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

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In the Matter of	)	
	)	
Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1

ORDER

Adopted: June 4, 2002 **Released: June 5, 2002**

By the Commission: Commissioner Copps dissenting and issuing a statement.

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I. INTRODUCTION

1. In the May 2000 *CALLS Order*, the Commission adopted comprehensive interstate access charge and universal service reforms for incumbent local exchange carriers (LECs) subject to price cap regulation.[1] Consistent with the goals and principles of the Communications Act, the purpose of these reforms is to promote competition by removing implicit subsidies from access charges, while ensuring affordable and reasonably comparable rates through explicit universal service support.[2] Among other things, the Commission adopted a schedule to reduce the implicit subsidies in access rates while gradually increasing the cap on the subscriber line charge (SLC),[3] a flat-rated charge imposed by LECs on end users to recover the interstate-allocated portion of local loop costs.[4] Under the rules adopted in the *CALLS Order*, the SLC cap for residential and single-line business lines will increase to $6.00 on July 1, 2002, and to $6.50 on July 1, 2003.[5] To verify that the increases above the current $5.00 cap are appropriate, the Commission stated that it would conduct a cost review proceeding prior to any scheduled increases above this cap to examine forward-looking cost information associated with the provision of retail voice-grade access to the public switched telephone network.[6] The Commission subsequently concluded that, if the cost review proceeding verified that increases were appropriate for price cap carriers, then the same increases were appropriate for carriers subject to rate-of-return regulation because these carriers generally have higher costs than price cap carriers.[7] We began that cost review proceeding in September 2001 and, based on the record

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[1] *Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (2000) (*CALLS Order*), *aff'd in part, rev'd in part, and remanded in part, Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied, Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 70 U.S.L.W. 3444 (U.S. Apr. 15, 2002).

[2] *See* 47 U.S.C. § 254(b) and (e). The Communications Act of 1934, 47 U.S.C. §§ 151 *et seq.* (the Act), was amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act).

[3] This charge is also referred to as the end user common line (EUCL) charge. *See* 47 C.F.R. § 69.152.

[4] A local loop is the connection between the telephone company's central office building and the customer's premises. Pursuant to the jurisdictional separations process, 25 percent of the cost of the loop is allocated to the interstate jurisdiction. 47 C.F.R. § 36.154(c).

[5] *See* 47 C.F.R. § 69.152(d)(1)(i).

[6] *CALLS Order*, 15 FCC Rcd at 12994, para. 83. This proceeding examines only the SLC cap for primary residential and single-line business lines, not the separate $7.00 SLC cap for non-primary residential lines.

[7] *See Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, 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, 16 FCC Rcd 19613, 19637, para. 48 (2001) (*Rate-of-Return Access Charge Reform Order*).

before us, we now conclude that such increases are appropriate – and indeed necessary – to fulfill the Commission's access charge reform objectives.

2. Under the Communications Act, the Commission has a statutory duty to regulate the interstate rates of common carriers, including the interstate access rates charged by incumbent LECs.[8] In performing that duty, the Commission is required to balance the Communications Act's goals of promoting competition and preserving and advancing universal service.[9] More specifically, the Act directs us to convert implicit subsidies, such as those found in access charges, into explicit support, while simultaneously promoting the goals of affordability and reasonable comparability of rates throughout the nation.[10] To promote economically efficient competition and to avoid cross-subsidization, the Commission has recognized that, to the extent possible, LECs should recover costs of interstate access in the same way that they are incurred.[11] Thus, traffic-sensitive costs should be recovered through corresponding per-minute access rates. Similarly, non-traffic-sensitive costs, such as loop costs, should be recovered through fixed, flat-rated fees.

3. To address the affordability concerns of universal service, however, the Commission has limited the amount of interstate costs that LECs can recover directly from residential and business customers through the flat-rated SLC.[12] Specifically, the SLC is subject to a cap that, particularly for residential customers, is often too low to enable the LECs to recover the entire interstate-allocated cost of the local loop. The remaining loop costs that LECs cannot recover from the SLC are recovered through charges imposed on interexchange carriers (IXCs), which pass these charges on to their customers. Thus, long-distance customers subsidize the rates that LECs charge to residential and single-line business end users. In addition to the inefficient implicit subsidies in the rate structure, LECs historically have averaged their SLCs over relatively large geographic areas. Geographic rate averaging means that customers in low-cost areas are subsidizing the rates of customers in high-cost areas. To the extent the SLC cap is set below cost, it inhibits a LEC's ability to deaverage its SLC rates, thus maintaining implicit subsidies running from low-cost areas to high-cost areas.[13]

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[8] *See* 47 U.S.C. §§ 151, 152, 201-209. Competitive LECs also may impose SLCs on their end-user customers. Although the Commission has, in many instances, chosen not to regulate the rates charged by competitive LECs, including SLCs, we note that competitive LECs may look to the SLCs assessed by incumbent LECs as a benchmark in setting their own SLCs. Therefore, although the instant order specifically addresses only incumbent LEC SLC caps, the proceeding may affect competitive LEC SLCs as well.

[9] *See* 47 U.S.C. §§ 251 and 254.

[10] *See* 47 U.S.C. § 254(e) (universal service support should be explicit and sufficient); Joint Explanatory Statement of the Committee of Conference, H.R. Conf. Rep. No. 458, 104th Cong., 2d Sess. at 113 (support mechanisms should be explicit rather than implicit); 47 U.S.C. § 254(b)(1), (3) (services should be available at affordable and reasonably comparable rates).

[11] *See CALLS Order*, 15 FCC Rcd at 12967, para. 12.

[12] *See, e.g.*, *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 16010-11, para. 73 (1997) (*Access Charge Reform First Report and Order*), *aff'd*, *Southwestern Bell v. FCC*, 153 F.3d 523 (8th Cir. 1998).

[13] *See infra* paras. 18-19.

4. To reduce the inefficient implicit subsidies caused by the residential and single-line business SLC cap, the Commission in the *CALLS Order* implemented a schedule of increases to this cap, with corresponding decreases to the charges imposed on IXCs.[14] The cap was $3.50 prior to the *CALLS Order*, and was raised to $4.35 on July 1, 2000, and to $5.00 on July 1, 2001. The cap is scheduled to increase to $6.00 on July 1, 2002 and to $6.50 on July 1, 2003.[15] In setting these SLC caps, the Commission balanced the goals of removing implicit subsidies and ensuring the affordability of basic telephone service for residential and single-line business customers, and concluded that gradual increases in the SLC could bring substantial benefits that outweigh any affordability concerns.[16] Specifically, the Commission found that increasing the SLC cap would:

- Remove inefficient implicit subsidies in the access charge rate structure by more closely aligning cost recovery with cost causation;
- Remove inefficient implicit subsidies inherent in geographic rate averaging by allowing LECs greater flexibility to deaverage SLCs;
- Promote competition by sending appropriate pricing signals through deaveraged SLCs that more closely reflect the actual costs of providing service; and
- Not jeopardize affordable local telephone rates for qualifying low-income consumers, due to additional Lifeline support available to cover any SLC rate increases resulting from the increased cap.[17]

5. As stated in the *CALLS Order*, the Commission initiated the current proceeding to verify that it is appropriate to increase the residential and single-line business SLC caps above $5.00. We find that even the most conservative estimate of forward-looking costs shows that a substantial number of lines exceed both the current $5.00 SLC cap, and the ultimate $6.50 SLC cap. Thus, we determine that raising the SLC cap to the levels set forth in the *CALLS Order* is justified by the record in this proceeding. We also find that those increases to the SLC cap are necessary to achieve our access charge reform goals, as stated in the *CALLS Order*, of removing implicit subsidies by moving to a more cost-causative rate structure and enabling greater opportunities for SLC deaveraging. As discussed below, raising the SLC cap does not mean that the SLC rate will increase for all customers.[18] In any event, to the extent that the SLC rates for some residential and single-line business customers increase as a result of the SLC cap increases, we have previously found that the ultimate SLC cap of $6.50 is affordable for these customers, and the Fifth Circuit Court of Appeals upheld this finding.[19] Therefore, to achieve the benefits of

[14] *CALLS Order*, 15 FCC Rcd at 12975, para. 30.

[15] *CALLS Order*, 15 FCC Rcd at 12988-89, 12991, paras. 70, 76; 47 C.F.R. § 69.152(d)(1)(ii).

[16] *CALLS Order*, 15 FCC Rcd at 12975-76, paras. 31-34.

[17] *CALLS Order*, 15 FCC Rcd at 12976, para. 33.

[18] Under the Commission's price cap rules, SLCs must be the lower of the SLC cap or the carrier's CMT revenue requirement. *See* 47 C.F.R. § 69.152(d)(1). *See also* para. 16 *infra*.

[19] *See Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313, 323 (5th Cir. 2001).

removing implicit subsidies and allowing SLC deaveraging, while maintaining affordable residential and single-line business rates for consumers, we will allow the SLC cap to increase as set forth in the *CALLS Order*, the *Rate-of-Return Access Charge Reform Order*, and sections 69.152 and 69.104 of our rules.[20]

II. BACKGROUND

A. Access Charges

6. *The Telephone Network and Cost Recovery.* The local telephone network is a series of facilities operated by the LECs that enable subscribers to make local calls and to connect with IXCs to make long distance calls. Various components comprise the local telephone network, including local loop facilities through which the customers connect to the network, and switching facilities that route calls to the appropriate destinations. The LECs incur costs to build, operate and maintain their local telephone network facilities. As a general matter, these costs are higher per subscriber in less populous rural areas, and lower in more densely populated urban areas.

7. By statute, the task of regulating the manner in which LECs recover their costs is divided between federal and state authorities.[21] The LECs' network costs are separated between the intrastate and interstate jurisdictions, with the states regulating the recovery of intrastate costs and the Commission regulating the recovery of interstate costs.[22] Specifically, the Commission regulates the LECs' charges for providing interstate access services, and permits LECs to recover their network costs through rates charged to the LECs' end-user customers, as well as through rates charged to IXCs that use the LECs' facilities.[23]

8. *Pricing Regulation.* Prior to 1991, LECs' access revenues were governed by "rate-of-return" regulation. Under rate-of-return regulation, an incumbent LEC is limited to recovering its costs plus a prescribed return on investment, and is potentially obligated to provide refunds if its interstate rate of return exceeds the authorized level.[24] In 1991, the Commission implemented a price cap system for the largest incumbent LECs that altered the regulation of their interstate access charges.[25] Rather than focusing on costs plus a rate of return, price cap regulation focuses primarily on the rates incumbent LECs may charge and the revenues they may generate from

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[20] 47 C.F.R. §§ 69.152(d), 69.104(n).

[21] *See, e.g.,* 47 U.S.C. §§ 151, 152, 254(b)(5).

[22] The general process of separating these costs between the interstate and intrastate jurisdictions is discussed by the Supreme Court in *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133 (1930).

[23] Incumbent LECs must record all expenses, investments, and revenues in accordance with the Uniform System of Accounts in part 32 of our rules, 47 C.F.R. §§ 32.1- 32.9000; divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities, 47 C.F.R. §§ 64.901-64.904; determine the fraction of regulated expenses and investment that should be allocated to the interstate jurisdiction, 47 C.F.R. §§ 36.1- 36.741; and then translate these interstate costs into charges for specific interstate access services according to part 69 of our rules, 47 C.F.R. §§ 69.1-69.731.

[24] *See Rate-of-Return Access Charge Reform Order*, 16 FCC Rcd at 19624, para. 19.

[25] *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (*LEC Price Cap Order*).

interstate access services.[26] By severing the direct link between authorized rates and realized costs, the price cap system was intended to create incentives for LECs to reduce costs and improve productivity, while maintaining affordable rates for consumers through the caps on prices.[27]

9. Although the initial price cap rates were set equal to the rates the LECs were charging under rate-of-return regulation, the prices of price cap LECs have been limited ever since by price indices that have been adjusted annually pursuant to formulas set forth in our Part 61 rules. Price cap carriers are permitted to earn returns significantly higher, or potentially lower, than the prescribed rate of return that incumbent LECs are allowed to earn under rate-of-return regulation. Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels. Individual companies retain an incentive to cut costs and increase productivity because, in the short run, their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs.

10. As noted above, the Commission has recognized that the costs of providing interstate access services should be recovered in the same way that they are incurred.[28] Therefore, the Commission determined that traffic-sensitive local switching costs would be recovered through per-minute charges, and non-traffic-sensitive local loop costs would be recovered through a fixed charge on end users, the SLC.[29] Affordability concerns, however, prompted the Commission to limit the SLC that LECs could charge to end users.[30] These caps on the flat-rated SLC kept carriers from recovering the entire interstate-allocated local loop costs from end users. Price cap LECs recovered the shortfall through the carrier common line (CCL) charge, which is a per-minute charge assessed on the end user's IXC whenever the end user placed an interstate long-distance call.[31] The IXC, in turn, passed this charge on to its customers in the form of higher rates. By making the end-user rate for long distance calls more expensive, the CCL charge artificially suppresses demand for interstate long distance services.[32]

B. Telecommunications Act of 1996

11. In 1996, Congress passed legislation that sought to establish "a pro-competitive, deregulatory national policy framework" for the United States telecommunications industry.[33] In the 1996 Act, Congress directed that universal service support "should be explicit and sufficient

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[26] *See LEC Price Cap Order*, 5 FCC Rcd at 6787, para. 2.

[27] *Id.*

[28] *See CALLS Order*, 15 FCC Rcd at 12967, para. 12.

[29] *See Access Charge Reform First Report and Order*, 12 FCC Rcd at 15998, para. 36.

[30] *See Access Charge Reform First Report and Order*, 12 FCC Rcd at 15998-99, para. 37.

[31] *See Access Charge Reform First Report and Order*, 12 FCC Rcd at 15999, para. 37.

[32] *See CALLS Order*, 15 FCC Rcd at 12970, para. 18.

[33] The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151 *et seq.*

to achieve the purposes" of section 254,[34] which include enabling access to telecommunications services for all Americans at affordable and reasonably comparable rates. The courts have confirmed that, as directed by the 1996 Act, the Commission should remove implicit subsidies in favor of explicit subsidies where possible.[35] The courts have acknowledged, however, that Congress vested considerable discretion with the Commission to make difficult policy choices that balance the goals of competition and universal service.[36]

C. Access Charge Reform

1. Access Charge Reform First Report and Order

12. Subsequent to passage of the 1996 Act, the Commission reformed its access charge rules to meet Congress' objectives. Specifically, the Commission aligned the access charge rate structure more closely with the manner in which the costs are incurred.[37] In the 1997 *Access Charge Reform First Report and Order*, the Commission created the presubscribed interexchange carrier charge (PICC), a flat per-line charge imposed by a price cap LEC on an end user's IXC, to recover a portion of the LEC's interstate-allocated loop costs that is not recovered through the SLC. To the extent that the SLC cap prevented a price cap LEC from fully recovering its costs through the SLC, the LEC could recover those costs through the PICC, up to the PICC cap.[38] Any costs above the PICC cap could be recovered through the CCL charge.[39] PICCs markedly reduced the inefficient per-minute recovery of local loop costs through the CCL charge, and increased the portion of loop costs recovered through flat charges. Unfortunately, the advent of PICCs also created market inefficiencies.[40] Because IXCs recovered the residential PICCs on a per-account basis, residential customers with only one line paid the same as those with two or more lines, and so paid more than the costs IXCs incurred for providing them service.[41] In addition, because PICCs were not assessed directly on consumers, but instead were subjected to averaging and mark-ups by the IXCs, consumers were prevented from making head-to-head comparisons among local service providers.[42]

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[34] 47 U.S.C. § 254(e).

[35] *See Comsat Corp. v. FCC*, 250 F.3d 931, 938 (5th Cir. 2001); *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000); *Texas Office of Public Util. Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999).

[36] *See Texas Office of Public Util. Counsel v. FCC*, 265 F.3d at 321-23; *Alenco v. FCC*, 201 F.3d at 615; *Nat'l Ass'n of Regulatory Util. Comm'rs v. FCC*, 737 F.2d 1095, 1134 (D.C. Cir. 1984).

[37] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 15998, para. 36.

[38] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16022, para. 99. Under the Commission's rules, there were separate caps for the residential and single-line business PICC and the multi-line business PICC. As discussed below, the Commission eliminated the residential and single-line business PICC in the *CALLS Order*.

[39] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16005, para. 60.

[40] *See CALLS Order*, 15 FCC Rcd at 12970, para. 19.

[41] *Id.*

[42] *Id.*

13. In the *Access Charge Reform First Report and Order*, the Commission also stated that it would rely on market forces as its primary method for bringing about cost-based access charges.[43] The Commission anticipated creating, in a later stage of access reform, a mechanism whereby rate regulation of services would be lessened, and eventually eliminated, as competition developed.[44] To the extent that competition did not fully achieve the goal of moving access rates toward costs, the Commission reserved the right to adjust rates in the future to bring them into line with forward-looking costs.[45]

2. The CALLS Order

14. *Overview.* In May 2000, building on the *Access Charge Reform First Report and Order*, the Commission adopted a five-year interstate access and universal service reform plan for price cap LECs in response to proposals submitted by a group of price cap LECs and IXCs, the Coalition for Affordable Local and Long Distance Service (CALLS).[46] In the *CALLS Order*, the Commission modified the rate structure of price cap LECs to remove implicit subsidies from the interstate access charge system and replaced these subsidies with an interstate access universal service support mechanism that provides portable support to incumbent LECs as well as their competitors. The Commission implemented a system for reducing per-minute traffic-sensitive rates for switched access services to specific target levels that more closely approximate the costs of providing these services.[47] For non-traffic-sensitive facilities, the *CALLS Order* attempted to reduce or eliminate implicit subsidies among customer classes through two means: 1) by permitting a greater proportion of the local loop costs of residential and single-line business customers to be recovered through the SLC, rather than through the implicit subsidies in the CCL charge and the multi-line business PICC; and 2) by permitting LECs to deaverage their SLCs once they eliminate CCL charges and multi-line business PICCs. In general, to the extent that carriers serving high-cost areas cannot fully recover their costs from a combination of the gradually increasing SLC and the gradually decreasing CCL charge and multi-line business PICC, the interstate access universal service support mechanism provides explicit universal service support to these carriers.[48]

15. *CMT Revenue.* As an initial matter, the Commission adopted a new term in the *CALLS Order* – CMT Revenue – to represent the maximum revenues that a price cap LEC may collect for common line rate elements under the price cap formulas.[49] CMT revenue is the total

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[43] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16001-02, para. 44.

[44] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16003, para. 49. The Commission adopted such a mechanism in the *Pricing Flexibility Order*. *See Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 98-63, 98-157, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221 (1999) (*Pricing Flexibility Order*). Under the pricing flexibility rules, carriers can gain increasing amounts of flexibility to set their interstate access rates if they can demonstrate that certain levels of competition have developed in their service areas. *See Pricing Flexibility Order*, 14 FCC Rcd at 14225, paras. 3-4.

[45] *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16003, para. 48.

[46] *CALLS Order*, 15 FCC Rcd 12962.

[47] *CALLS Order*, 15 FCC Rcd at 13029, 13033, paras. 162, 170.

[48] *See CALLS Order*, 15 FCC Rcd at 13043-55, paras. 195-213.

[49] "CMT" stands for common line, marketing, and transport interconnection charge (TIC).

revenue a price cap LEC is permitted to receive through its common line charges: the SLC, the PICC, and the CCL charge.[50] Under the Commission's rules, a price cap LEC collects its CMT revenue from SLCs, PICCs, and CCL charges in a cascading fashion. First, a price cap LEC collects CMT revenue from the SLCs it charges to end users. To the extent the SLC cap prevents the full satisfaction of the CMT revenue requirement through the SLC rate, a carrier next collects its CMT revenue from multi-line business PICCs assessed on IXCs. To the extent the cap on the multi-line business PICC prevents the full satisfaction of the CMT revenue requirement through the PICC rate, the carrier may collect its CMT revenue from CCL charges on IXCs.

16. In the event that a price cap carrier operates in a relatively low-cost area, however, it may not have a large CMT revenue requirement and may be able to collect all of its CMT revenue through the SLC. To prevent a carrier from collecting more than its CMT revenue in such a situation, the Commission's rules provide that a price cap carrier's SLC cannot exceed the lesser of its average CMT revenue per line or the SLC cap.[51] For example, unless it deaveraged its SLCs, a price cap carrier with average CMT revenue of $4.50 per line could not charge a SLC *rate* higher than $4.50 per line even though the current SLC *cap* is $5.00 per line.[52] Thus, an increase to the SLC cap does not mean that all consumers will see higher SLCs on their bills.

17. *SLC Cap.* In the *CALLS Order* the Commission eliminated the residential and single-line business PICC, and implemented a schedule for increasing the residential and single-line business SLC cap. Prior to the *CALLS Order*, the residential and single-line business SLC cap was $3.50. The *CALLS Order* established the following increases to this cap:

July 1, 2000 -- $4.35
July 1, 2001 -- $5.00 (current cap)
July 1, 2002 -- $6.00
July 1, 2003 -- $6.50

The Commission stated that it would conduct a cost proceeding prior to the cap increasing above $5.00 on July 1, 2002 to verify that the further increases are appropriate.[53]

18. *Deaveraging.* Deaveraging refers to charging different rates in different geographic areas or zones, to reflect the relative costs of providing service in each zone. Deaveraging enhances the efficiency of the local telephone market by allowing prices to more accurately reflect costs. The Commission found that deaveraged rates more closely reflect the actual cost of providing service, which promotes competition and efficiency by allowing a LEC to compete for subscribers when it is the lowest cost service provider, and by removing support flows to the

[50] Certain marketing expenses and residual interconnection charges are also included in a carrier's CMT revenue.

[51] 47 C.F.R. § 69.152(d)(1). These rules govern rates in study areas that do not have deaveraged SLCs. The rules for study areas with deaveraged SLCs are discussed below.

[52] Through deaveraging a price cap carrier could charge a SLC higher than its CMT revenue in high-cost zones, however, the average SLC for the study area could not exceed $4.50.

[53] *CALLS Order*, 15 FCC Rcd at 12994, para. 83.

LEC's higher-cost customers.[54] By contrast, averaging rates across low-cost and high-cost areas may distort the operation of the markets in high-cost areas because LECs must offer services in those areas at prices substantially lower than their costs of providing service.[55] This will discourage competitors from entering these high-cost areas.

19. In the *CALLS Order*, the Commission permitted price cap carriers, in certain circumstances, to deaverage their SLCs to reflect the different cost characteristics of different geographic areas within their study areas. This increased pricing flexibility "enhances the efficiency of the local telephone market by allowing prices to be tailored more easily and accurately to reflect costs and, therefore, promotes competition in both urban and rural areas. In addition, deaveraging SLCs will have the effect of reducing implicit subsidies that otherwise exist under the current rate structure."[56] Because SLC rates should be closely aligned with unbundled network element (UNE) rates, price cap LECs may geographically deaverage their SLCs only after a state commission establishes deaveraged UNE rates by zone.[57] In addition, to ensure the reduction of inefficiencies and implicit subsidies in the access rate structure, deaveraging is permitted only after PICCs and CCL charges are eliminated, i.e., the price cap carrier is able to recover its loop costs solely through the SLC.[58]

20. *Protection for Low-Income Consumers.* In the *CALLS Order*, the Commission also ensured that rates would remain affordable for qualifying low-income consumers, even if their SLCs increased following the residential and single-line business SLC cap increases. The Commission expanded the Lifeline support available to low-income consumers to cover the full amount of the SLC, including any subsequent SLC increases related to an increased cap.[59]

21. *Other Issues.* In conjunction with its review of increasing the residential and single-line business SLC cap above $5.00, the Commission also stated that it would reexamine two other issues. First, the Commission rejected the idea of merging the multi-line business SLC and PICC in the *CALLS Order*, but committed to reexamine this issue in the SLC review proceeding.[60] Second, the Commission agreed to revisit the cost-shifting exemption granted to rural price cap carriers in the *CALLS Order*.[61] To ensure that the switched access usage charge

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[54] *Expanded Interconnection with Local Telephone Company Facilities*, CC Docket Nos. 91-141, 92-222, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7454, para. 178 (1992) (*Special Access Expanded Interconnection Order*).

[55] *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, 11 FCC Rcd 21354, 21434, para. 183 (1996) (*Access Charge Reform NPRM*); *Pricing Flexibility Order*, 14 FCC Rcd at 14254, para. 61.

[56] *CALLS Order*, 15 FCC Rcd at 13007, para. 113.

[57] *CALLS Order*, 15 FCC Rcd at 12989-90, 13008, paras. 73, 115. Additional limitations on SLC deaveraging are specified in the *CALLS Order* and the Commission's rules. *See id.*; 47 C.F.R. § 69.152(q).

[58] *CALLS Order*, 15 FCC Rcd at 12989-90, 13014, paras. 73, 128.

[59] *CALLS Order*, 15 FCC Rcd at 13013, para. 126; 47 C.F.R. § 54.403. The Commission's Lifeline support mechanism reduces the monthly cost of telephone service for qualifying low-income consumers.

[60] *CALLS Order*, 15 FCC Rcd at 13005, para. 109.

[61] *CALLS Order*, 15 FCC Rcd at 13024, 13026, paras. 147, 154.

reductions required by the *CALLS Order* did not unduly burden rural carriers, this exemption allows rural price cap carriers to shift switched access usage charges to the common line basket to yield their share of the total rate reductions.[62]

22. *Decision on Appeal.* Several parties sought review of the *CALLS Order* before the Fifth Circuit Court of Appeals.[63] Among other issues, the court reviewed the planned SLC cap increases and found them to be a "reasoned attempt to maintain the difficult balance between the principles of ensuring affordability and encouraging competition," and concluded that the Commission articulated "rational reasons" for the increased caps.[64] In reaching that conclusion, the court noted that the Commission agreed to conduct a cost study before the SLC cap increases above $5.00.[65]

D. SLC Cost Review Proceeding

23. By Public Notice issued on September 17, 2001, the Commission initiated a proceeding to verify that increases to the residential and single-line business SLC cap above $5.00 are appropriate.[66] Price cap carriers submitted their cost studies on November 16, 2001. Specifically, Aliant, Cincinnati Bell, Iowa Telecom, and Sprint based their cost studies on the Synthesis Model used by the Commission to determine costs for universal service support purposes.[67] The remaining price cap LECs, BellSouth, Citizens, Qwest, SBC, Valor, and Verizon, used other cost models, some of which are proprietary. Parties submitted comments on these studies on January 24, 2002. In addition to filing comments opposing the SLC cap increases, the National Association of State Utility Consumer Advocates (NASUCA) filed a cost study of its own.[68] Parties submitted reply comments on February 14, 2002.

III. DISCUSSION

A. Review of the Scheduled Increases to the SLC Cap

1. Purpose and Scope of the Review

24. The purpose of the instant proceeding is to verify that increases to the SLC cap above $5.00 are warranted. Specifically, pursuant to the Commission's plan for allowing SLCs to increase gradually, the SLC cap for residential and single-line business lines is scheduled to increase to $6.00 on July 1, 2002, and to $6.50 on July 1, 2003, provided that "such increases are

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[62] *CALLS Order*, 15 FCC Rcd at 13023-24, 13026, paras. 147, 154.

[63] *See Texas Office of Public Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

[64] *Id.* at 322.

[65] *Id.* at 323.

[66] *Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Docket Nos. 96-262, 94-1, Public Notice, 16 FCC Rcd 16705 (2001).

[67] *See Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45, 97-160, Tenth Report and Order, 14 FCC Rcd 20156 (1999) (*Universal Service Tenth Report and Order*).

[68] *See* NASUCA Comments.

appropriate and reflect higher costs where they are to be applied."[69]

25. To verify that the scheduled SLC cap increases are appropriate, the Commission stated that it would examine the price cap carriers' "forward-looking" costs of providing retail voice grade access to the public switched telephone network.[70] Forward-looking costs are the costs that an efficient carrier would incur to provide service in a competitive market.[71] Most markets today are not yet competitive and the incumbent LEC is the dominant provider of service for residential and single-line business customers. Even in a fully competitive environment, however, there may be a continued need for a SLC cap because the cost of providing service in certain rural and insular regions is high and will likely continue to be high for the foreseeable future. By examining forward-looking costs in this proceeding, the Commission can verify that increases to the SLC cap would be appropriate if the market were, in fact, competitive. Thus, by evaluating the SLC cap in light of forward-looking costs, we can ensure that the upper limit placed on consumer rates reflects competitive market conditions even though full competition has not yet arrived.

26. This proceeding was not designed to change the existing method of setting SLC *rates*, which relies on the application of the price cap formula to CMT revenues. Rather, we examine only whether the planned increases in the SLC *cap* above $5.00 per line are warranted. In the *CALLS Order*, we stated that we would conduct this cost review on the basis of forward-looking costs. This was not because we planned to adopt forward-looking costs as the means for setting SLC rates in the middle of the CALLS plan. Rather, we intended to ensure that SLC rates derived under the price cap formula would not climb beyond the reasonably anticipated outer limits of a competitive market price, as measured by forward-looking costs. Thus, our examination of forward-looking costs, with their assumption of competitive efficiency, is a more conservative approach – and one less likely to cause an unjustified increase in the SLC cap – than one that relies on carriers' embedded costs, although embedded costs are admittedly still used to set rates. If even a forward-looking cost study supports an increase in the SLC cap, we have even greater confidence that such an increase is justified.

27. Applying this analysis, we conclude that the scheduled SLC cap increases are appropriate if the record demonstrates that efficient carriers in a competitive market would have a substantial number of lines with forward-looking costs that exceed the current $5.00 SLC cap and the ultimate $6.50 SLC cap. A substantial number of lines with costs that exceed the current $5.00 cap shows that, at a level where affordability is not yet a paramount concern, the current cap is impeding the efficient recovery of costs in a meaningful way. A substantial number of lines with costs that exceed the ultimate $6.50 cap shows that, at a level where affordability becomes a paramount concern, the ultimate cap serves a legitimate purpose by protecting consumers from potentially unaffordable rates. Determining what constitutes a "substantial" number of lines, however, is not an exact science. In making this determination we rely on our expertise in regulating interstate access charges, as well as our discretion in balancing the

[69] *CALLS Order*, 15 FCC Rcd at 12994, para. 83.

[70] *Id.*

[71] *See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket Nos. 96-98, 95-185, First Report and Order, 11 FCC Rcd 15499, 15847, para. 679 (1996) (*Local Competition First Report and Order*) (subsequent history omitted).

removal of implicit subsidies with ensuring affordability. We conclude on the record before us – where the most conservative estimate shows at least 27 million non-rural/33 million total residential and single-line business price cap lines with costs above $5.00, and at least 14 million non-rural/20 million total residential and single-line business price cap lines with costs above $6.50 – that raising the cap is necessary to enable SLC deaveraging as discussed below. Therefore, we need not determine precisely what figure might require us to override the planned increase of the SLC cap.

28. As a result of the Commission's decisions in the *CALLS Order* and the *Rate-of-Return Access Charge Reform Order*, there is currently one primary residential and single-line business SLC cap that applies to all carriers.[72] We determine that it is appropriate to retain a single national cap to apply to all incumbent LECs. One cap, as opposed to multiple caps for carriers or regions, promotes reasonable comparability of rates in different geographic areas,[73] and is simpler to administer. In addition, although the SLC cap will increase, SLCs will be constrained by price cap carriers' CMT revenues, and by rate-of-return carriers' costs.[74] We therefore decline to adopt the Florida Commission's suggestion that "the SLC be made state-specific for each company" so carriers cannot average rates across their regions.[75] Maintaining one national SLC cap preserves carriers' existing flexibility to average rates across their regions. Eliminating this flexibility would force carriers to recover more of their common line costs through the inefficient subsidy of PICC and CCL charges. Moreover, as discussed above, the Commission in the *CALLS Order* has provided LECs the flexibility to deaverage their SLCs within study areas once certain conditions are met.[76] Raising the SLC cap will provide LECs with a greater ability to take advantage of study area deaveraging. To the extent carriers do not avail themselves of the opportunity to deaverage their SLCs after the cap reaches $6.50, however, the Commission will have the opportunity to revisit this issue if necessary.

29. Our decision in this proceeding affects both the price cap carriers regulated under our rules adopted in the *CALLS Order*, and rate-of-return carriers. Although the access charge reforms, including the SLC cap increases, adopted in the *CALLS Order* applied only to price cap carriers, in 2001 the Commission implemented a separate access charge reform plan for rate-of-return carriers,[77] which serve roughly 10.9 million lines.[78] Pursuant to the Commission's

[72] *See* 47 C.F.R. §§ 69.152(d)(1), 69.104(n)(1); *Rate-of-Return Access Charge Reform Order*, 16 FCC Rcd at 19637, para. 48.

[73] *See* 47 U.S.C. § 254(b)(3).

[74] Rate-of-return carriers' rates are based directly on their costs, rather than on price cap formulas. Under our separations rules, rate-of-return carriers recover only 25 percent of their common line costs from the interstate jurisdiction. Thus, the majority of their common line costs are recovered from the intrastate jurisdictions, and intrastate rate increases are subject to state review and approval.

[75] Florida Commission Comments at 2.

[76] *See* para. 19 *supra*; 47 C.F.R. § 69.152(q).

[77] *Rate-of-Return Access Charge Reform Order*, 16 FCC Rcd 19613.

[78] This estimation is based on line count information in the National Exchange Carrier Association (NECA) access tariff filings, and line count information from the remaining rate-of-return carriers that are not included in NECA's tariff, ALLTEL Georgia Communications Corporation, Georgia ALLTEL Telecom, Inc., CenturyTel of Ohio, Inc., Great Plains Communications, Inc., Interstate Telephone Company, and Warwick Valley Telephone Company.

decision in the *Rate-of-Return Access Charge Reform Order*, the residential and single-line business SLC cap for rate-of-return carriers is synchronized with the *CALLS Order* schedule for increases above $5.00, pending the findings of the Commission in the price cap carrier SLC review proceeding.[79] In the *Rate-of-Return Access Charge Reform Order*, the Commission stated that, if SLC cap increases are justified for price cap carriers, then SLC cap increases also are justified for rate-of-return carriers because rate-of-return carriers generally have higher common line costs than price cap carriers. The Rural Task Force has documented these higher costs, finding that rate-of-return carriers in rural areas have high loop costs because of a lack of economies of scale and density, and total investment in plant per loop is substantially higher for rural carriers than for non-rural carriers.[80] Furthermore, parity in SLC cap levels among price cap and rate-of-return carriers is appropriate to ensure reasonable comparability of rates in urban and rural areas.[81]

2. Analysis of the Record

30. We find that the most conservative estimate on the record in this proceeding demonstrates that there are a substantial number of residential and single-line business price cap lines – at least 27 million non-rural and 33 million total – with forward-looking costs above the current $5.00 SLC cap, as well as a substantial number of lines – at least 14 million non-rural and 20 million total – with forward-looking costs above the ultimate $6.50 SLC cap.[82] We therefore find that it is appropriate to allow the SLC cap increases set out in the *CALLS Order* to take effect as scheduled. On the current record, these increases in the SLC cap are justified because we conclude that the current cap may prevent efficient cost recovery in a meaningful number of cases. That is, the cap increases are necessary to achieve the Commission's competitive goals, as stated in the *CALLS Order*, of reducing implicit subsidies and enabling LECs to deaverage SLCs across UNE zones. At the same time, however, under the schedule established in the *CALLS Order*, the SLC cap will go no higher than $6.50 – a level the Commission previously found to be affordable, and a level affirmed by the Fifth Circuit.

31. The record in this proceeding shows a divergence of viewpoints on the costs of residential and single-line business lines. As an initial matter, a few commenters suggest that we look at information other than forward-looking cost studies submitted by the parties in determining whether the SLC cap should increase. Ad Hoc advises the Commission to rely on

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[79] *Rate-of-Return Access Charge Reform Order*, 16 FCC Rcd at 19634, para. 42.

[80] *See The Rural Difference*, Rural Task Force White Paper 2, 10, 13 (Jan. 2000) <http://www.wutc.wa.gov/rtf>. The Rural Task Force is an independent advisory panel appointed by the Federal-State Joint Board on Universal Service to provide guidance on universal service issues affecting rural telephone companies.

[81] *Rate-of-Return Access Charge Reform Order*, 16 FCC Rcd at 19634-37, paras. 43-45, 48.

[82] *See* NASUCA Comments at 47, App. B. NASUCA's study examined the forward-looking cost of 105 million residential and single-line business non-rural price cap lines. As discussed below, NASUCA did not include residential and single-line business lines from price cap carriers' rural study areas, which are likely to have relatively high costs. We estimate that there are approximately 6,400,000 rural price cap residential and single-line business lines. Adding these lines to NASUCA's results shows that 33 million lines out of 112 million (30 percent) have forward-looking costs above $5.00, and 20 million lines (18 percent) have forward-looking costs above $6.50. *See* Attachment A.

ARMIS data.[83] As explained above, the Commission agreed to review forward-looking costs when evaluating whether the SLC cap should increase above $5.00. ARMIS data are based on embedded costs rather than forward-looking costs. Therefore, reliance on ARMIS data is inappropriate in this case. Other commenters suggest evaluating the SLC cap by examining TELRIC studies conducted by state public utility commissions.[84] Although state TELRIC studies may be informative in a general sense, this Commission does not have the resources needed to review and evaluate studies from each of the states in a timely manner because of the individualized nature of state TELRIC proceedings and the myriad state-specific decisions made in such proceedings. Moreover, state TELRIC proceedings are conducted to set the UNE prices that incumbents charge to competitors, and not all of the assumptions made in those proceedings may be valid in this proceeding. Accordingly, we decline to rely on state TELRIC proceedings here.

32. The forward-looking cost information submitted by the price cap LECs shows that approximately 122 million lines, or almost all, of their residential and single-line business lines have forward-looking costs greater than $5.00.[85] Even after the cap is raised to $6.50, according to the price cap LEC submissions, 75 million, or 62 percent of their residential and single-line business lines, will have costs that exceed the cap.[86] Lines with forward-looking costs higher than the SLC cap are not limited to particular geographic regions, but are located throughout the country.[87]

33. A number of commenters, however, criticize the price cap carriers' cost submissions.[88] Specifically, the commenters assert that the price cap LECs submitted only the summary results of their cost studies, without providing access to electronic versions of the models or disclosing the inputs used.[89] The commenters argue that, due to this lack of disclosure,

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[83] Ad Hoc Comments at 10-11; GSA Reply at 4. Automated Reporting Management Information System (ARMIS) data consist of financial and operational information submitted to the Commission by LECs with annual revenues of $117 million or more. Ad Hoc's analysis of ARMIS data demonstrates that more than half of the states have average costs above the current $5.00 SLC cap. Commenters, however, argue that this analysis understates costs because Ad Hoc used universal service fund costs, which exclude significant expense amounts, rather than common line costs. *See* BellSouth Reply at 4; Verizon Reply at 8-9.

[84] Ad Hoc Comments at 15-17; NASUCA Comments at 23-24; WorldCom Comments at 9; GSA Reply at 4. "TELRIC" stands for total element long-run incremental cost.

[85] Attachment B lists the price cap LECs' cost submissions. *See also* Attachment A. The price cap carriers submitted information regarding only their own lines; therefore rate-of-return carrier residential and single-line business lines are not included in the 122 million line count.

[86] *See* Attachment A.

[87] *See* Aliant Cost Submission; BellSouth Cost Submission; Cincinnati Bell Cost Submission; Citizens Cost Submission; Iowa Telecom Cost Submission; Qwest Cost Submission; SBC Cost Submission; Sprint Cost Submission; Valor Cost Submission; Verizon Cost Submission.

[88] *See* Ad Hoc Comments at 3-8; California Commission Comments at 5-15; Florida Commission Comments at 2-4; NASUCA Comments at 24-26; WorldCom Comments at 7-8.

[89] Ad Hoc Comments at 3-6; California Commission Comments at 5-7; NASUCA Comments at 19-20; WorldCom Comments at 7-8.

it is impossible to replicate or confirm the price cap LECs' results.[90] The California Commission notes that state commissions have expressly rejected one of the cost models Verizon relies on in this proceeding.[91] Commenters also argue that several assumptions made by the price cap LECs in their submissions are flawed. For example, commenters assert that costs of capital and depreciation estimates are not transparently presented or are inappropriate, shared and common costs are not properly allocated, information on outside plant assumptions and fill factors are not provided or are inappropriate, and marketing expenses are not properly incorporated in the submissions.[92]

34. In contrast to the price cap carriers' submissions, NASUCA, which opposes the scheduled increases to the SLC cap, submitted a cost study of its own. NASUCA's analysis shows that price cap carriers would face forward-looking costs above $5.00 for at least 27 million non-rural residential and single-line business lines and above $6.50 for at least 14 million non-rural such lines.[93] NASUCA excludes from its cost examination rate-of-return carrier lines and price cap carrier lines in rural areas.[94] In addition, NASUCA's study allocates common costs differently from the Commission when it calculates costs for universal service support purposes. Universal service support is calculated based on the total costs for a wire center. Therefore common costs need not be allocated among elements and all common costs are allocated to the loop. To use the model for determining loop costs, NASUCA allocates common costs among the loop, switching, and transport baskets.[95] NASUCA also presents the results of six different model runs, with each run highlighting an assumption over which parties have debated. The first, or default, run of the model uses all assumptions relied on by the Commission in determining forward-looking costs for universal service purposes, with the exception of the method for allocating common costs described above. The other five runs are based on the default run, but with changes to certain parameters of the model, which we discuss below.[96]

35. Some commenters criticize NASUCA's use of the Synthesis Model in this context as underestimating the price cap carriers' forward-looking costs.[97] These commenters assert that the Commission has recognized the limited applicability of this model – its focus on estimating the state-wide costs of an efficient provider using a hypothetical network, rather than using company-specific data – and has cautioned against expanding its use beyond the universal service arena.[98] The commenters also assert that it is inappropriate for NASUCA to rely on the

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[90] Ad Hoc Comments at 3-6; California Commission Comments at 5-7; NASUCA Comments at 19-20; WorldCom Comments at 7-8.

[91] California Commission Comments at 10.

[92] California Commission Comments at 10-15; NASUCA Comments at 27-34.

[93] *See* NASUCA Comments at 47; *see also* Attachment A.

[94] NASUCA Comments at 39.

[95] NASUCA Comments at 40-41.

[96] NASUCA Comments at 44.

[97] BellSouth Reply at 6; Qwest Reply at 13-16; SBC Reply at 11; Sprint Reply at 7; Verizon Reply at 6.

[98] BellSouth Reply at 6; Qwest Reply at 13-16; SBC Reply at 11; Sprint Reply at 7; Verizon Reply at 6.

nationwide average cost inputs of the Synthesis Model to evaluate SLCs, which are specific to each tariff entity.[99]

36. After considering the various submissions on the record, we find that the record demonstrates that a substantial number of lines have forward-looking costs above the current $5.00 cap and the ultimate $6.50 cap. As noted, the cost studies of the price cap LECs provide results showing the greatest number of lines with costs above $5.00 and $6.50 respectively, but we are disinclined to use those results because of the criticisms discussed above. Proceeding cautiously, and assuming for the sake of argument that these criticisms are valid, we find that NASUCA's more conservative cost study still shows that there are a substantial number of lines above the SLC caps. Commission staff were able to verify NASUCA's results using the cost model and NASUCA's assumptions.[100] In addition, we observe that certain parties that support raising the SLC cap also relied on the Synthesis Model.[101] Although some of these parties modified various parameters of the model, they generally agreed that the model provided a reasonable estimate of forward-looking costs for the limited purpose of this proceeding.[102] The Commission has cautioned parties against using the results of the Synthesis Model to set rates,[103] however, and we emphasize that we are not doing so in this proceeding. Instead, we are relying on NASUCA's cost study because it is the most conservative one in our record addressing the question of whether the proposed SLC cap increases, applicable to all carriers on a national basis, are appropriate.

37. As noted above, NASUCA's default run of the model relies on the same assumptions, with the exception of common cost allocation, as does the Commission in using the Synthesis Model for universal service purposes. NASUCA's other five runs are based on the default run, but with the following changes: distribution and feeder networks share structures; SLC costs do not include traffic-sensitive loop plant; cost of capital is 13.18 percent; a reduction in the projected lives of major investment categories; and a reduction in maximum copper loop length from 18 thousand to 12 thousand feet.[104] NASUCA admits that the parties are in disagreement over these changed assumptions,[105] and the Commission has not relied on them in its use of the Synthesis Model. Moreover, in three of these scenarios, the number of lines with forward-looking costs above the current $5.00 cap and the ultimate $6.50 cap is actually greater than in NASUCA's default run.[106] Given the disagreement over the assumptions in NASUCA's alternate

[99] BellSouth Reply at 6; Qwest Reply at 13-16; SBC Reply at 11; Sprint Reply at 6-7; Verizon Reply at 7.

[100] For purposes of this proceeding, we refer to the assumptions in NASUCA's default run of the model.

[101] *See* Ad Hoc Comments at 12-15; WorldCom Comments at 9.

[102] *See* Ad Hoc Comments at 12-15.

[103] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Ninth Report and Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432, 20455, para. 41 (1999) (*Universal Service Ninth Report and Order*); *Universal Service Tenth Report and Order*, 14 FCC Rcd at 20172, para. 32.

[104] NASUCA Comments at 44.

[105] *See* NASUCA Comments at 44.

[106] Under the following scenarios, the number of lines with forward looking costs above the current $5.00 cap and the ultimate $6.50 cap is greater than in NASUCA's default run: (1) reduction in loop length - 30 million lines above $5.00 and 16 million above $6.50; (2) depreciation - 33 million lines above $5.00 and 17 million lines above $6.50;

(continued....)

model runs, we believe the more cautious approach is for the Commission to rely on the results of NASUCA's default run of the Synthesis Model, rather than any of the model runs where NASUCA selectively has adjusted model parameters.

38. NASUCA's cost study, although conservative, still amply demonstrates that a substantial number of residential and single-line business lines have forward-looking costs above the current $5.00 SLC cap, and above the fully phased-in $6.50 SLC cap. Specifically, NASUCA's analysis shows that at least 27 million non-rural price cap lines have forward-looking costs above $5.00, and at least 14 million non-rural price cap lines have forward-looking costs above $6.50. The actual number of lines with forward-looking costs above the $5.00 and $6.50 caps presumably is even higher because NASUCA examined the results of only 80 study areas in the Synthesis Model, including only non-rural study areas served by price cap carriers.[107] NASUCA did not include approximately 6 million lines from price cap carriers' rural study areas,[108] which are likely to have relatively high costs.[109] Thus, NASUCA's study is conservative not only as a result of its reliance on the Synthesis Model, which was not intended to be used for ratemaking purposes, but also as a result of its exclusion of high-cost study areas, which introduces a downward bias to its cost estimates. NASUCA's analysis shows that lines with forward-looking costs above the caps are geographically dispersed and exist in every state.[110] Given the substantial number of geographically-dispersed lines above the caps, we find that the scheduled increases in the SLC cap are appropriate.

39. We wish to emphasize, however, that simply because we are increasing the SLC cap does not mean that every consumer will see increased SLCs on their bills. As explained above, the Commission's rules do not allow price cap carriers automatically to impose SLCs on

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and (3) cost-of-capital - 36 million lines above $5.00 and 18 million lines above $6.50. By contrast, in the following scenarios the number of lines is less than in NASUCA's default run: (1) feeder/distribution structure sharing - 25 million lines above $5.00 and 12 million above $6.50; (2) exclusion of traffic-sensitive loop plant - 24 million lines above $5.00 and 10 million lines above $6.50. *See* NASUCA Comments at App. B.

[107] *See* NASUCA Comments at 39.

[108] Based on the *Universal Service Administrative Company, Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2002* (Jan. 31, 2002), there are approximately 10 million total rural price cap carrier lines, and approximately 164 million total non-rural price cap carrier lines. Roughly 64 percent of the non-rural price cap lines, 105 million, are residential and single-line business lines. Therefore, we estimate that approximately 64 percent of the rural price cap carrier lines, or 6 million, are residential and single-line business lines.

[109] *See The Rural Difference*, Rural Task Force White Paper 2, 10, 13 (Jan. 2000) <http://www.wutc.wa.gov/rtf>.

[110] NASUCA's default run of the model shows that all but four states served by price cap carriers (Arizona, Colorado, Minnesota, and New Jersey) have entire zones with average forward-looking costs higher than the $5.00 cap, and all but nine (first four plus Idaho, Montana, New York, Rhode Island and Utah) have entire zones with average forward-looking costs higher than $6.50. *See* NASUCA Comments at App. B. All nine of these states have wire centers with costs above $5.00 and $6.50. NASUCA's analysis did not deaverage rates by zone in Arizona, Colorado, Idaho, Minnesota, and Montana. As noted above, NASUCA excluded from its analysis price cap carrier lines in rural areas. Thirty-six states (Alabama, Arizona, Arkansas, California, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming) have rural price cap lines.

residential and single-line business customers at the amount of the cap. Instead, a price cap carrier's SLC is determined from its CMT revenue per line. If a price cap carrier's average CMT revenue per line in a study area is lower than the SLC cap, that carrier must charge at least some of its customers SLCs below the cap. Therefore, even though the SLC cap will be increasing, not all customers will see increased SLCs on their bills. In Washington, DC, for example, Verizon has an average CMT revenue of $3.81 per line, and thus its customers currently pay a SLC of $3.81.[111] Across the country, there are currently 20 million price cap carrier residential and single-line business lines in study areas with average CMT revenue per line below $5.00. Therefore, the average SLC for residential and single-line business lines in study areas like these will not increase when the SLC cap increases.[112]

3. Benefits of Raising the SLC Cap

40. Our determination to increase the SLC cap is further supported by the record evidence that failing to raise the cap would impede the access charge reforms adopted by the Commission.[113] One of the Commission's primary goals in the *CALLS Order* was to remove inefficient implicit subsidies in the price cap rate structure.[114] Such an implicit subsidy exists when the full cost of providing a local loop to a residential or single-line business customer exceeds the SLC cap and is not recovered from the customer in a cost-causative manner. In that case, the carrier recovers the costs of the residential or single-line business user's loop from another customer, in the form of the multi-line business PICC or the CCL charge paid by IXCs and passed on to their customers. As a result, the customers paying the multi-line business PICC or CCL charge are subsidizing the residential and single-line business customer's use of loops. Raising the residential and single-line business SLC cap will enable carriers to recover the costs of the loops in a more cost-causative manner, while removing inefficient implicit subsidies.[115] For example, Sprint estimates that its multi-line business PICC and CCL charges are subsidizing residential and single-line business rates by $45,315,613 under the current $5.00 SLC cap.[116] Raising the SLC cap to $6.50, however, will reduce this subsidy by 97 percent, to $1,402,910.[117]

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[111] *See* Letter from W. Scott Randolph, Director-Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1, Att. (Apr. 30, 2002) (Verizon April 30 *ex parte*). Verizon does not deaverage its SLCs in Washington, DC. We also note that Verizon's CMT revenue per line is below the $6.00 cap in Maryland, therefore the average SLC in Maryland will not reach that cap. *Id.*

[112] Due to the potential availability of deaveraging in these study areas, the SLC in high-cost zones may increase, while SLCs in the low-cost zones would decrease. The average SLC for the study area would remain below $5.00. When the SLC cap is increased to $6.50, not all subscribers' SLC rates will increase due to carriers with CMT revenue per line below that cap. Verizon reports that 18.6 percent of its access lines are in study areas where the average CMT revenue per line is at or below the $6.00 cap. *See* Verizon April 30 *ex parte* at Att. .

[113] *See* Cincinnati Bell Reply at 4; SBC Reply at 4; Verizon Reply at 7-8.

[114] *See CALLS Order*, 15 FCC Rcd at 12975, paras. 31-32; BellSouth Reply at 3.

[115] *See* GSA Comments at i; WorldCom Comments at 3-4; Cincinnati Bell Reply at 4.

[116] *See* Letter from Pete Sywenki, Director Federal Regulatory Affairs, to William Caton, Acting Secretary, Federal Communications Commission, CC Docket Nos. 96-262 and 94-1, Att. (Apr. 16, 2002) (Sprint April 16 *ex parte*).

[117] *Id.*

41. As discussed in the *CALLS Order*, increasing the SLC cap also will facilitate SLC deaveraging by price cap carriers. Deaveraged rates more closely reflect the actual cost of providing service than do averaged rates. Therefore, deaveraged rates promote competition and efficiency and send the appropriate pricing signals to competitors. Competitors are more likely to enter high-cost areas if the incumbent LECs' rates are closer to cost, rather than below cost because of averaging. This enables competition to constrain rates. Deaveraging also allows incumbent LECs greater flexibility in responding to competition in low-cost areas. In addition, deaveraging helps to remove the implicit subsidy inherent in geographically-averaged rates.

42. As noted above, under the rules adopted in the *CALLS Order*, a price cap carrier may deaverage its SLCs under certain circumstances.[118] Among other things, a carrier's average CMT revenue per line in a given study area must be below the SLC cap for the carrier to have sufficient "head room" to deaverage across zones in that study area. For example, at the current SLC cap of $5.00, a carrier with average CMT revenue per line of $4.50 could deaverage by raising its SLC in the highest cost zone to $5.00, while lowering its SLC in the lowest cost zone to $4.00.[119] If the benefits of SLC deaveraging are to be realized, there must be a large number of below-cap lines that can be deaveraged. Currently 98 million, out of 118 million, residential and single-line business price cap lines are in study areas with average CMT revenue requirements above the $5.00 SLC cap, leaving only 20 million under the cap and potentially eligible for deaveraging. Allowing the cap gradually to increase to $6.50, however, would create potential deaveraging opportunities for an additional 45 million lines, permitting lower SLCs in the low-cost zones and sending more accurate price signals for all of the affected lines. Thus, raising the SLC cap can bring the benefits of deaveraging to a substantial number of lines.

4. Other Issues Related to the SLC Cap

43. Some commenters have argued that, in addition to examining the SLC *cap*, the Commission should use this proceeding to evaluate carriers' SLC *rates*.[120] Unlike the SLC cap, SLC rates are based on the CMT revenue that a carrier is permitted to earn under the price cap formulas in the Commission's rules.[121] We decline at this time to revisit how carriers' SLC rates are developed under the price cap regime.[122] As discussed at length above, the Commission instituted the price cap regime more than a decade ago as a way to increase carrier efficiencies, and adopted the *CALLS Order* in 2000 as a transitional plan while competition begins to take root.[123] Contrary to NASUCA's claims, the fact that a particular carrier may be earning higher

[118] *See* 47 C.F.R. § 69.152(q).

[119] For simplicity, this example assumes three UNE zones in the study area, with an equal number of lines in each zone.

[120] *See* Florida Commission Comments at 2-3; D.C. Public Service Commission Reply at 2-4; Joint Consumer Commenters Reply at 3-6.

[121] *See* 47 C.F.R. § 69.152(d)(1).

[122] In its reply, the D.C. Commission asserts that Verizon is improperly including special access marketing expenses in its CMT revenue requirement. D.C. Commission Reply at 3-4. A rulemaking proceeding is not the proper forum to address this issue. Instead, the D.C. Commission may file a formal complaint pursuant to section 208 of the Act, 47 U.S.C. § 208 if it wishes to challenge Verizon's calculation of its CMT revenue.

[123] *See* BellSouth Reply at 2; SBC Reply at 6-8.

returns now than it would have earned under rate-of-return regulation does not necessarily suggest a need to reduce the carrier's rates.[124] Indeed, the stated purpose of price cap regulation is to create incentives for carriers to become more efficient by allowing them to earn higher returns, within the price caps specified in our rules.[125]

44. Moreover, following the passage of the 1996 Act, the Commission reviewed and updated the price cap regime in the 1997 *Access Charge Reform First Report and Order*.[126] The Commission again reviewed and updated the price cap regime in 2000 when it adopted a five-year plan for access charge reform in the *CALLS Order*.[127] On appeal of that order, the 5th Circuit reviewed the increase to the SLC cap and held that the increase represents a "reasoned attempt" to balance the goals of ensuring affordability and promoting competition, and that the Commission had provided "sufficient justification" for this change in the price cap regime.[128] The Commission has also initiated a wide-ranging examination of all intercarrier compensation mechanisms, including the price cap regime for access charges, with the *Intercarrier Compensation NPRM*.[129] That proceeding seeks a long-term plan for the operation of the Commission's access charge and reciprocal compensation mechanisms in a more competitive environment, and also seeks comment on alternatives to traditional intercarrier compensation mechanisms, such as a bill-and-keep system.[130] Given that we have completed only two years of the five-year plan adopted in the *CALLS Order*, and also that we are contemplating a regime to follow the *CALLS Order* in the *Intercarrier Compensation NPRM*, we see no reason to revisit the method of setting SLC rates at this time; here, we focus only on the cap applicable to those rates.

45. We also disagree with NASUCA's claim that raising the SLC cap will increase an alleged "subsidy" running from consumers to the LECs.[131] NASUCA argues that, based on its forward-looking cost results, residential and single-line business customers currently are subsidizing LECs by paying SLC rates that exceed the forward-looking cost of the common line.[132] According to NASUCA, if the SLC cap were increased to $6.50, the aggregate revenue derived from SLC rates will be approximately $2 billion greater per year than the forward-looking cost of the loop.[133] NASUCA appears to imply that this purported subsidy could be

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[124] *See* NASUCA Comments at 11, App. A.

[125] *See* Verizon Comments at 3; SBC Reply at 7-8. *See Southwestern Bell v. FCC*, 153 F.3d 523, 548 (8th Cir. 1998).

[126] *See Access Charge Reform First Report and Order*, 12 FCC Rcd 15982.

[127] *See CALLS Order*, 15 FCC Rcd 12962.

[128] *See Texas Office of Public Util. Counsel v. FCC*, 265 F.3d at 321-22.

[129] *See Developing a Unified Intercarrier Compensation Regime*, CC Docket Nos. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610(2001) (*Intercarrier Compensation NPRM*).

[130] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9611, para. 1.

[131] *See* NASUCA Comments at 43. *See also* Joint Consumer Commenters Reply at 5.

[132] NASUCA Comments at 43.

[133] *See* NASUCA Comments at 53.

eliminated if SLCs were based on forward-looking costs, rather than on the price cap formulas.

46. As discussed at length above, the purpose of this proceeding is to verify that increases in the SLC cap are warranted, and we do not intend to reexamine how rates are set under the price cap regime at this time.[134] Moreover, while the Commission has endorsed forward-looking costs for certain purposes, including the instant review of the SLC *cap*, the Commission has not yet adopted a forward-looking cost standard for setting end-user retail *rates*.[135] In addition, the Commission repeatedly has cautioned parties against using the Synthesis Model to set rates.[136] Because NASUCA's argument ignores these issues, we find no basis to consider it.

47. NASUCA argues that, in conducting this cost review proceeding, the Commission must address how the costs of the loop should be allocated, pursuant to section 254(k) of the Communications Act, between voice service and advanced services provided over the high-frequency portion of the loop.[137] Section 254(k) prohibits telecommunications carriers from using services that are not competitive to subsidize services that are subject to competition. We decline to address this issue in the context of the SLC cap review proceeding.[138] The courts have already affirmed our general approach to recovering loop costs through SLCs as being consistent with the requirements of section 254(k).[139] Moreover, we are currently seeking comment on the section 254(k) issue that NASUCA raises in another proceeding, and parties will have a better opportunity to develop a full record on this issue in that notice and comment rulemaking proceeding.[140]

B. Other Issues from the *CALLS Order*

1. Combining the Multi-line Business SLC and the Multi-Line Business PICC

48. In the *CALLS Order*, the Commission rejected commenters' request to combine the multi-line business SLC and the multi-line business PICC, but agreed to revisit the issue during the residential and single-line business SLC cap cost review proceeding.[141] After weighing the

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[134] *See* Verizon Reply at 2-4.

[135] *See* Sprint Reply at 5.

[136] *See Universal Service Ninth Report and Order*, 14 FCC Rcd at 20455, para. 41; *Universal Service Tenth Report and Order*, 14 FCC Rcd at 20172, para. 32; BellSouth Reply at 6; Qwest Reply at 13-16; SBC Reply at 11; Sprint Reply at 7; Verizon Reply at 6.

[137] NASUCA Comments at 59-109.

[138] *See* Qwest Reply at 18-19 (arguing that this proceeding is not the proper place for the Commission to consider a change to its cost allocation rules); Verizon Reply at 13 (arguing against NASUCA's attempt to turn the proceeding into a cost allocation proceeding).

[139] *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d at 323-24. *See also Southwestern Bell Telephone Company v. FCC*, 153 F.3d 523, 558-59 (8th Cir. 1998).

[140] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket Nos. 02-33, 95-20, 98-10, Notice of Proposed Rulemaking, FCC 02-42, para. 83 (Feb. 15, 2002) (*Broadband NPRM*).

[141] *See CALLS Order*, 15 FCC Rcd at 13005, paras. 107-09.

competing goals of removing implicit subsidies and maintaining affordable rates for consumers, we determine that it is not appropriate to combine the multi-line business SLC and PICC charged by price cap LECs at this time.

49. In declining commenters' suggestions to combine the multi-line business SLC and PICC, we observe that the multi-line business PICC will be reduced or eliminated for most carriers when the residential and single-line business SLC cap reaches $6.50.[142] If necessary, we will examine ways to eliminate the multi-line business PICC, as well as another charge containing implicit subsidies, the CCL charge, after the residential and single-line business SLC reaches the cap of $6.50 in July 2003.

50. In addition, we are concerned with the affordability issues raised by increasing the multi-line business SLC above the current $9.20 cap. Some carriers that operate in high-cost areas still recover their loop costs by charging IXCs up to the full amount of the multi-line business PICC cap of $4.31. The IXCs, in turn, recover the PICC from all of their multi-line business customers, effectively spreading the PICC across a much larger group and thereby lowering the amount recovered from each customer. If we were to combine the charges at this time, some multi-line business customers in high-cost areas would be subject to SLCs at or near $13.51 per line per month. Increasing to this level the SLCs of these customers, who are not eligible for Lifeline support, would raise affordability concerns. Additionally, we are disinclined to recover the subsidy represented by the multi-line business PICC entirely from the narrow class of high-cost multi-line business customers, rather than spreading its effect more broadly by continuing to recover it from IXCs, which have considerable flexibility in how they recover this cost.

51. Ad Hoc argues that, if the Commission increases the residential and single-line business SLC cap on the basis of forward-looking cost studies, then it should recalculate other common line charges, specifically the multi-line business SLC and PICC, based on forward-looking cost studies.[143] The Commission historically has exercised caution in increasing end-user charges for residential and very small business customers.[144] This heightened sensitivity to ensuring affordable rates led the Commission to single out the residential and single-line business SLC cap for review in the *CALLS Order* because, as a general matter, competition does not yet serve as an effective constraint on residential and single-line business rates. By contrast, multi-line business customers are more likely to receive the benefits of competition, including downward pressure on rates, and do not raise the same level of affordability concerns in this context.[145] We therefore decline Ad Hoc's suggestion to use forward-looking cost data to set common line rates or caps for multi-line business customers in this proceeding.

52. We similarly decline to adopt GSA's suggestion of implementing a unified cap for

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[142] For example, Sprint estimates that the amount it recovers through the multi-line business PICC will decrease from $42,562,991 to $1,402,910 after the SLC cap reaches $6.50. *See* Sprint April 16 *ex parte* at Att.

[143] Ad Hoc Comments at 18-19.

[144] *See Access Charge Reform First Report and Order*, 12 FCC Rcd at 16011, para. 73.

[145] *See Access Charge Reform First Report and Order*, 12 FCC Rcd at 16005, para. 58.

both categories of SLCs, multi-line business and residential/single-line business.[146] GSA suggests a greater and quicker increase to the residential and single-line business SLC cap than contemplated by the Commission in the *CALLS Order*, to either $6.50 or $7.00 on July 1, 2002.[147] In the alternative, GSA recommends gradually lowering the multi-line business SLC cap to meet the ultimate $6.50 residential and single-line business cap, with the first decrease to $8.00 to occur on July 1, 2002.[148] As discussed above, the Commission carefully balanced its statutory goals of promoting competition and ensuring affordable rates in setting the SLC caps in the *CALLS Order*. GSA's proposal to increase the residential and single-line business SLC cap raises affordability issues, and its alternative proposal to lower the multi-line business SLC cap would create higher multi-line business PICCs and CCL charges, thus increasing implicit subsidies. Neither of these results is consistent with the Commission's access charge goals as stated in the *CALLS Order*. The Commission, however, will have the opportunity to review the operation of the SLC caps and can make appropriate adjustments as necessary at that time.

2. The Rural Price Cap LEC Exception

53. At paragraph 154 of the *CALLS Order*, the Commission adopted an option that allows rural price cap LECs some relief from achieving the required switched access usage charge reductions solely through rate decreases.[149] Specifically, non-Bell Operating Company price cap carriers that have at least 20 percent of total holding company lines operated by rural telephone companies may elect to shift to the common line basket the switched access usage charges necessary to yield those filing entities' proportionate share of the total reduction in switched access usage charge rates. These carriers would include these amounts in the CMT revenue requirement, and, to the extent they cannot recover all of the revenue requirement within a filing entity, they may increase their multi-line business PICCs and multi-line business SLCs in other filing entities within the same holding company, up to the amount of the applicable SLC and PICC cap. The Commission stated that this mechanism was to be reviewed in the instant cost proceeding to determine whether retaining this exception or transferring the additional switched access reduction amounts to the CMT basket is warranted.[150]

54. We note that no party has raised any objection to retaining the rural price cap exception and we are not aware of any problems created by the exception. We believe that the rationale for adopting it in the *CALLS Order* remains, i.e., it is in the public interest to allow rural price cap LECs some ability to recover the switched access usage charge reductions through shifting them to the CMT basket. We therefore retain the exception.

IV. ORDERING CLAUSES

55. Accordingly, IT IS ORDERED that, pursuant to sections 1, 4(i) and (j), 201-205, 218-222, 254, 303(r), and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i),

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[146] *See* GSA Comments at 6-7.

[147] GSA Comments at 6.

[148] *Id.*

[149] *CALLS Order*, 15 FCC Rcd at 13023-24, 13026, paras. 147, 154.

[150] *CALLS Order*, 15 FCC Rcd at 13026, para. 154.

154(j), 201-205, 218-222, 254, 303(r), and 403, this Order is HEREBY ADOPTED.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch

Marlene H. Dortch
Secretary

ATTACHMENT A

Price Cap Carrier Filings

Total price cap carrier residential and SLB lines*	121,736,960
Total residential and SLB lines with costs above $5.00	121,648,892 (99.9%)
Total residential and SLB lines with costs above $6.50	75,349,867 (62%)

NASUCA Filing

Residential and SLB lines**	105,203,351
Residential and SLB lines with costs above $5.00	26,950,167 (26%)
Residential and SLB lines with costs above $6.50	13,922,265 (13%)

NASUCA Filing + Rural Price Cap Lines

Residential and SLB lines***	111,603,351
Residential and SLB lines with costs above $5.00	33,350,167 (30%)
Residential and SLB lines with costs above $6.50	20,322,265 (18%)

* These numbers are based on the price cap carriers' submissions in this proceeding.

** NASUCA's analysis does not include the residential and SLB lines of all price cap carriers.

*** There are approximately 10 million total rural price cap carrier lines, and approximately 164 million total non-rural price cap carrier lines. Roughly 64 percent of the non-rural price cap lines, 105 million, are residential and single-line business lines. Therefore, we estimate that approximately 64 percent of the rural price cap carrier lines, or 6,400,000, are residential and single-line business lines. We note that this may underestimate the number of rural residential and single-line business price cap lines, because the proportion of multi-line business lines is likely to be smaller in rural than in non-rural areas.

	Total Res. & SLB Lines		Lines with Costs Above $5.00		Lines with Costs Above $6.50	
	Carrier Filing	NASUCA Filing	Carrier Filing	NASUCA Filing	Carrier Filing	NASUCA Filing
BellSouth	14,648,695	17,645,065	14,648,695 (100%)	4,964,695 (28%)	8,569,641 (59%)	3,553,029 (20%)
Cincinnati Bell	734,605	678,917	734,605 (100%)	214,263 (32%)	156,860 (21%)	67,764 (10%)
Qwest	10,391,371	7,685,475	10,391,371 (100%)	1,192,543 (16%)	8,215,340 (79%)	693,405 (9%)
SBC	27,346,626	36,756,917	27,346,626 (100%)	7,602,142 (21%)	11,437,477 (42%)	3,122,430 (9%)
Verizon	61,055,374	41,428,297	61,055,374 (100%)	12,974,954 (31%)	39,901,360 (65%)	6,484,067 (16%)

ATTACHMENT B
Parties Filing Pleadings

I. COST SUBMISSIONS

A. Original Submissions Filed November 16, 2001

1. Aliant Communications Co. (Aliant)
2. BellSouth Telecommunications, Inc. (BellSouth)
3. Cincinnati Bell Telephone Company (Cincinnati Bell)
4. Iowa Telecommunications Services, Inc. (Iowa Telecom)
5. Qwest Corporation (Qwest)
6. SBC Communications Inc. (SBC)
7. Sprint Corporation (Sprint)
8. Valor Telecommunications Enterprises LLC (Valor)
9. Verizon

B. *Ex Parte* Filings Supplementing Cost Submissions

1. Letter from John W. Kure, Executive Director-Federal Policy and Law, Qwest, to William F. Caton, Acting Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Mar. 22, 2002).
2. Letter from Patricia L. Rupich, Cincinnati Bell, to William F. Caton, Acting Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Mar. 28, 2002).
3. Letter from Pete Sywenki, Director Federal Regulatory Affairs, Sprint, to William Caton, Acting Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Apr. 2, 2002).
4. Letter from W. Scott Randolph, Director-Regulatory Affairs, Verizon, to William F. Caton, Acting Secretary, Federal Communications Commission, CC Docket Nos. 94-1, 96-262 (Apr. 2, 2002).
5. Letter from Jamie M. Tan, Associate Director Federal Regulatory, SBC Communications, Inc., to William F. Caton, Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Apr. 17, 2002).
6. Letter from Randall J. Brockmann, Manager-Economic Costing, Frontier, to Office of the Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Apr. 19, 2002).
7. Letter from James U. Troup, Counsel for Iowa Telecommunications Services, Inc., McGuire Woods, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1 (Apr. 19, 2002).

II. COMMENTS

1. Ad Hoc Telecommunications Users Committee (Ad Hoc)
2. People of the State of California (California Commission)
3. Florida Public Service Commission (Florida Commission)
4. General Services Administration (GSA)
5. National Association of State Utility Consumer Advocates (NASUCA)

6. WorldCom, Inc. (WorldCom)

III. REPLY COMMENTS

1. Ad Hoc
2. BellSouth
3. Cincinnati Bell
4. District of Columbia Public Service Commission (D.C. Commission)
5. GSA
6. NASUCA
7. Qwest
8. SBC
9. Sprint
10. Texas Office of Public Utility Counsel *et al.* (Joint Consumer Commenters)
11. Verizon

STATEMENT OF COMMISSIONER MICHAEL J. COPPS, DISSENTING

Re: Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps

I am troubled that consumers will face an increase in the line charge on their local bill without the Commission undertaking a thorough analysis of forward-looking cost data. In 2000, when the Commission adopted access charge reform for price cap carriers, the Commission pledged that it would initiate and complete before July 1, 2002 a cost review proceeding to ensure that consumers are not overpaying for telecommunications services. This has not been done. Carriers were required to provide, and the Commission stated that it would examine, forward-looking cost data. A significant number of carriers, however, submitted summary data without disclosing the inputs used, cost models that were not transparent, or in some cases, models that have been rejected by the state commissions. NASUCA, the association of state consumer advocates filed its data purporting to show that the cap should not increase, but it used a model that the Commission has cautioned may have limits in establishing costs. The Commission then failed to conduct its own independent analysis of the cost data. By failing to undertake the thorough analysis of cost data that was promised in the access reform order, we are neglecting our obligation to consumers.

I suspect there is a case to be made for proceeding with an increase in the cap. Indeed, in all probability, there are many areas of the country in which forward-looking costs exceed $5. But as the courts have recently been at pains to tell the Commission, we need to obtain the data and conduct our analysis before we act. Without such data, I am unable to support an increase in the line charges on consumers' bills.

I also remain concerned about the line charges imposed on rural consumers. As the cap increases, it is highly likely that the disparity in line charges between rural consumers and urban ones will increase. For example, as the Order points out, those living in Washington, DC, will pay less than $4 per month whereas those in most rural areas will soon pay over $6 for this one charge on their bills. In 2000, the Commission determined that this line charge was not subject to the rate integration and rate averaging directives in the statute. Although a reexamination of that issue is not before us in this proceeding, before allowing further increases in the line charge, I would urge the Commission to consider this disparity and whether it runs afoul of section 254(g) or the Congressional mandate that the rates paid by those living in high-cost areas are reasonably comparable to those paid by consumers in urban areas.