 Comments of GSA, p. 8.

43 Further Notice, para. 224.

44 *Id.*

45 Comments of GSA, pp. 9–10.

smaller carriers should transition to price caps is whether state programs are a dependable means to ensure adequate service quality levels.⁴⁶ Specifically, GVNW is concerned that smaller carriers driven to meet financial goals under a price cap regime will be strongly motivated to compromise service quality levels.⁴⁷

GSA concurs with GVNW's views regarding the need to ensure high performance levels. Uniformly high quality in all areas is especially important to geographically dispersed users such as the FEAs. Large users, including government agencies and many commercial firms, are experienced in procuring telecommunications services in a competitive environment, but they still need service quality information.⁴⁸

Although service quality levels are often specified in contracts, business users depend on public information concerning the service levels met by carriers. In fact, service quality for the carriers operating in a region may be a primary factor in establishing the technical specifications in a request for proposals for firms to provide telecommunications services. Also, reported service quality levels can provide a means of assessing the likelihood that a carrier will meet the commitments in a proposal to provide telecommunications services under a contract. Finally, service quality reporting in a uniform format will provide an important motivation for rate-of-return carriers to maintain high service quality levels.

In its comments, AT&T addresses issues concerning the competition experienced by incumbent LECs.⁴⁹ AT&T states that the pricing behavior of these carriers and their minimal investment in many metropolitan areas provide evidence

⁴⁶ Comments of GVNW, p. 4.

⁴⁷ *Id.*

⁴⁸ Comments of GSA, p. 9.

⁴⁹ Comments of AT&T, pp. 19-23.

that they face little real competitive pressure.⁵⁰ Indeed, GSA explained in its Comments that competition among carriers providing local services has not reached the point where it replaces the need for regulatory surveillance.⁵¹ Moreover, any ensuing increases in competition will not eliminate the need for service quality data. A procedure that helps consumers to predict service levels and weigh carriers' service claims is particularly important with more competition.⁵²

50 *Id.*, p. 21.

51 Comments of GSA, p. 9.

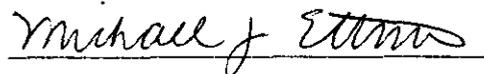
52 *Id.*, p. 10.

V. CONCLUSION

As a major user of telecommunications services, GSA urges the Commission to implement the recommendations set forth in these Reply Comments.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, MICHAEL J. ETTNER, do hereby certify that copies of the foregoing "Reply Comments of the General Services Administration" were served this 18th day of March 2002, by hand delivery or postage paid to the following parties.

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