

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

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for LECs	)	CC Docket No. <u>94-1</u>
	)	
Low-Volume Long Distance Users	)	CC Docket No. 99-249
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

**ORDER ON REMAND**

**Adopted: July 3, 2003**

**Released: July 10, 2003**

By the Commission:

**I. INTRODUCTION**

1. In this order, we address two issues before the Commission on remand from the United States Court of Appeals for the Fifth Circuit.<sup>1</sup> In the *CALLS Order*, the Commission adopted comprehensive reforms to the interstate access charge regime and universal service support for price cap carriers, based in part on a proposal submitted by the Coalition for Affordable Local and Long-Distance Service (CALLS).<sup>2</sup> On September 10, 2001, the Fifth Circuit affirmed the *CALLS Order* in most respects, but remanded for further analysis and explanation the decisions to size the Interstate Access Support (IAS) mechanism at \$650 million and to adopt the 6.5 percent X-factor.<sup>3</sup> For the reasons explained below, we conclude that the

<sup>1</sup> *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5<sup>th</sup> Cir. 2001) (*TOPUC*).

<sup>2</sup> *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board on Universal Service*, 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 Utility Counsel*, 265 F.3d 313 (5<sup>th</sup> Cir. 2001) (*TOPUC*). CALLS consisted of the following members: AT&T, Bell Atlantic, BellSouth, GTE, SBC, and Sprint, representing both incumbent local exchange carriers (LECs) and interexchange carriers (IXCs).

<sup>3</sup> *TOPUC*, 265 F.3d at 317.

\$650 million IAS amount included in the integrated CALLS plan represents a reasonable estimate of the implicit support in access charges to be replaced with explicit support and is supported by the record in this proceeding. We also conclude that the record supports the adoption of a 6.5 percent X-factor to achieve the Commission's target rate levels for price cap carriers.

## II. BACKGROUND

### A. Interstate Access Charges

2. Interstate access charges are imposed by local exchange carriers (LECs) to recover the costs of providing access to their networks for interstate and long-distance service.<sup>4</sup> The Commission has long recognized that, to the extent possible, interstate access costs should be recovered in the manner in which they are incurred. In particular, non-traffic-sensitive costs—costs that do not vary with the amount of traffic carried over the facilities—should be recovered through flat-rate charges, and traffic-sensitive costs should be recovered through per-minute charges.<sup>5</sup> This approach fosters competition and efficient pricing. The Part 69 rules governing access charges, however, have not been fully consistent with this goal. For example, the costs of the common line or loop that connects an end user to a LEC's central office should be recovered from the end user through a flat charge, because loop costs do not vary with usage.<sup>6</sup> Yet the subscriber line charge (SLC), a flat monthly charge assessed directly on end users to recover interstate loop costs, has been capped since its inception due to affordability concerns.<sup>7</sup> Historically, LECs recovered their remaining common line costs through per-minute carrier common line (CCL) charges imposed on interexchange carriers (IXCs) which, in turn, passed these charges on to their customers in the form of higher long distance rates.<sup>8</sup> By making the end-user rate for long distance calls more expensive, CCL charges artificially suppressed demand

<sup>4</sup> The Commission uses a multi-step process to identify the cost of providing access service. First, an incumbent LEC must record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations. See 47 C.F.R. §§ 32.1-32.9000. Second, these carriers must divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities. See 47 C.F.R. §§ 64.901-64.904. Third, the separations rules determine the fraction of the incumbent carrier's regulated expenses and investment that should be allocated to the interstate jurisdiction. See 47 C.F.R. §§ 36.1-36.741. After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. See 47 C.F.R. §§ 69.1-69.731.

<sup>5</sup> *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982, 15992-93, para. 24 (1997) (*Access Charge Reform First Report and Order*).

<sup>6</sup> *Access Charge Reform First Report and Order*, 12 FCC Rcd at 16013, para. 77 ("Because common line costs do not vary with usage, these costs should be recovered on a flat-rated instead of per-minute basis. In addition, these costs should be assigned, where possible, to those customers who benefit from the services provided by the local loop.")

<sup>7</sup> This charge is also referred to as the end user common line (EUCL) charge. See 47 C.F.R. § 69.152.

<sup>8</sup> See *CALLS Order*, 15 FCC Rcd at 12969-70, para. 18.

for interstate long distance services.<sup>9</sup> CCL charges also created significant implicit subsidies flowing from high-volume to low-volume users of interstate long distance services, which have a disruptive effect on competition in the markets for local exchange and exchange access services.<sup>10</sup>

3. 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.<sup>11</sup> In 1991, the Commission implemented a price cap system for the largest incumbent LECs that altered the regulation of their interstate access charges.<sup>12</sup> Rather than focusing on costs, price cap regulation focuses primarily on the rates incumbent LECs may charge and the revenues they may generate from interstate access services.<sup>13</sup> 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.<sup>14</sup>

4. Although the initial price cap rates were set equal to the rates the LECs were charging under rate-of-return regulation, the rates of price cap LECs have been limited ever since by price indices that have been adjusted annually pursuant to formulas set forth in the Commission's Part 61 rules. Price cap carriers may earn returns higher or 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.

## B. Universal Service

5. One of the primary purposes of universal service support is to help provide access to

<sup>9</sup> *CALLS Order*, 15 FCC Rcd at 12969-70 para. 18.

<sup>10</sup> *Access Charge Reform First Report and Order*, 12 FCC Rcd at 15986 para. 6, 15995-96 para. 30, 16013 para. 76.

<sup>11</sup> See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent LEC and IXC's*, 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, 19624, para. 19 (2001) (*MAG Order*).

<sup>12</sup> 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*).

<sup>13</sup> See *LEC Price Cap Order*, 5 FCC Rcd at 6787, para. 2.

<sup>14</sup> *Id.*

telecommunications service in areas where the cost of such service otherwise might be prohibitively expensive.<sup>15</sup> Historically, this purpose has been achieved both through explicit monetary payments and implicit support flows that enable carriers to serve high-cost areas at below-cost rates. Congress established principles for the preservation and advancement of universal service in the Telecommunications Act of 1996, directing the Commission to create explicit universal service support mechanisms that will be specific, predictable, and sufficient.<sup>16</sup> The Commission has approached this goal by, among other things, pursuing reforms intended to make universal service explicit and portable to competitive carriers.<sup>17</sup> Congress also articulated a national goal that consumers in all regions of the nation, including rural, insular, and high-cost areas, should have access to telecommunications services at rates that are affordable and reasonably comparable to rates charged for similar services in urban areas.<sup>18</sup> Section 254 provides that federal universal service support mechanisms should be specific, predictable, and sufficient to achieve the purposes of the Act.<sup>19</sup>

### C. Prior Commission Orders

6. With the passage of the 1996 Act, the Commission determined that it was necessary to make substantial revisions to access charges and universal service in order to promote competition and preserve and advance universal service. Specifically, the Commission aligned the access charge rate structure more closely with the manner in which costs are incurred.<sup>20</sup> In the *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 the extent that the SLC cap prevented a price cap LEC from fully recovering its costs through the SLC,<sup>21</sup> the LEC could recover those costs through the PICC, up to the PICC ...

<sup>15</sup> See, e.g., *Federal-State Joint Board on Universal Service, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking in CC Docket No. 96-45*, and *Report and Order in CC Docket No. 00-256*, 16 FCC Rcd 11244, 11251, para. 13 (2001) (*RTT Order*).

<sup>16</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act). The 1996 Act amended the Communications Act of 1934 (the Act) (codified at 47 U.S.C. §§ 151 *et seq.*); see also 47 U.S.C. § 254(e).

<sup>17</sup> *Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order*, 12 FCC Rcd 8667, 8801-03, paras. 46-51 (1997) (subsequent history omitted) (adopting the principle under section 254(b)(7) of the Act that federal support mechanisms should be competitively neutral); see also 47 U.S.C. § 254(e). In November 2002, the Commission referred to the Federal-State Joint Board on Universal Service several issues related to the portability of universal service support. *Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Order*, 17 FCC Rcd 22642 (2002).

<sup>18</sup> 47 U.S.C. § 254(b)(3).

<sup>19</sup> 47 U.S.C. §§ 254(b)(5), (e).

<sup>20</sup> *Access Charge Reform First Report and Order*, 12 FCC Rcd at 15998, para. 36.

<sup>21</sup> As discussed above, due to affordability concerns, the SLC is subject to a cap that, particularly for residential customers, is often below the level that would enable the LEC to recover the entire interstate cost of the local loop. See para. 2, *supra*.

cap.<sup>22</sup> Any costs above the PICC cap could be recovered through the CCL charge.<sup>23</sup> 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.<sup>24</sup>

7. Unfortunately, the advent of PICCs also created market inefficiencies.<sup>25</sup> 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.<sup>26</sup> 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.<sup>27</sup> Moreover, residential consumers paid more overall because IXCs included “transaction costs,” such as Lifeline costs, universal service contributions, and bad debts associated with non-paying subscribers, in the PICCs passed through to their customers.<sup>28</sup>

#### D. The *CALLS Order*

8. On May 31, 2000, the Commission adopted the *CALLS Order*, a five-year transitional interstate access and universal service reform plan for price cap carriers, largely based on a proposal from the *CALLS* members.<sup>29</sup> In the *CALLS Order*, the Commission sought to address several controversial and interrelated issues. Incumbent LECs have traditionally argued that they must maintain their revenue streams from access charges in order to support universal service goals, while IXCs and consumers have argued that the prices charged and revenues recovered by incumbent LECs reflect the inefficient rate structure developed in a monopoly environment.<sup>30</sup> In order to resolve these difficult issues, the *CALLS* members proposed their plan for comprehensive reform of the interrelated aspects of the interstate access charge regime and universal service.<sup>31</sup> The Commission exercised its own independent judgment in reviewing the

<sup>22</sup> *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*.

<sup>23</sup> *Id.* at 16005, para. 60.

<sup>24</sup> *See CALLS Order*, 15 FCC Rcd at 12970, para. 19.

<sup>25</sup> *See id.* at 12970, para. 19.

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 12992, para. 78.

<sup>29</sup> *Id.* at 12964, para. 1.

<sup>30</sup> *Id.* at 12973, 12978, paras. 26, 38.

<sup>31</sup> *Id.* at 12974, para. 28.

CALLS plan.<sup>32</sup> The Commission reviewed it as a single, integrated proposal. “focus[ing its] inquiry on the reasonableness of the proposal taken as a whole.”<sup>33</sup> The Commission found, among other things, that “its essential constituent parts individually fall within the range of reasonableness.”<sup>34</sup> It also found that the CALLS plan served the public interest because it resolved several controversial, interrelated issues in a manner satisfactory to traditionally adverse industry groups and advanced the Commission’s competitive and universal service goals.<sup>35</sup>

9. In the *CALLS Order*, the Commission further reformed the access charge regime for price cap carriers. Recognizing that the PICCs created market inefficiencies, the Commission sought to establish a more straightforward, economically rational common line rate structure.<sup>36</sup> Therefore, the Commission increased SLC caps,<sup>37</sup> eliminated the residential and single-line business PICC,<sup>38</sup> and capped multi-line business PICCs.<sup>39</sup> The Commission limited a price cap carrier’s recovery from SLCs, the new Interstate Access Support (IAS) mechanism, multi-line business PICCs, and CCL charges to “Price Cap CMT Revenue.”<sup>40</sup> It also addressed the historically controversial “X-factor” in the price cap formula by changing the X-factor’s function from a productivity offset to a transitional mechanism for reducing per-minute access charges to target levels proposed by the CALLS members.<sup>41</sup> In addition, the Commission approved an immediate \$2.1 billion reduction in per-minute switched access charges, which the CALLS IXC

<sup>32</sup> *Id.* at 12981-82, para. 49.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* at 12981-82, para. 49.

<sup>35</sup> *Id.* at 12977, para. 36, 12981-82 paras. 48-49.

<sup>36</sup> *Id.* at 12970, para. 19.

<sup>37</sup> *See id.* at 12991-93, paras. 76-79. In the *CALLS Order*, the Commission approved graduated increases in the SLC cap for residential and single-line business lines to \$5.00 per month, and approved a series of further increases conditioned on cost studies to be submitted in a future cost review proceeding. *CALLS Order*, 15 FCC Rcd at 12994, para. 83. In order to preserve affordability for low-income consumers, the Commission also increased universal service support under the Lifeline mechanism. *CALLS Order*, 15 FCC Rcd at 13057-59, paras. 218-21. Recently, the Commission approved increases in residential and single-line SLC caps to \$6.50. *Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge (SLC) Caps*, CC Docket Nos. 96-262, 94-1, Order, 17 FCC Rcd 10868, 10869-70, para. 1 (2002) (*SLC Cap Review Order*).

<sup>38</sup> *CALLS Order*, 15 FCC Rcd at 12991-93, paras. 76-79.

<sup>39</sup> *Id.* at 13004-06, paras. 105-12. The multi-line business PICC is a transitional mechanism that recovers revenue that would otherwise be recoverable through charges on residential and single-line business lines. *Id.* at 13004, para. 106. In the *CALLS Order*, the Commission concluded that “maintaining this transitional mechanism continues to be a reasonable measure to avoid an adverse impact on universal service and residential customers, and is the better approach in establishing a more efficient interstate access charge rate structure consistent with our long-term universal service goals in a competitive local exchange environment.” *Id.*

<sup>40</sup> *Id.* at 12988-89, para. 70. Price Cap CMT Revenue includes common line costs, marketing expenses, and residual revenues previously recovered through the transport interconnection charge. *Id.*

<sup>41</sup> *Id.* at 13028-39, paras. 160-84. We discuss the X-factor in greater detail in section III.B. *infra*.

members committed to pass through to their customers.<sup>42</sup>

10. Furthermore, the Commission established a new interstate access support mechanism, sized at \$650 million annually, to replace implicit support in the interstate access charges of price cap carriers.<sup>43</sup> The IAS mechanism provides price cap carriers with the support required to recover a portion of their Price Cap CMT Revenues that cannot be recovered through SLCs. The Commission found \$650 million to be a reasonable amount that would provide sufficient, but not excessive, support.<sup>44</sup> In this regard, it observed that a range of funding levels might be deemed “sufficient” for the purposes of the 1996 Act, and that “identifying an amount of implicit support in our interstate access charge system is an imprecise exercise.”<sup>45</sup>

### E. Fifth Circuit Decision

11. On September 10, 2001, the United States Court of Appeals for the Fifth Circuit upheld the *CALLS Order* in most respects, but remanded to the Commission for further consideration its decisions to size the IAS mechanism at \$650 million and to set the X-factor at 6.5 percent.<sup>46</sup> The court held that the Commission reasonably interpreted sections 254(b)(1) and 254(i) as aspirational with respect to the maintenance of affordable rates and therefore upheld the decision to increase the residential and single-line business SLC caps.<sup>47</sup> The court found that, though the Commission could not reverse past policy regarding SLC caps without explanation, the Commission had articulated rational reasons for the increases.<sup>48</sup> The court also held that the Commission reasonably concluded that section 254(k), which requires that the Commission establish cost allocation rules, concerns allocation of joint and common costs, rather than the SLC and the PICC, which relate to the recovery of such costs.<sup>49</sup> The court further held that the

<sup>42</sup> *Id.* at 13075, paras. 151-52.

<sup>43</sup> *Id.* at 13046, para. 202; see *TOPUC*, 265 F.3d at 327-28. We discuss the Commission's decision to size IAS at \$650 million in greater detail in section III.A. *infra*.

<sup>44</sup> *CALLS Order*, 15 FCC Rcd at 13046, para. 202.

<sup>45</sup> *Id.* at 13046, para. 201 (“The various implicit support flows (e.g., business to residential, high-volume to low-volume, and geographic rate averaging) are not easily severable and quantifiable. Moreover, the competitive pricing pressures present during this transitional period between monopoly and competition present additional complexities in identifying a specific amount of implicit support.”).

<sup>46</sup> See *TOPUC*, 265 F.3d at 329. The court also found that the Commission did not violate the Administrative Procedure Act with respect to the abbreviated notice-and-comment period for the revised *CALLS* proposal and *ex parte* contacts between the Commission and *CALLS* proponents. *Id.* at 325-27.

<sup>47</sup> *Id.* at 322.

<sup>48</sup> *Id.* The court noted several reasons for increasing the SLC cap: the effects of inflation since the last SLC cap increase minimized the real effect of the increase; studies indicating that telephone subscribership would not be negatively affected by the SLC cap increase; the increased funding of the Lifeline support program, which allayed some prior fears about affordability; the promise to conduct a cost study before the latter stages of the SLC increase; and the offset of the SLC increase by the pro-competitive benefits of the elimination of the PICC. *Id.*

<sup>49</sup> *Id.* at 324.

Commission could reasonably rely on market forces to restructure access rates and need not conduct a forward-looking cost study to set access rates.<sup>50</sup>

12. The court did find, however, that the Commission needed to provide further explanation of two aspects of the *CALLS Order*. With respect to the \$650 million size of the IAS mechanism, the court concluded that, while identifying a specific amount of support is an imprecise exercise, the Commission must better explain how it arrived at the \$650 million amount.<sup>51</sup> Similarly, the court found that the Commission must demonstrate a rational basis for its derivation of the 6.5 percent X-factor.<sup>52</sup> In response to the remand, the Common Carrier Bureau issued a public notice seeking further comment regarding the \$650 million IAS amount.<sup>53</sup>

### III. DISCUSSION

#### A. \$650 Million Interstate Access Support Amount

13. We conclude that \$650 million is a reasonable estimate of the implicit support in the interstate access rate structure that must be replaced by IAS in order to accomplish the Commission's competitive and universal service goals in adopting the transitional *CALLS* plan. The *CALLS* members proposed a \$650 million support amount as part of their integrated proposal for resolving several interrelated and difficult issues associated with access charge reform. The Commission stated that it would adopt individual elements of the proposal, including the \$650 million support amount, if the elements were, in the Commission's independent judgment, within a range of reasonableness.<sup>54</sup> Careful consideration of all of the studies submitted in this proceeding allows us to define a relatively narrow range of reasonable support amounts. The \$650 million IAS amount proposed by the *CALLS* members falls within this range of reasonable support amounts. Moreover, as we discuss below, we conclude that nothing in the record, including recent studies by NASUCA and Qwest, indicates that there is a more reasonable support amount than the one proposed in the *CALLS* plan. We find that a \$650 million support amount adequately balances our various policy goals, including the availability of service in all areas at rates that are affordable and reasonably comparable to nationwide rates, the promotion of competition and efficient investment in rural America, and the facilitation of the transitional reforms of the access rate structure adopted in the *CALLS Order*:

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<sup>50</sup> *Id.* at 324-25.

<sup>51</sup> *Id.* at 328; *see also* para. 17, *infra*.

<sup>52</sup> *TOPUC*, 265 F.3d at 328-29; *see also* para. 38, *infra*.

<sup>53</sup> *Common Carrier Bureau Seeks Comment on Remand of \$650 Million Support Amount Under Interstate Access Support Mechanism for Price Cap Carriers*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, Public Notice, 16 FCC Rcd 21307 (Com. Car. Bur. 2001) (*CALLS Remand Public Notice*). The Bureau did not seek further comment on the remand of the 6.5 percent X-factor, indicating that it would rely on the existing record with respect to that issue. *Id.* at 21308 n. 5. Pursuant to an agency reorganization, the Common Carrier Bureau subsequently became the Wireline Competition Bureau.

<sup>54</sup> *CALLS Order*, 15 FCC Rcd at 12981-82, para. 49.

## 1. Background

14. As discussed above, in the *CALLS Order*, the Commission adopted several reforms designed to rationalize, and remove implicit support from, price cap carriers' interstate access rates.<sup>55</sup> In order to make these reforms possible, the Commission adopted a new explicit universal service mechanism—IAS—to replace implicit support previously collected through interstate access charges.<sup>56</sup> The IAS mechanism distributes support to carriers serving lines in areas where they are unable to recover their permitted CMT revenues from SLCs despite the revised caps.<sup>57</sup> The IAS mechanism accomplishes this by using several mathematical calculations to determine per-line support amounts for each Unbundled Network Element (UNE) zone based on the extent to which the average allowable CMT revenue per line for the zone exceeds certain benchmarks.<sup>58</sup> Specifically, in any geographically deaveraged UNE zone where the average common line revenue per line for that zone would exceed a benchmark of \$7.00 per line for residential and single-line business lines and a benchmark of \$9.20 per line for multi-line business lines, the IAS mechanism would provide support for a portion of the difference between CMT revenue allowed and the benchmarks.<sup>59</sup> Although the aggregate difference between permitted common line revenue per line and the benchmarks exceeds \$650 million, the IAS mechanism employs a series of formulas to apportion support so that it does not exceed \$650 million per year.<sup>60</sup> The amount of IAS provided in each study area is also adjusted on a phased-in basis so that by July 1, 2003, CCL charges and multi-line business PICCs will be eliminated for most lines served by price cap LECs.<sup>61</sup> To the extent that carriers cannot recover their allowable

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<sup>55</sup> Carriers recover costs assigned to the interstate jurisdiction pursuant to either the Commission's price cap regulations or its rate-of-return regulations. The Commission addressed reform of the access rate structure for rate-of-return carriers in the *MAG Order*. *MAG Order*, 16 FCC Rcd at 19616, para. 2. The Commission's universal service rules also distinguish between rural carriers, which are typically small carriers that meet the definition of "rural telephone company" in the Act, and non-rural carriers for the purpose of distributing support for costs assigned to the intrastate jurisdiction. See 47 U.S.C. § 153(37). Although most rural carriers are subject to rate-of-return regulation, there are approximately 105 rural price cap carriers. See NASUCA Reply at 11.

<sup>56</sup> *CALLS Order*, 15 FCC Rcd at 13039, para. 185.

<sup>57</sup> *Id.* at 13043, para. 195; see also *supra* note 40 and accompanying text.

<sup>58</sup> *CALLS Order*, 15 FCC Rcd at 13043-44, para. 196. A UNE zone is a state-created zone pursuant to section 51.507(f) of the Commission's rules, which requires states to establish different rates for unbundled network elements in at least three defined geographic areas within the state to reflect geographic costs differences. 47 C.F.R. § 51.507(f).

<sup>59</sup> *CALLS Order*, 15 FCC Rcd at 13043 para. 196. For purposes of calculating IAS, the SLC cap on non-primary residential lines and single-line business lines is set at \$7.00, and the SLC cap on multi-line business lines is set at \$9.20. Although the maximum residential SLC cap changed from \$7.00 in the Original *CALLS* Proposal to \$6.50 in the Modified Proposal, the *CALLS* members continued to use \$7.00 for purposes of allocating IAS to each price cap LEC's service area to maintain consistency of benchmarks between primary and non-primary residential lines. *Id.* at 13043 n. 427.

<sup>60</sup> *Id.* at 13043-44, para. 196.

<sup>61</sup> *Id.*

CMT revenues through SLCs and IAS, they recover their CMT revenues through a multi-line business PICC—up to a monthly cap of \$4.31—and then CCL charges.<sup>62</sup>

15. In adopting this mechanism, the Commission found the proposed \$650 million IAS support amount to be a reasonable estimate of the amount of implicit support to be replaced in the price cap access rate structure with explicit, portable support.<sup>63</sup> In light of the inherently imprecise nature of identifying implicit support in the access rate structure, the Commission found the \$650 million support amount reasonable for several reasons. The divergent interests of the CALLS members—IXCs and low-cost LECs that are net contributors to the universal service fund and high-cost LECs that are net recipients of universal service—provided significant incentive for the CALLS members to ensure that the estimate was reasonable.<sup>64</sup> The Commission further noted that the CALLS group submitted an AT&T-developed forward-looking cost study that estimated a support amount of \$613 million.<sup>65</sup> This estimate relied on the Commission's model for calculating high cost loop support for non-rural carriers and assumed increases to the SLC cap consistent with those the Commission adopted.<sup>66</sup>

16. The Commission found further evidence of the reasonableness of the \$650 million support amount in the fact that this amount was within the widely ranging estimates of implicit support in various studies before the Commission. For example, the United States Telecom Association estimated, based on embedded costs, that interstate common line rates then contained \$3.9 billion in implicit universal service support.<sup>67</sup> Commission economists William Rogerson and Evan Kwerel compared embedded costs to forward-looking costs to estimate that interstate access rates included \$1.9 billion in implicit support.<sup>68</sup> The CALLS members noted, but did not advocate reliance on, a study that used the HAI forward-looking model to estimate a

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<sup>62</sup> See 47 C.F.R. §§ 61.46(d), 69.153.

<sup>63</sup> *CALLS Order*, 15 FCC Rcd at 13046-47, para. 202.

<sup>64</sup> *Id.* at 13046-47, para. 202.

<sup>65</sup> *Id.* at 13045, para. 200. The other members of the CALLS group did not join in the citation of this study. See *Memorandum in Support of the Revised Plan of the Coalition for Affordable Local and Long Distance Service*, CC Dockets 94-1, 96-45, 99-249, 96-262, filed by CALLS on March 8, 2000.

<sup>66</sup> *CALLS Order*, 15 FCC Rcd at 13045, para. 200. In the *Universal Service Fifth Report and Order*, the Commission approved the Synthesis model for use in calculating high-cost support for non-rural carriers. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifth Report and Order, 13 FCC Rcd 21323 (1998) (*Universal Service Fifth Report and Order*). The Synthesis model is a series of algorithms that allow the user to estimate the cost of building a telephone network. *CALLS Order*, 15 FCC Rcd at 13045 n. 438; see also generally *Universal Service Fifth Report and Order*.

<sup>67</sup> *CALLS Order*, 15 FCC Rcd at 13045, para. 199 (citing USTA Comments, CC Dockets 96-45 and 96-262 filed July 23, 1999).

<sup>68</sup> *Id.* at 13045, para. 199 (citing *A Proposal for Universal Service and Access Reform*, Rogerson and Kwerel, CC Docket Nos. 96-45 and 96-262 (filed May 27, 1999) (Rogerson and Kwerel study)).

\$250 million support amount.<sup>69</sup> US West used the Commission's Synthesis model to estimate a support amount of \$1.2 billion, but did not assume increases to the SLC cap consistent with those the Commission adopted.<sup>70</sup> ALTS and Time Warner proposed an alternative plan that would provide \$300 million in explicit universal service support, but provided no empirical evidence in support of this amount.<sup>71</sup> Also before the Commission, but not cited with respect to the Commission's decision to size the IAS mechanism at \$650 million, was a study filed by the Common Carrier Bureau's Industry Analysis Division (IAD).<sup>72</sup>

17. The Fifth Circuit remanded the *CALLS Order* to the Commission for further analysis and explanation of the \$650 million support amount.<sup>73</sup> The court recognized that "identifying a specific amount is an 'imprecise exercise' and that [its] review of the [support amount] is especially deferential due to its transitional nature."<sup>74</sup> The court concluded, however, that the Commission "failed to exercise sufficiently independent judgment in establishing the \$650 million amount," by granting "near-total deference" to the fact that many parties agreed that \$650 million was an adequate support amount.<sup>75</sup> The court stated that "the [Commission] must provide some explanation as to why it found one study more persuasive than the other, even if it does not determine a precise amount as the 'only' correct figure."<sup>76</sup> In particular, the court noted that the Commission "hint[ed] at a reasoned analysis" with respect to the AT&T study based on the Synthesis model and the ALTS/Time Warner estimate, but failed to address other studies.<sup>77</sup> On remand, the court therefore directed the Commission to provide further analysis and explanation justifying \$650 million as an appropriate amount of support available under the IAS

<sup>69</sup> *Id.* at 13045, para. 199 (citing *CALLS Supplemental Reply* at 11 n. 20 (filed April 17, 2000)). The *CALLS* members noted this study as an example of the wide-ranging estimates of the appropriate size of the mechanism. *CALLS Supplemental Reply* at 11. AT&T developed the study based on the HAI model, but has advocated that the Commission rely on its other study, which used the Synthesis model. Like the Synthesis model, the HAI model uses a series of algorithms to estimate the cost of building a telephone network. *CALLS Order*, 15 FCC Rcd at 13045 n. 436. The Commission incorporated some elements of the HAI model in developing the Synthesis model, but has not approved the HAI model for use in calculating universal service support. See generally *Universal Service Fifth Report and Order*.

<sup>70</sup> *CALLS Order*, 15 FCC Rcd at 13048, para. 204 (citing US West Supp. Comments at 7).

<sup>71</sup> *Id.* at 13048, para. 204 (citing ALTS and Time Warner Supp. Comments at 17).

<sup>72</sup> *CALLS Analysis*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, (filed by Industry Analysis Division, Common Carrier Bureau on May 25, 2000) (IAD *CALLS Study*). IAD is now known as the Industry Analysis and Technology Division. The work underlying this study is posted to the Commission website at [www.fcc.gov/wcb/iatd/lec.html](http://www.fcc.gov/wcb/iatd/lec.html). The Commission relied on this study in other aspects and attached portions of the study as Appendix C of the *CALLS Order*. See *CALLS Order*, 15 FCC Rcd at 12978-79 para. 41, 13140-43.

<sup>73</sup> *TOPUC*, 265 F.3d at 327-28.

<sup>74</sup> *Id.* at 328.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

mechanism.<sup>78</sup>

18. In response to the remand, the Common Carrier Bureau (Bureau) issued a public notice seeking further comment on the \$650 million support amount.<sup>79</sup> Specifically, the Bureau sought comment on the uses of a cost model, including the Commission's Synthesis model and the AT&T study, to identify the appropriate size of the IAS mechanism.<sup>80</sup> The Bureau also sought comment on the use of other studies to determine whether \$650 million is the support amount that best serves the Commission's universal service goals.<sup>81</sup> In addition to the comments and reply comments addressing the studies previously filed in the proceeding, NASUCA filed reply comments outlining its own study, which relied on the Commission's Synthesis model, albeit with significant alterations.<sup>82</sup> Based on this study, NASUCA claims that the IAS mechanism should be sized at \$336 million if the residential and single-line business SLC cap is \$6.50.<sup>83</sup> Qwest, successor to US West, revised US West's earlier estimate of \$1.2 billion to \$978 million to reflect the higher SLC caps adopted by the Commission.<sup>84</sup>

## 2. Discussion

19. We conclude that the record in this proceeding supports the Commission's decision to size the IAS mechanism at \$650 million. Below, we address each of the cost studies filed in this

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<sup>78</sup> *Id.*

<sup>79</sup> *CALLS Remand Public Notice*, 16 FCC Rcd at 21307. The Bureau did not seek further comment regarding the 6.5 percent X-factor. *Id.* at 21308 n. 5. The Bureau is now known as the Wireline Competition Bureau.

<sup>80</sup> *Id.* at 21308.

<sup>81</sup> *Id.* at 21308.

<sup>82</sup> NASUCA Reply. The NASUCA study was originally developed for the SLC cap review proceeding. See NASUCA Reply in CC Docket Nos. 96-262, 94-1, and 96-45 (filed January 24, 2002). In the *CALLS Order*, the Commission stated that it would conduct a cost review proceeding prior to the scheduled increase to the residential and single-line business SLC cap above \$5.00. *CALLS Order*, 15 FCC Rcd at 2994, para. 85. As stated above, the Commission recently approved graduated SLC cap increases to \$6.50. *SLC Cap Review Order*, 17 FCC Rcd at 10869-70, para. 1.

<sup>83</sup> On January 14, 2002, eight days before comments were due in response to the *CALLS Remand Public Notice*, NASUCA filed a petition requesting modification of the Interim Protective Order in the non-rural high-cost proceeding in order to permit it to use wire center line data necessary to its detailed study. *Request of National Association of State Utility Consumer Advocates for a Second Limited Modification of Interim Protective Order (IPO)*, CC Docket Nos. 96-262, 94-1, and 96-45 (filed January 14, 2002). On February 6, 2002, two days after reply comments were due, NASUCA filed "reply comments" in which it outlined the conclusions of its study along with some of its major features. On May 6, 2002, the Commission released a modification to the Interim Protective Order to permit NASUCA to file its complete cost study. *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45, Order, 17 FCC Rcd 8252 (2002). On May 29, 2002, NASUCA made two *ex parte* filings which included its detailed cost study. Letters from Michael J. Travieso, Maryland People's Counsel, to Marlene H. Dortch, FCC, filed May 29, 2002 (NASUCA *ex parte* letters).

<sup>84</sup> Qwest Comments at 7-10.

proceeding. We conclude that they establish a range of reasonable support amounts, based on forward-looking and embedded cost estimates, from \$593 million to \$978 million. Because the \$650 million IAS amount proposed in the CALLS members' comprehensive plan for access reform falls within this range of reasonable estimates, we then address whether the \$650 million IAS amount appropriately balances the Commission's relevant goals. We conclude that the \$650 million support amount is a reasonable estimate of the amount of implicit support in access charges to be replaced by explicit, portable support. This support amount appropriately balances the Commission's relevant policy goals. We therefore do not change the support amount adopted in the *CALLS Order*.

**a. Cost Studies in the Record**

20. In this section, we address each of the cost studies in the proceeding, as requested by the Fifth Circuit. We first discuss the relevance, as a general matter, of forward-looking cost studies to our analysis. We then address each of the seven cost studies discussed by the Commission in the *CALLS Order*. Finally, we address the more recent study filed by NASUCA in response to the *CALLS Remand Public Notice*.

21. As an initial matter, we agree with commenters that it is appropriate to consider forward-looking cost estimates in determining the reasonableness of the \$650 million support amount.<sup>85</sup> We disagree, however, with commenters who contend that IAS should be sized solely on the basis of a forward-looking cost estimate.<sup>86</sup> In the *Universal Service First Report and Order*, the Commission established that, ideally, federal universal service support would be based on the forward-looking economic cost of constructing and operating the network used to provide supported services, rather than on a carrier's embedded costs.<sup>87</sup> Forward-looking support mechanisms promote efficiency and send the correct signals for entry, innovation, and investment.<sup>88</sup> In the context of determining the appropriate size of the IAS mechanism, forward-

<sup>85</sup> AT&T Comments at 2-3; NASUCA Reply at 3-4. The studies in this proceeding use two kinds of methodologies to estimate the amount of implicit support that should be replaced with explicit support. Forward-looking cost studies—such as those submitted by AT&T, US West, and NASUCA—estimate the amount of costs incurred in constructing and maintaining a theoretical efficient network that cannot be recovered through a carrier's end-user charges, such as SLCs. On the other hand, embedded cost studies—such as those provided by USIA and IAD—estimate the difference between price cap carriers' allowable CMT revenues and their revenues from SLCs. The difference, or "gap," indicates the amount of allowable CMT revenues that may only be recovered through explicit support or inefficient rate elements that contain implicit support, such as the PICC or the CCL charge.

<sup>86</sup> NASUCA Reply at 4-6; Focal Communications Supplemental Comments at 16 (filed April 3, 2000); Level 3 Supplemental Comments at 5-6 (filed April 3, 2000). We do not address NASUCA's contention that we should not provide support to price cap carriers that exceeds the forward-looking cost of service. NASUCA Reply at 3. This contention relates to the IAS distribution formula, which is not at issue on remand, rather than the size of the IAS mechanism.

<sup>87</sup> *Universal Service First Report and Order*, 12 FCC Rcd at 8899-901, paras. 224-29. We note that in the *MAG Order*, 16 FCC Rcd at 19668, para. 129, the Commission concluded that the appropriate level of interstate support for rate-of-return carriers should be determined based on embedded costs.

<sup>88</sup> *Id.* at 8899 para. 224.

looking studies may provide useful insight into the costs associated with providing services with an efficient network and, in turn, an appropriate amount of support for an efficient network. We conclude, however, that it would not be appropriate to rely solely on estimates derived from forward-looking analysis in determining the amount of support to provide under the *CALLS Order*. The access reform measures adopted in the *CALLS Order* continue to rely on embedded costs rather than forward-looking costs. Specifically, the IAS mechanism adopted by the Commission distributes support based on embedded costs because the Commission concluded that this would best facilitate the transitional reform of the access rate structure.<sup>89</sup> Also, the Commission concluded that forward-looking costs should not be used to set rates for price cap carriers, and the access rate structure that was reformed in the *CALLS Order* continues to rely on embedded costs to set rates for SLCs, multi-line business PICCs, and CCL charges, a decision upheld by the Fifth Circuit Court of Appeals.<sup>90</sup> We further note that the Commission has, at this time, authorized use of the forward-looking Synthesis model only for the distribution of non-rural high-cost support, and not for other universal service mechanisms. Moreover, the Synthesis model does not include data for the approximately 105 rural study areas served by price cap carriers subject to the *CALLS Order*.<sup>91</sup> For these reasons, we find that the Commission's Synthesis model produces useful evidence for estimating the appropriate size of the IAS mechanism, but that it would be inappropriate to rely solely on forward-looking cost estimates to determine an IAS amount.

22. Several estimates of the appropriate size of the IAS mechanism were considered by the Commission in the *CALLS Order*. Of these, AT&T's estimate of \$613 million was the most reasonable forward-looking study available. The study utilizes the Synthesis model, which has been studied by many parties and approved by the Commission for calculating intrastate high-cost support for non-rural carriers. The study's methodology - comparison of the interstate portion of the costs generated by the model to the then-proposed SLC caps of \$7.00 for residential and single-line business lines and \$9.20 for multi-line business lines - is generally reasonable. Nevertheless, there are some problems with AT&T's study. Some parties have questioned AT&T's method of aggregating the lines in the model into three zones per study area.<sup>92</sup> AT&T offers no justification for this aggregation method.<sup>93</sup> AT&T has not provided sufficient supporting documentation for the Commission staff to quantify the effect of using

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<sup>89</sup> *CALLS Order*, 15 FCC Rcd at 13049-55, paras. 206-13.

<sup>90</sup> *See id.* at 12990-3007, paras. 75-112; *TOPUC*, 265 F.3d at 324-25.

<sup>91</sup> *See NASUCA Reply* at 11. In comparison, there are 80 non-rural price cap studies in the model. *See id.*

<sup>92</sup> Qwest Comments at 6; NASUCA Reply at 10.

<sup>93</sup> *See NASUCA Reply* at 10. Elsewhere, AT&T states that a different aggregation method based on UNE zones creates the most appropriate balance of incentives for price cap carriers. AT&T Reply at 2-4 ("[The *CALLS Order*] created a unified and harmonized structure between SLC deaveraging, UNE bundling and interstate access support centering on the UNE zone (which reflects aggregated wire center data). That structure creates balanced incentives for all parties to seek reasonable disaggregation. Disassociating USF from the UNE zone would unbalance those incentives.").

AT&T's aggregation method, rather than another method.<sup>94</sup> Notwithstanding these deficiencies, the AT&T study methodology generally appears reasonable. We conclude that the AT&T study provided the most reasonable estimate based on forward-looking costs available at the time of the *CALLS Order*.

23. Staff in the Bureau's Industry Analysis Division also performed a credible analysis based on publicly available embedded cost data that permits an IAS estimate of \$978 million.<sup>95</sup> The IAD CALLS Study compares forecasted rates and revenues under the existing rules at the time of the CALLS plan to what would likely occur for each year of the CALLS plan.<sup>96</sup> The study reasonably forecasts growth for each price cap study area and estimates the amount of revenue that will be recovered by each price cap carrier from each of the various revenue streams, including SLCs, universal service support, multi-line business PICCs, and CCL charges.<sup>97</sup> These estimates accurately account for each of the access reforms adopted by the Commission, including the phased-in increases to the residential and single-line business SLC caps, the elimination of the residential and single-line business PICCs, and the cap on the multi-line business PICC.<sup>98</sup> The study concludes that, in the final year of the transitional reforms adopted in the *CALLS Order*, the gap between the capped SLC revenues and allowable CMT revenues will be approximately \$978 million.<sup>99</sup> We note that this finding is consistent with comments filed by Verizon and SBC, who argue that the \$650 million support amount is appropriate because it permits price cap carriers to recover most, but not all, of the gap between their SLC revenues and their allowable CMT revenues through IAS.<sup>100</sup> As discussed below, we

<sup>94</sup> Qwest contends that AT&T's method of aggregation results in a downward bias in the estimated support amount. See Qwest Comments at 6 ("AT&T inappropriately combines high cost, low-density areas with urban and suburban areas in a way that dramatically underestimates the amount of universal service support needed in very high-cost, low-density areas"). But see also NASUCA Reply at 3 (contending that AT&T uses inappropriate aggregation method and that results of AT&T study are too high).

<sup>95</sup> CALLS Analysis, CC Docket Nos. 96-262, 94-1, 99-249, and 98-45 (filed by Industry Analysis Division, Common Carrier Bureau on May 25, 2000) (IAD CALLS Study). IAD is now known as the Industry Analysis and Technology Division. The work underlying this study is posted to the Commission website at [www.fcc.gov/web/iatd/lec.html](http://www.fcc.gov/web/iatd/lec.html).

<sup>96</sup> IAD CALLS Study.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> IAD estimated that in the final year of the CALLS plan, price cap carriers would recover \$650 million in CMT revenues from the IAS mechanism, \$238 million from multi-line business PICCs, and \$90 million from CCL charges. IAD CALLS Study, Appendix D at 4 (estimating IAS and multi-line business PICC revenue), Appendix E at 11 (estimate of CCL charge revenues equals difference between originating and terminating per-minute access rates multiplied by forecasted minutes of use). Thus, the IAD CALLS Study suggests an explicit universal service mechanism totaling \$978 million would be necessary to eliminate completely all of the implicit support remaining in the access rate structure after the access charge reforms that the Commission adopted are taken into account.

<sup>100</sup> Verizon Comments at 3-6 (arguing that \$650 million represents approximately 70 percent of the price cap carriers' allowable CMT revenues); SBC Comments at 3-4 ("The purpose of the \$650 million is to provide support for a portion of the difference between an incumbent LEC's actual common line revenue requirement and the (continued....)

agree that it is appropriate to size the IAS mechanism to permit carriers to recover most, but not all, of this gap in order to balance the Commission's access reform and universal service policy goals in this proceeding.<sup>101</sup>

24. The remaining cost studies considered by the Commission at the time of the *CALLS Order* provide little or no aid in identifying a reasonable range of support amounts. We do not find Qwest's \$978 million forward-looking estimate persuasive.<sup>102</sup> Qwest used the Synthesis model in its "density zone" mode, which clusters lines within a study area to non-contiguous zones based on the density of their line populations.<sup>103</sup> This tends to aggregate very high-cost lines with only other very high-cost lines, thereby substantially reducing the effects of rate averaging and increasing the estimated support amount.<sup>104</sup> For example, aggregating lines at the wire center—still a very fine level of granularity, but larger than density zones—decreases the amount of support required under Qwest's study to \$765 million.<sup>105</sup> We find that, contrary to Qwest's arguments, this failure to provide any rate averaging benefit creates a significant upward bias in the amount of support required.

25. We also find that it would be inappropriate to rely on USTA's \$3.9 billion embedded cost estimate in determining a range of reasonable support amounts. USTA's estimate, which was examined by the Commission at the time but was not provided by USTA specifically for the *CALLS* proceeding, provides insufficient documentation for the Commission to determine whether there are any flaws in the methodology.<sup>106</sup> The estimate appears to include universal service support for purposes that are not at issue in this proceeding, such as intrastate support for

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incumbent LEC's permitted common-line end user recovery.

<sup>101</sup> See section III.A.2.b., *infra*.

<sup>102</sup> When the *CALLS Order* was adopted, US West—Qwest's predecessor—used the same general methodology to estimate a \$1.2 billion support amount. See *CALLS Order*, 15 FCC Rcd at 13048, para. 204. That study assumed a \$6.50 SLC cap on multi-line business lines, when a \$9.20 SLC cap was, in fact, adopted by the Commission. *Id.* The Qwest study filed in this proceeding corrects this assumption. Qwest Comments at 8. We note that the \$978 million estimated by Qwest's forward-looking study is the same as the amount estimated by IAD's embedded cost analysis. These results are merely coincidental, however, and are not relevant to our conclusions that the methodology underlying IAD's study is persuasive while the methodology underlying Qwest's study is not persuasive.

<sup>103</sup> Qwest Comments at 7-8. The Synthesis model is able to calculate costs for an entire study area or, at a more disaggregated level, on either a wire center or density zone basis. In all cases, the model first identifies clusters of customer locations. In each cluster, density is computed by dividing surface area (in square miles) by the number of lines. The model aggregates clusters into either wire centers or density zones, depending on the "output mode" chosen by the programmer. In wire center aggregation mode, the model assigns all clusters within a particular wire center to that wire center. In density zone aggregation mode, the model assigns each cluster to one of nine density zones (e.g., 0-5 lines per square mile, 5-100 lines per square mile, etc.), which are not necessarily contiguous.

<sup>104</sup> AT&T Reply at 2-3; NASUCA Reply at 10-11.

<sup>105</sup> Qwest Comments at 9 n. 32.

<sup>106</sup> USTA Comments, CC Docket Nos. 96-45 and 96-262 (filed July 23, 1999).

non-rural carriers and implicit support in the access rate structure for rate-of-return carriers.<sup>107</sup> Thus, we cannot conclude that the USTA study represents a reliable estimate for our purposes in this proceeding.

26. As part of a separate proposal to reform the interstate access rate structure and universal service filed prior to the first CALLS proposal, Commission economists Rogerson and Kwerel submitted a study indicating that the support amount with a \$6.50 SLC cap should be \$1.9 billion.<sup>108</sup> The Rogerson and Kwerel methodology is primarily concerned with promoting efficient competition in all regions, including those with significant geographic rate-averaging. It seeks to accomplish this goal by making available a large amount of support to completely eliminate alleged competitive advantages for competitive carriers that serve only low-cost areas within a study area.<sup>109</sup> We therefore find the Rogerson and Kwerel study inappropriate for the purposes of identifying the appropriate size of the IAS mechanism because it is not specifically designed to estimate the amount of implicit support in interstate access charges to be replaced by explicit support in order to accomplish the *CALLS Order's* reforms.

27. Finally, the ALTS/Time Warner study and the HAI model study cited by the CALLS members are unsupported. As the Commission noted in the *CALLS Order*, ALTS and Time Warner "merely assert, without any empirical support, that the interstate access universal service support mechanism would be more appropriately sized at \$300 million."<sup>110</sup> In addition, the interstate support mechanism proposed by ALTS and Time Warner was based on an alternate plan which would have substantially reduced the need for interstate access support and was ultimately rejected by the Commission.<sup>111</sup> The CALLS members cited the \$250 million estimate based on the forward-looking HAI model to demonstrate the widely ranging estimates of appropriate support amounts, but no party, including the CALLS members, advocated its use in this proceeding or provided a detailed description of the study.<sup>112</sup> Moreover, the Commission previously had rejected the use of the HAI model as the appropriate tool for estimating forward-looking costs for purposes of calculating non-rural high-cost support and our reasons for doing so apply here as well.<sup>113</sup> Therefore, we do not believe that it would be appropriate to use the HAI

<sup>107</sup> *Id.*

<sup>108</sup> Rogerson and Kwerel study.

<sup>109</sup> *Id.* at 4. The Rogerson and Kwerel study computes forward-looking loop costs for each wire center in a company study area. *Id.* at 9. It then computes an average loop cost in three different density zones by inflating these forward-looking costs proportionally to obtain deaveraged loop costs, so that each ILEC will recover permitted revenue if it charges prices equal to the deaveraged loop costs. *Id.* at 9, 12 n.3. Finally, the study computes a support amount by comparing average cost per zone to a company's SLC revenues in that zone. *Id.* at 12 nn. 4-5, 15, 31.

<sup>110</sup> *CALLS Order*, 15 FCC Rcd at 13048, para. 204.

<sup>111</sup> See ALTS/Time Warner Supplemental Comments at 14 (filed April 3, 2000); AT&T Comments at 6.

<sup>112</sup> *CALLS Supplemental Reply* at 11 n. 20 (filed April 17, 2000). AT&T developed the study, but never advocated its use in this proceeding.

<sup>113</sup> *Universal Service Fifth Report and Order*, 13 FCC Rcd at 21323, para. 3; The Commission included elements (continued....)

model to size IAS.

28. In addition to the studies before the Commission at the time it adopted the *CALLS Order*, one party filed a new study in response to the *CALLS Remand Public Notice*. NASUCA filed a forward-looking study estimating that IAS should be sized at \$336 million if the SLC cap on residential and single-line business lines were \$6.50.<sup>114</sup> Although a useful starting point, we find that the NASUCA study would require significant adjustment to yield a reliable forward-looking cost estimate.<sup>115</sup> The NASUCA study includes changes to the Synthesis model that the Commission declined to adopt in the *SLC Review* proceeding.<sup>116</sup> Specifically, NASUCA modifies the model results to permit structure sharing between the feeder and distribution networks, to remove loop costs that it considers to be traffic-sensitive in nature, and to attribute different portions of the port to the interstate jurisdiction and different portions of the corporate overhead to the loop.<sup>117</sup> In the *SLC Review* proceeding, the Commission declined to rely on NASUCA's studies that incorporated these changes because their results were unverifiable by the Commission staff and because the changed assumptions in those studies generated disagreement among parties.<sup>118</sup> Moreover, these loop and port costs are currently included in price cap carriers' allowed CMT revenues and therefore recoverable through the IAS mechanism. We do

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of the HAI model (as well as other proposed models) in its Synthesis model, but found that the HAI model did not permit the Commission "to adopt a framework or platform that would estimate the cost of building a telephone network to the subscriber's actual geographic location, taking into account the actual clustering of customers groupings such as neighborhoods and towns." *Id.* Additionally, the HAI model did not sufficiently permit the Commission to vary engineering assumptions. *Id.* The HAI results are not readily accessible to the public, while the Synthesis model's results are posted to the Commission's website.

<sup>114</sup> NASUCA Reply at 11-12; NASUCA *ex parte* letters. As stated above, the Commission approved incremental increases to the SLC cap on June 4, 2002. 17 FCC Rcd 10868, 10869-70, para. 1 (2002) (*SLC Cap Review Order*, 17 FCC Rcd at 10869-70 para. 1). The SLC cap will be \$6.50 beginning July 1, 2003. *Id.*

<sup>115</sup> Among its merits, the NASUCA study aggregates lines by UNE zone, which is consistent with the Commission's decisions to permit price cap carriers to disaggregate universal service support and deaverage SLCs by UNE zone. NASUCA Reply at 9-11.

<sup>116</sup> *SLC Review Order*, 17 FCC Rcd at 10884-85 para. 37. In the *SLC Review* proceeding, NASUCA presented the results of six different model runs, with each run highlighting an assumption over which parties debated. *Id.* at 10883 para. 34. The first, or default, run used 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 (which is unnecessary for purposes of calculating non-rural high-cost support, but is necessary for determining loop costs). The other runs were based on the default run, but changed certain parameters of the model. *Id.* at 10883 para. 34.

<sup>117</sup> NASUCA Reply at 6-11. We note that there is a limited record in this proceeding with respect to NASUCA's proposed changes to the model. This circumstance may be attributable to NASUCA's filing of its study in its reply comments. In an *ex parte* filing with the Commission, however, Sprint contests the appropriateness of NASUCA's changes to the model. Letter from Pete Sywenki, Sprint, to Marlene H. Dortch, Federal Communications Commission, filed September 13, 2002 (*Sprint Ex Parte Letter*). Sprint argues that, contrary to NASUCA's assertions, the feeder and transmission portion of the digital loop carrier are not traffic sensitive components of the loop and that the formula on which NASUCA relies to determine the amount of feeder and distribution network that share common structure has flaws that result in overstatement of shared structure. *Id.*

<sup>118</sup> *SLC Cap Review Order*, 17 FCC Rcd at 10884-85, para. 37.

not consider this remand proceeding an appropriate venue for reexamining the underlying decision to allocate costs in this manner. For the same reasons, we agree with Sprint that it is inappropriate to rely on NASUCA's study as submitted.<sup>119</sup> NASUCA's study is further flawed because it does not include forward-looking costs associated with serving multi-line business lines, which are also supported in certain high-cost areas. We also note that NASUCA estimates the amount of support for rural price cap study areas that are not in the Synthesis model based on actual IAS received, rather than forward-looking model results.<sup>120</sup> NASUCA's inability to use the Synthesis model to estimate forward-looking costs for these study areas demonstrates the inappropriateness of relying solely on forward-looking costs to size IAS.<sup>121</sup> For these reasons, we do not find NASUCA's \$336 million estimate to be a reasonable IAS amount.

29. Nevertheless, we find that NASUCA's study, with appropriate adjustments, permits us to reasonably estimate forward-looking costs.<sup>122</sup> Undoing NASUCA's modifications to the Synthesis model related to structure sharing and costs that NASUCA argues are traffic-sensitive increases the support amount estimated by NASUCA's study from \$336 million to \$516 million. Including multi-line business lines in the study increases the support amount estimated by the model by another \$80 million to \$593 million. We note that this support estimate may still be conservative, because we believe that there may be merit to Sprint's argument that NASUCA's methodology underestimates support required for rural price cap study areas not reflected in the Synthesis model.<sup>123</sup> Without NASUCA's alterations to the Commission's Synthesis model, and with the costs of multi-line business lines included, the NASUCA study yields a forward-looking cost estimate of \$593 million.

**b. Appropriateness of \$650 million IAS amount**

30. The studies before us, therefore, establish a range of reasonable estimates of implicit support to be replaced by IAS between \$593 million, as established by the restated NASUCA

<sup>119</sup> *Sprint Ex Parte Letter*.

<sup>120</sup> NASUCA Reply at 11-12; NASUCA *ex parte* letters. NASUCA also uses actual support amounts for four Qwest study areas that have UNE zones below the wire center level. *Id.* Sprint argues that NASUCA's methodology underestimates the amount of support for rural price cap study areas, because it assumes that the impact of reducing support for non-rural companies would be directly proportional to the impact on rural companies. *Sprint Ex Parte Letter*. Because rural price cap carriers tend to serve higher cost lines than non-rural price cap carriers, Sprint contends that the support amount estimated for rural price cap carriers should be higher than estimated by NASUCA's study. *Id.*

<sup>121</sup> See para. 21, *supra*.

<sup>122</sup> See Appendix A (describing Commission staff's methodology for restating NASUCA study).

<sup>123</sup> *Sprint Ex Parte Letter*. We did not quantify the impact of Sprint's concern regarding NASUCA's methodology for estimating support for rural price cap carriers because the record before us does not include any alternative methodology for performing this estimate. The Commission's restatement of the NASUCA study does adjust the amount of support attributed to rural price cap study areas to reflect its other adjustments to the non-rural price cap portion of the NASUCA study, but does so proportionally to non-rural study areas as done in NASUCA's methodology. See Appendix A.

study, and \$978 million, as established by the IAD CALLS Study. As we have noted, identifying the amount of implicit support to be replaced by explicit universal service support is an imprecise task.<sup>124</sup> The court recognized, however, that the Commission does not need to determine “a precise amount as the only ‘correct’ figure.”<sup>125</sup> Rather, we must explain why, in our independent judgment, the \$650 million support amount is appropriate. Having determined that the \$650 million IAS amount proposed by the CALLS members is within the range of reasonable support amounts, we address whether there is any basis for concluding that a different support amount within the range would better balance the Commission’s goals. We conclude that the IAS amount proposed by the CALLS members as part of its integrated plan for reforming access charges reasonably and appropriately balances all of the Commission’s relevant policy goals.

31. We conclude that the \$650 million amount more appropriately balances the Commission’s goals than would a higher support amount. By conservatively setting the support amount at \$650 million, we ensure that a substantial portion of the gap between SLC revenues and allowable CMT revenues will be covered by support, while minimizing the risk that the support amount will be too large. The Commission will, at the end of the transitional period of reform adopted in the *CALLS Order*, consider permanent resolution of any remaining issues related to the price cap access rate structure. The amount of support in the IAS mechanism may then be adjusted upward or downward, as warranted by the Commission’s experience.<sup>126</sup> The Commission may, at that time, conclude that there are inefficiencies in embedded costs that the Commission may wish to discourage by excluding from IAS. Setting the IAS amount at the high end of the range at this time, however, may commit the Commission to providing universal service support for any inefficient embedded costs reflected in the price cap access rate structure in a manner that would be difficult to reverse. As several commenters note, adjusting the support amount upward at that time may be administratively easier than adjusting the amount downward.<sup>127</sup> Erring toward a conservative support amount—i.e., one that may not permit complete recovery through the universal service fund of the “gap” between SLC revenues and allowable CMT revenues—facilitates proper adjustments when the Commission further addresses interstate access reform for price cap carriers at the end of the transitional period. Moreover, because price cap carriers will retain the ability to recover their allowable CMT revenues through multi-line business PICCs and CCL charges, the consequences of setting the support amount slightly low are less problematic than the consequences of setting the support amount too high.

32. On the other hand, we conclude that a lower support amount than \$650 million would not permit price cap carriers to realize significant enough reductions to inefficient rate elements

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<sup>124</sup> *CALLS Order*, 15 FCC Rcd at 13046, para. 201.

<sup>125</sup> *TOPUC*, 265 F.3d at 328.

<sup>126</sup> See *Universal Service First Report and Order*, 12 FCC Rcd at 8929-30, paras. 281-82.

<sup>127</sup> *CALLS Comments*, Appendix Bt 2 (“By sizing universal service at the lower end of the range indicated by studies in the record . . . the Commission left itself greater latitude in later adjusting that level of support, if necessary, based upon the empirical experience gained during the five years that the size of universal service is to be fixed.”)

that contain implicit support, like the multi-line business PICC and the CCL charge.<sup>128</sup> For example, setting the support amount at \$593 million, as suggested by the restated NASUCA study, would leave an additional \$57 million, or approximately 17 percent, in those inefficient, implicit-support-containing rate elements in the final year of the transitional plan.<sup>129</sup> Thus, the \$650 million support amount encourages efficient investment in rural America and allows price cap carriers to recover their permitted revenues while making significant reductions to inefficient rate elements.

33. Based on the foregoing considerations, the record does not indicate that another support amount would better serve the Commission's policy goals. We also note that the CALLS members proposed a \$650 million support amount as part of their integrated proposal for resolving several interrelated and difficult issues associated with access charge reform. The \$650 million support amount reflects the CALLS plan's comprehensive approach to resolving a number of complicated and interrelated issues. The rules governing the distribution of the IAS reflect the proposed \$650 million support amount, and adjusting the amount may have unexpected ramifications with respect to the distribution method. For example, the distribution method was designed to promote competition by creating additional incentives for price cap carriers to deaverage their UNE rates.<sup>130</sup> As the Commission noted in the *CALLS Order*, the fact that both net payers and net recipients of universal service support agreed to the \$650 million amount as members of CALLS also indicates strongly that the CALLS plan appropriately balanced the various and divergent interests implicated in access charge reform. The \$650 million IAS mechanism, in concert with other reforms to the interstate access rate structure adopted in the *CALLS Order*, has resulted in the \$2.6 billion reduction in recovery of common line costs through inefficient rate elements that contain implicit universal service support.<sup>131</sup> Thus, the \$650 million amount is part of a "single, cohesive" transitional plan for accommodating the Act's universal service goals with the development of fuller, more rational competition. For all of these reasons, we conclude that the record in this proceeding supports the Commission's decision to size the IAS mechanism at \$650 million.

<sup>128</sup> As noted above, allowable CMT revenues that cannot be recovered through SLCs and IAS will be recovered through multi-line business PICCs and CCL charges, which are inefficient and contain implicit support. See para. 14, *supra*. Reducing the size of the IAS mechanism will create a dollar-for-dollar increase in recovery from multi-line PICCs and CCL charges.

<sup>129</sup> Setting the support amount at \$336 million, as proposed by NASUCA, would leave an additional \$214 million, or 65 percent, in the inefficient rate elements.

<sup>130</sup> See *CALLS Order*, 15 FCC Rcd at 13049 para. 206.

<sup>131</sup> From July 1, 1999, to June 30, 2000, prior to the *CALLS Order's* effect, price cap carriers recovered \$2.7 billion through PICCs, see IAD CALLS Study, Chart 2, and an estimated \$688 million through CCL charges. See Trends in Telephone Service, Industry Analysis Division, September 1999, at Table 1.4; Trends in Telephone Service, Industry Analysis Division, March 2000, at Table 1.4; Trends in Telephone Service, Industry Analysis Division, December 2000, at Table 1.4. From July 1, 2000, to June 30, 2001, after the *CALLS Order* became effective, price cap carriers recovered \$670 million through PICCs and \$133 million through CCL charges. See generally Tariff Review Plans.

## B. The Commission's Selection of a 6.5 Percent X-Factor

34. In its review of the *CALLS Order*, the court remanded to the Commission for further explanation the selection of the 6.5 percent X-factor by which price cap LECs' rates are reduced.<sup>132</sup> The 6.5 percent X-factor in the *CALLS Order* applied to price cap LECs' switched access rates and served as a transitional mechanism to reduce switched access rates to specified target rate levels.<sup>133</sup>

### 1. Background

35. The X-Factor Prior to the *CALLS Order*. When the Commission first established price cap regulation in 1990, it included a productivity offset in the price cap formula that was meant to represent the amount by which LEC productivity exceeded that of the economy as a whole.<sup>134</sup> This productivity offset became known as the "X-factor" and was applied to reduce the rates in each of the service groups, or "price cap baskets," of the price cap LECs.<sup>135</sup> The productivity factor initially adopted in the *LEC Price Cap Order* included a component based on historical LEC productivity, and an additional productivity obligation of 0.5 percent as a consumer productivity dividend (CPD) to ensure that consumers shared in the anticipated productivity gains in the form of lower rates.<sup>136</sup> The Commission prescribed two productivity factors: a minimum 3.3 percent factor and an optional 4.3 percent factor.<sup>137</sup> Price cap LECs that opted to use the higher 4.3 percent productivity factor were allowed to retain larger shares of their earnings.<sup>138</sup> Pursuant to the *LEC Price Cap Order*, the Commission performed periodic

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<sup>132</sup> See *TOPUC*, 265 F.3d at 328-29. The Commission's 6.5 percent X-factor was applied to reduce price cap LECs' switched access rates. The Commission also adopted a separate X-factor to reduce price cap LECs' special access rates. At the time the *CALLS Order* was adopted and the petitioners sought court review of the order, the X-factor was 3 percent for the special access rates. The petitioners did not challenge, nor does it appear that the court addressed, the X-factor for special access service. We therefore restrict our discussion to the X-factor applicable to switched access service.

<sup>133</sup> See *CALLS Order*, 15 FCC Rcd at 13020-21, para. 140.

<sup>134</sup> See *LEC Price Cap Order*, 5 FCC Rcd at 6796, para. 74.

<sup>135</sup> The price cap baskets are broad groupings of LEC services. Each basket is subject to its own price cap. The Commission initially adopted four price cap baskets: (1) common line services; (2) traffic sensitive services; (3) special access services; and (4) interexchange services. The Commission applied a separate, lower productivity factor of 3 percent to the interexchange services basket because its evaluation of LEC productivity included only interstate access activity; therefore, the record did not support a higher productivity factor for LEC interexchange services. See *LEC Price Cap Order*, 5 FCC Rcd at 6811, paras. 200-201, 206. In 1994 the Commission removed transport services from the traffic sensitive basket and combined them with special access services to create a new trunking basket. See *Transport Rate Structure and Pricing*, CC Docket No. 91-213, Second Report and Order, 9 FCC Rcd 615, 622, para. 12 (1994).

<sup>136</sup> See *LEC Price Cap Order*, 5 FCC Rcd at 6796, paras. 74-75.

<sup>137</sup> See *LEC Price Cap Order*, 5 FCC Rcd at 6787, 6796, paras. 5, 74.

<sup>138</sup> Initially, price cap LECs were required to share a portion of their earnings in excess of specified rates of return with their access customers by temporarily reducing the price cap ceiling in a subsequent period. The price cap (continued....)

reviews of the price cap regime.<sup>139</sup> After the first performance review in 1995, the Commission found that the initial productivity factor was too low, and increased the minimum productivity factor from 3.3 percent to 4.0 percent.<sup>140</sup> The Commission also provided two optional productivity factors of 4.7 and 5.3 percent.<sup>141</sup> In the next price cap performance review in 1997, the Commission increased the productivity factor to 6.5 percent for all price cap LECs.<sup>142</sup> This productivity factor prescription primarily relied on a staff study of the historical rate of growth in LEC total factor productivity (TFP).<sup>143</sup>

36. Several entities filed petitions for review of the *1997 Price Cap Review Order* with the United States Court of Appeals for the D.C. Circuit. In *USTA v. FCC*, the court reversed and remanded for further explanation the Commission's prescription of a 6.5 percent productivity factor, although it affirmed the order against the petitioners' remaining challenges.<sup>144</sup> The court rejected the Commission's stated rationales for selecting 6.0 as the historical component of the productivity factor, and sought further explanation of the Commission's choice of a 0.5 percent CPD component.<sup>145</sup> The court withheld issuance of its mandate, pending the Commission's reconsideration of the productivity factor, through June 30, 2000.<sup>146</sup>

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sharing requirement established three sharing zones determined by specified rate-of-return levels. In the first "no sharing zone," price cap LECs were allowed to keep all of their earnings up to the first rate-of-return ceiling. Above that ceiling, in the "50-50 sharing zone," price cap LECs were entitled to retain 50 percent of their earnings and were required to return 50 percent of their earnings to ratepayers up to the second ceiling. Price cap LECs were required to return 100 percent of any earnings above the "50-50 sharing zone" ceiling to ratepayers. See *LEC Price Cap Order*, 5 FCC Rcd at 6801-02, paras. 122-26.

<sup>139</sup> See *LEC Price Cap Order*, 5 FCC Rcd at 6789, para. 20.

<sup>140</sup> See *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9053-54, para. 209 (1995) (*1995 Price Cap Review Order*).

<sup>141</sup> See *1995 Price Cap Review Order*, 10 FCC Rcd 8961 at 9055-56, paras. 213-15. No sharing obligations were imposed on LECs that chose the highest productivity factor of 5.3 percent. See *id.* at 9057-58, paras. 220-22.

<sup>142</sup> See *Price Cap Performance Review for Local Exchange Carriers*, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642, 16645, para. 1 (1997) (*1997 Price Cap Review Order*). The Commission also eliminated the sharing requirements. *Id.*

<sup>143</sup> See *1997 Price Cap Review Order*, 12 FCC Rcd at 16645, 16693-98, paras. 1, 133-43. TFP measurement is a methodology commonly used to measure productivity and productivity growth in the economy as a whole. Productivity is measured as the ratio of an index of the outputs of a firm (or industry, or nation) to an index of its inputs. Productivity growth is measured by changes in this ratio over time. The 1997 staff TFP study calculated the historical difference in productivity growth between LECs and the economy nationwide for the period 1986 through 1995. Specifically, it calculated the differential reflecting the difference in the rate of change of LEC input prices as compared with the economy as a whole. These two factors were then added together for each year. *Id.* at 16696, para. 138.

<sup>144</sup> See *USTA v. FCC*, 188 F.3d 521, 530 (D.C. Cir. 1999) (*USTA*).

<sup>145</sup> See *USTA*, 188 F.3d at 525-28.

<sup>146</sup> See *USTA v. FCC*, Order, No. 97-1469 *et al.* (D.C. Cir. June 21, 1999); *USTA v. FCC*, Order, No. 97-1469 *et al.* (continued....)

37. The CALLS Order X-Factor. On May 31, 2000, the Commission reformed its price cap regulation regime in the *CALLS Order*.<sup>147</sup> The rulemaking leading to adoption of the *CALLS Order* was initiated by the Commission in response to a proposal put forth by CALLS.<sup>148</sup> Among other things, this proposal changed the price cap basket structure by separating trunking services and special access services into two separate baskets.<sup>149</sup> The Commission adopted CALLS' proposal to reduce the rates for the traffic sensitive switched access services and transport services baskets to specified average traffic sensitive (ATS) target rates.<sup>150</sup> CALLS proposed that price cap LECs would reduce their ATS rates over time by applying an annual reduction of 6.5 percent until the target rates are reached.<sup>151</sup> This transitional mechanism was called an "X-factor," although the Commission made clear that it was not tied to productivity, but was merely meant to reduce rates to the target levels at a reasonable pace over the course of the five-year period of the *CALLS* proposal.<sup>152</sup> The Commission stated, "During the five-year term of the *CALLS* Proposal, the X-factor as adopted herein will not be a productivity factor as it has been in past price cap formulas. Instead, the X-factor is now a transitional mechanism to lower access charges to target rates for switched access . . . ."<sup>153</sup>

38. Court Decision. In challenging the *CALLS Order* before the United States Court of Appeals for the Fifth Circuit, petitioner NASUCA raised several issues regarding the 6.5 percent X-factor. First, NASUCA argued that the D.C. Circuit previously had rejected use of a 6.5 percent X-factor in *USTA v. FCC*.<sup>154</sup> Second, NASUCA argued against the targeting of the 6.5 percent reductions to the ATS rates (i.e., switched access usage rates) as opposed to applying them to local loop rates (the CMT elements).<sup>155</sup> Third, NASUCA argued that the X-factor reduction should not be set equal to inflation after the target rates are reached.<sup>156</sup> In its decision,

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*at.* (D.C. Cir. Apr. 13, 2000).

<sup>147</sup> See generally *CALLS Order*, 15 FCC Rcd 12962.

<sup>148</sup> CALLS consisted of several price cap LECs and IXCs. See note 2, *supra*.

<sup>149</sup> See *CALLS Order*, 15 FCC Rcd at 13021, 13025, paras. 141, 149; 47 C.F.R. § 61.42(3), (5). After the *CALLS Order*, there are five price cap baskets for: (1) common line, marketing and transport interconnection charge (CMT) elements; (2) traffic sensitive switched interstate access elements; (3) trunking services; (4) interexchange services; and (5) special access services.

<sup>150</sup> The target rates are \$0.0055 for regional Bell Operating Companies; \$0.0095 for very low-density price cap LECs, and \$0.0065 for other price cap LECs. See *CALLS Order*, 15 FCC Rcd at 13021-22, para. 142; 47 C.F.R. § 61.3(qq).

<sup>151</sup> See *CALLS Order*, 15 FCC Rcd at 13020-21, para. 140.

<sup>152</sup> See *CALLS Order*, 15 FCC Rcd at 13028, para. 160.

<sup>153</sup> See *CALLS Order*, 15 FCC Rcd at 13028, para. 160.

<sup>154</sup> See Initial Brief for Petitioner National Association of Regulatory Utility Consumer Advocates (NASUCA), 5<sup>th</sup> Cir. Case No. 00-60434 at 56 (filed Sept. 20, 2000) (NASUCA Initial Brief).

<sup>155</sup> See NASUCA Initial Brief at 56. See also note 40, *supra* (defining CMT revenue).

the court remanded to the Commission only the issue of the selection of the 6.5 percent X-factor.<sup>157</sup>

## 2. Discussion

39. In its decision, the court affirmed several important components of the Commission's *CALLS Order*. Specifically, the court upheld the Commission's authority to set access charge rates that are not based on forward-looking cost, so long as they are just, reasonable and nondiscriminatory as required by sections 201(b) and 202(a) of the Communications Act, thus leaving intact the Commission's adoption of the target ATS rates.<sup>158</sup> The court also left intact the Commission's decision to target the X-factor's reductions to switched access services as opposed to common line services, and to adjust the X-factor to the rate of inflation after the ATS target rates are met. Finally, the court did not find unreasonable the Commission's use of the X-factor as a transitional mechanism for reducing rates, as opposed to a productivity factor.<sup>159</sup> The only issue related to the X-factor remanded by the court for further explanation was the Commission's basis for picking the precise figure of 6.5 percent as the transitional X-factor.<sup>160</sup>

40. Using 6.5 percent as a transitional X-factor was the Commission's reasoned approach to reconciling the competing goals of moving traffic-sensitive access charges closer to cost-based rates while avoiding a flash cut.<sup>161</sup> The Commission wanted to ensure that ATS rates reached the target levels within a reasonable period of time to ensure that consumers reaped the benefits of the *CALLS Order* as soon as possible. Some commenters, however, argued that the Commission should avoid a flash cut of access-charge rates, which could harm competition.<sup>162</sup> Moreover, the Commission previously has held that flash cuts in access rates should be avoided to provide LECs, IXCs, and end users time to adjust to changes in rate structures.<sup>163</sup> Thus, the Commission

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<sup>158</sup> See NASUCA Initial Brief at 56. In the *CALLS Order*, the Commission found that, once a price cap LEC reached the applicable ATS target rate, the 6.5 percent reduction factor would be set to equal inflation, which, under the price cap formula for these services, essentially would freeze the price caps for services in the traffic sensitive switched access and trunking services baskets. See *CALLS Order*, 15 FCC Rcd at 13022, 13029, paras. 144, 163.

<sup>157</sup> See *TOPUC*, 265 F.3d at 329.

<sup>158</sup> See *TOPUC*, 265 F.3d at 324; 47 U.S.C. §§ 201(b), 202(a).

<sup>159</sup> Indeed, the court explicitly recognized that the X-factor "is no longer tethered to any productivity measure." *TOPUC*, 265 F.3d at 329.

<sup>160</sup> See *TOPUC*, 265 F.3d at 329.

<sup>161</sup> See *CALLS Order*, 15 FCC Rcd at 13036-37, paras. 178-179.

<sup>162</sup> See Letter from Donald F. Shephard, Vice President Federal Regulatory Affairs & Policy, Time Warner Telecom, to Magalie R. Salas, Secretary, FCC, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45 (May 8, 2000).

<sup>163</sup> See *Access Charge Reform First Report and Order*, 12 FCC Rcd at 15987, 16083, paras. 9, 234 (adopting a gradual, market-based approach, rather than a flash cut, in eliminating implicit subsidies in interstate access charges and in migrating usage-based charges into flat-rated charges). Cf. *Access Charge Reform*, CC Docket No. 96-262, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923, 9937, para. 37 (2001) (declining to flash cut competitive LEC access rates to the level of the competing incumbent LEC and finding that a (continued....))

adopted a transitional X-factor to reduce ATS rates, in order to avoid the harms associated with a flash cut.

41. Having rejected an immediate reduction to target levels, the Commission then had to determine the most reasonable X-factor to apply. In doing so, it was necessary for the Commission to consider a number of criteria: which factor would work best for the broadest range of carriers; which factor could be most easily understood and implemented; and which factor was best supported by record evidence submitted by all parties. The 6.5 percent X-factor best fit these criteria, and was thus the most reasonable choice for the Commission to make. The 6.5 percent X-factor had been in place, although subject to a remand order, since 1997. Indeed, commenters in the *CALLS Order* proceeding did not propose any amount other than 6.5 percent for the transitional X-factor.<sup>164</sup> The Commission determined that the transitional mechanism, featuring a 6.5 percent X-factor, would achieve the goal of reducing rates over a reasonable time period, without reducing rates too quickly so as to harm LECs. The Commission was able to rely on the fact that the 6.5 percent transitional X-factor was proposed by CALLS, a group that included both price cap LECs and IXCs, as evidence that it reduced rates at a reasonable pace, i.e., not too quickly so as to harm LECs, but fast enough that the benefits of the rate reductions would flow to IXCs and their end-user customers in a timely manner.

42. The court has recognized the legitimacy of the Commission's reliance on its expertise in setting rates.<sup>165</sup> In *NARUC*, the court upheld the Commission's development of a \$25 private line surcharge, even though this charge was "an estimate based upon assumptions drawn from the collective experience of the Commission."<sup>166</sup> The record was inadequate to allow the Commission to derive a more precise rate; therefore the court found that it was reasonable for the Commission to rely on its expertise in setting the rate.<sup>167</sup> In the case of the 6.5 percent X-factor, the record did not provide any number other than 6.5 percent as the transitional mechanism. No party argued that 6.5 percent was an unreasonable number for the Commission to use as a transitional mechanism. Furthermore, the Commission had experience with using a 6.5 percent X-factor previously. It was therefore familiar with the types of reductions that could be expected from using this number, as opposed to some other number that no party had proposed, and that had not been used previously to reduce rates. As discussed above, the Commission relied on its expertise in determining that the 6.5 percent X-factor would achieve the policy goals of reducing ATS rates to target levels in a timely manner that would not harm LECs.

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gradual transition is more appropriate).

<sup>164</sup> ALTS/Time Warner submitted a proposal to use the 6.5 percent transitional X-factor, but to target 50 percent of the X-factor to ATS rates and 50 percent to CMT rates. See Joint Comments of the Association for Local Telecommunications Services and Time Warner Telecom, CC Docket Nos. 96-262, 94-1, 99-249, 96-45 at 16 (filed Apr. 3, 2000).

<sup>165</sup> See *Nat'l Ass'n of Regulatory Comm'rs v. FCC*, 737 F.2d 1095 (D.C. Cir. 1984) (*NARUC*).

<sup>166</sup> *NARUC*, 737 F.2d at 1139.

<sup>167</sup> *NARUC*, 737 F.2d at 1140.

43. Before adoption of the *CALLS Order* in 2000, Commission staff analyzed the potential effects of adopting the *CALLS* plan when compared to the access charge regulations in existence at the time.<sup>168</sup> In that analysis, IAD predicted when price cap carriers would reach their target rates using a 6.5 percent X-factor.<sup>169</sup> According to the IAD *CALLS* Study, carriers representing the following percentages of total access lines would reach their target rates: 6 percent in 2000; another 42 percent for a total of 48 percent in 2001; another 26 percent for a total of 74 percent in 2002; and another 22 percent for a total of 96 percent in 2003.<sup>170</sup> The application of the 6.5 percent X-factor has yielded results strikingly similar to those predicted by IAD in 2000. Price cap LEC companies that met their target ATS rates immediately upon filing their 2000 annual access filings represent approximately 58 million access lines, or 36 percent of the approximately 163 million total access lines.<sup>171</sup> In 2001, companies representing another 39 percent met their ATS target rates, for a total of 75 percent.<sup>172</sup> In 2002, companies representing another 21 percent met their ATS target rates, for a total of 96 percent.<sup>173</sup> There are only approximately 6 million lines, or 4 percent of the total, served by price cap LEC companies that have not yet met their target ATS rates.<sup>174</sup> These companies will continue to apply the 6.5 percent transitional X-factor to reduce their ATS rates. We note that companies representing approximately 3 million access lines were very close to meeting their ATS target rates in their 2002 annual access filings, and it is likely that these companies will meet the target rates in their 2003 access filing.<sup>175</sup> Therefore, we expect that, after the 2003 access filing, price cap LECs that have not reached their ATS target rates will represent fewer than 3 million lines, or 2 percent of total access lines, with companies representing 98 percent at their target rates. Actual application of the 6.5 percent X-factor generally followed Commission staff's predictions on when companies would reach their target rates, establishing a timely transition path and bringing benefits to consumers in a timely manner.

44. Application of a significantly different X-factor would have had very different consequences.<sup>176</sup> A higher X-factor would have reduced the price cap companies' ATS rates to

<sup>168</sup> See IAD *CALLS* Study.

<sup>169</sup> IAD *CALLS* Study at App. E.

<sup>170</sup> IAD *CALLS* Study at App. E. Approximate line counts from the carriers' 2002 annual access filings were used to determine the percentage of total access lines at the target levels in each year of the IAD *CALLS* Study.

<sup>171</sup> See Appendix B. Approximate access line counts for the price cap LEC companies are based on the 2002 annual access filings.

<sup>172</sup> See Appendix B.

<sup>173</sup> See Appendix B.

<sup>174</sup> See Appendix B.

<sup>175</sup> See Appendix B. For purposes of this analysis, we expect that companies with 2002 annual access tariff ATS rates less than \$0.001 above their target rates are likely to reach the ATS target rates in their 2003 annual access tariff filings.

<sup>176</sup> An X-factor slightly higher or lower than 6.5 percent, however, would not have had much impact on the (continued....)

the target levels at a faster rate, thereby possibly harming those smaller price cap companies that have not yet met the target rates. A lower X-factor would have reduced price cap companies' ATS rates to the target levels at a slower rate; therefore, IXCs and their end-user customers would not have received the benefits of these lower rates in as timely a manner. The Commission relied on the record before it and its expertise in selecting a 6.5 percent X-factor in 2000, and this X-factor has achieved the Commission's policy goals of reducing ATS rates in a timely manner without harming price cap companies by cutting rates too quickly.

45. The Commission's selection of a 6.5 percent X-factor as a transitional mechanism for moving to ATS target rates was based on the record before it. Indeed, the Commission was without a reasoned basis for selecting an alternative, transitional X-factor. The Commission's selection of a 6.5 percent X-factor in 2000 will bring ATS access charges to the target levels for price cap LECs representing at least 98 percent of total price cap access lines after the July 2003 annual access filing. This percentage represents reasonable levels of lines reaching the ATS target rates during the third and fourth years of the five-year CALLS proposal. The benefits of lower access charges are being provided to consumers in a timely manner as envisioned by the Commission in the *CALLS Order*. The remaining carriers continue to move toward the target rates in a manner that provides meaningful consumer benefits, while avoiding the kind of dramatic rate cut that, as the Commission previously discussed, could harm LECs. Although 6.5 percent is not the only possible transitional mechanism that the Commission could have adopted, for the reasons articulated above, it represents a reasonable exercise of the Commission's discretion in setting rates.

#### IV. PROCEDURAL MATTERS

##### A. Supplemental Final Regulatory Flexibility Certification

46. The Regulatory Flexibility Act of 1980, as amended (RFA)<sup>177</sup> requires that a regulatory flexibility analysis be prepared for rulemaking proceedings, unless the agency certifies that "the rule will not have a significant economic impact on a substantial number of small entities."<sup>178</sup> The RFA generally defines "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."<sup>179</sup> In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.<sup>180</sup> A small business concern is one which: (1) is independently owned and  
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timetable. Most carriers would have reached their target ATS rates on the same time schedule in that case.

<sup>177</sup> The RFA, *see* § 5 U.S.C. S 601 *et. seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

<sup>178</sup> 5 U.S.C. § 605(b).

<sup>179</sup> 5 U.S.C. § 601(6).

<sup>180</sup> 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in Small Business Act, 15 U.S.C. S § 632).

operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).<sup>181</sup>

47. On May 31, 2000, the Commission adopted the *CALLS Order*, which reformed the interstate access rate structure and created a new universal service mechanism, Interstate Access Support (IAS), for price cap carriers.<sup>182</sup> On September 10, 2001, the *Fifth Circuit* affirmed the *CALLS Order* in most respects, but remanded for further analysis and explanation the decisions to size the IAS mechanism at \$650 million and to adopt the 6.5 percent X-factor.<sup>183</sup> Specifically, with respect to the \$650 million size of the IAS mechanism, the court concluded that, while identifying a specific amount of support is an imprecise exercise, the Commission must better explain how it arrived at the \$650 million amount.<sup>184</sup> Similarly, the court found that the Commission must demonstrate a rational basis for its derivation of the 6.5 percent X-factor.<sup>185</sup>

48. In this Order on Remand, we provide further analysis and explanation as required by the court, but do not adopt any changes to the Commission's prior decisions. With respect to the \$650 million IAS mechanism, we examine each of the studies in the record to determine the range of reasonable estimates of implicit support to be replaced by explicit support,<sup>186</sup> and then explain why, in our independent judgment, \$650 million is the most appropriate amount of implicit support within this range to replace with explicit support.<sup>187</sup> Specifically, we conclude that by conservatively setting the support amount at \$650 million, we ensure that a substantial portion of the gap between SLC revenues and allowable CMT revenues will be covered by support, while minimizing the risk that the support amount will be too large. We also further explain the Commission's reasoned approach in the *CALLS Order* in adopting the transitional 6.5 percent X-factor as a means of achieving reductions in traffic-sensitive rates while avoiding a flash out in access rates that could harm competition.<sup>188</sup> Specifically the Commission considered all relevant criteria, include which factor would work best for the broadest range of carriers; which factor could be most easily understood and implemented; and which factor was best supported by record evidence submitted by all parties. The 6.5 percent X-factor best fit these criteria, and was thus the most reasonable choice for the Commission to make. Because this Order on Remand does not change either \$650 million IAS mechanism or the 6.5 percent X-factor, no economic impact of any kind result from our action. Therefore, we certify that this Order on Remand will not have a significant economic impact on a substantial number of small

<sup>181</sup> Small Business Act, § 15 U.S.C. S 632.

<sup>182</sup> *CALLS Order*, 15 FCC Rcd 12962; *see id.* at 13071-76 paras. 251-63 (Final Regulatory Flexibility Analysis).

<sup>183</sup> *TOPUC*, 265 F.3d at 317.

<sup>184</sup> *Id.* at 328; *see also* para. 17, *infra*.

<sup>185</sup> *TOPUC*, 265 F.3d at 328-29; *see also* para. 38, *infra*.

<sup>186</sup> *See supra* paras. 20-29.

<sup>187</sup> *See supra* paras. 30-33.

<sup>188</sup> *See supra* paras. 39-45.

entities.

49. The Commission will send a copy of this Order on Remand, including a copy of this supplemental certification, in a report to Congress pursuant to the Congressional Review Act.<sup>189</sup> In addition, this Order on Reconsideration and supplemental final certification will be sent to the Chief Counsel for Advocacy of the Small Business Administration, and will be published in the Federal Register.<sup>190</sup>

#### B. Paperwork Reduction Act Analysis

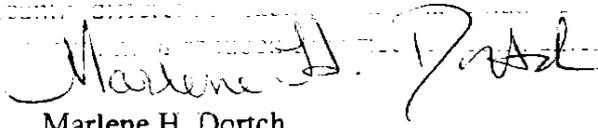
50. The decision herein has been analyzed with respect to the Paperwork Reduction Act of 1995, Pub. L. 104-13, and found to impose no new or modified reporting and/or recordkeeping requirements or burdens on the public.

#### V. ORDERING CLAUSES

51. IT IS ORDERED, pursuant to sections 1, 4(i) and (j), 201-209, 218-222, 254, and 403 of the Communications Act, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-209, 218-222, 254, and 403, that this Order IS HEREBY ADOPTED as described above.

52. IT IS FURTHER ORDERED that the Commission's Consumer Information Bureau, Reference Information Center, SHALL SEND a copy of this Order on Remand, including the Supplemental Final Regulatory Flexibility Certification, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

  
Marlene H. Dortch  
Secretary

<sup>189</sup> See 5 U.S.C. § 801(a)(1)(A).

<sup>190</sup> See 5 U.S.C. § 605(b).

## Appendix A

### FCC Staff Restatement Analysis of NASUCA Forward-Looking Cost Model

#### Introduction

NASUCA filed reply comments in this proceeding describing a forward-looking cost study which indicated that the Interstate Access Support (IAS) mechanism adopted in the *CALLS Order* would be appropriately sized at \$629 million if SLCs were capped at \$5.00 and \$336 million if SLCs were capped at \$6.50. On May 29, 2002, NASUCA filed ex parte letters further detailing its study. As discussed in the Order, the Commission concludes that the NASUCA study should be restated to eliminate certain assumptions.<sup>1</sup> The following sets forth the Commission staff's restatement analysis of NASUCA's study.

#### Restatement

##### 1. NASUCA's Assumptions Related to Structure Sharing and Traffic-Sensitive Costs

In its study (or "preferred scenario"), NASUCA makes certain changes to the Commission's Synthesis model in order to permit structure sharing between the feeder and distribution networks and to remove loop costs that it considers to be traffic-sensitive in nature. In order to estimate the amount of support using NASUCA's methodology, but without relying on these assumptions, Commission staff referred to the results of the "default scenario" submitted by NASUCA in the Cost Review proceeding.<sup>2</sup> This default scenario produces forward-looking costs that do not rely on NASUCA's changed assumptions.<sup>3</sup> Using these costs in NASUCA's methodology increases the estimate support from \$336 million to \$516 million, as shown in Table 1 below.

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<sup>1</sup> See para. 29, *supra*.

<sup>2</sup> In the SLC Cost Review Proceeding, NASUCA submitted several studies describing different model outputs resulting from different "scenarios," or sets of assumptions factored into the model. NASUCA Comments in CC Docket Nos. 96-262, 94-1, and 96-45 (filed January 24, 2002). These scenarios included the "default scenario," which utilized the Commission's model without changes and the scenario which herein is referred to at the "NASUCA preferred scenario," which make changes to the Commission's model consistent with NASUCA's arguments that certain costs should be removed from the model. NASUCA submitted these studies in Excel format, calling the file containing the default scenario "wc\_cost" and calling the file contained its preferred scenario "wc\_cost\_dlcfs."

<sup>3</sup> NASUCA's default scenario does include changed assumptions regarding the attribution of corporate overhead costs to the loop as compared to previous Commission uses of the Synthesis model. See para. 28, *supra*. Commission staff has not estimated the impact of this change by NASUCA.

Table 1.

<u>NASUCA Preferred Scenario</u>	(in millions)	Source
<b>NASUCA Preferred Scenario at \$5.00 SLC Cap</b>		
76 price cap, non-rural study areas with UNE Zones	\$472	L1=NASUCA Preferred Scenario
Additional 105 study areas	\$157	L2=USAC data
Total	\$629	L3=L1+L2
<b>NASUCA Preferred Scenario at \$6.50 SLC Cap</b>		
76 price cap, non-rural study areas with UNE Zones	\$252	L4=NASUCA Preferred Scenario
NASUCA Factor	53.39%	L5=L4 / L1
Additional 105 study areas	\$84	L6=L2 x L5
Total	\$336	L7 = L4+L5
<b><u>FCC Staff Analysis of NASUCA Study</u></b>		
<b>NASUCA Default Scenario at \$5.00 SLC Cap</b>		
76 price cap, non-rural study areas with UNE Zones	\$685	L1=NASUCA Default Scenario
Additional 105 study areas	\$157	L2=USAC data
Total	\$842	L3=L1+L2
<b>NASUCA Default Scenario at \$6.50 SLC Cap</b>		
76 price cap, non-rural study areas with UNE Zones	\$419	L4=NASUCA Default Scenario
NASUCA Factor Recomputed	61.17%	L5=L4 / L1
Additional 105 study areas	\$96	L6=L2 x L5
Total	\$516	L7 = L4+L5

As shown in Table 1, for the \$5.00 SLC cap, the NASUCA preferred scenario calculates a forward-looking support amount of \$472 M, to which is added another \$157 M of support for 105 study areas not included in the model. For the \$6.50 SLC cap, the NASUCA preferred scenario calculates a forward-looking support amount of \$252 M, to which is added another \$84 M of support for 105 study areas not included in the model. The \$84 M is derived using a

NASUCA factor, more fully explained in NASUCA pleadings.<sup>4</sup> A total of \$336 M in support is calculated.

For the \$5.00 SLC cap, the NASUCA default scenario calculates a forward-looking support amount of \$685 M, to which is added another \$157 M of support for 105 study areas not included in the model. For the \$6.50 SLC cap, the NASUCA default scenario calculates a forward-looking support amount of \$419 M, to which is added another \$96 M of support for 105 study areas not included in the model. The \$96 M is derived using a modified NASUCA factor computed in the same manner as the original factor.<sup>5</sup> A total of \$516 M in support is calculated.

## 2. NASUCA's Exclusion of Multi-Line Business Lines

The NASUCA study also fails to include SLC revenues and costs for multi-line business (MLB) lines. To include these MLB lines in the NASUCA default scenario, Commission staff modified the worksheet (resbusbyzone) in wc\_cost so that the SLC revenues and costs are computed to include MLB lines.<sup>6</sup> This was accomplished in the following manner. The MLB lines are already displayed in a separate column in the same worksheet. The formulas in the columns labeled "SLC revenues" and "economic costs" were modified.

The SLC revenue formulas must be changed to reflect the relevant SLC caps. These SLC caps were obtained from publicly available CMT revenue per line data. For example, SWB-AK's CMT revenue per line = \$5.20, therefore SLC revenues at a \$5.00 residential and single line business cap =  $((\$5.20 * \text{MLB lines}) + \$5.00 * (\text{SLB lines} + \text{residential lines})) * 12$ . For another example, GTE NW-WA (Contel)'s CMT revenue per line is \$9.37, therefore SLC revenues at a \$6.50 residential and single-line business cap =  $[(9.37 * \text{MLB lines}) + \$6.50 * (\text{SLB lines} + \text{residential lines})) * 12$

The cost formulas in the column labeled "economic costs" were modified to include the MLB lines (i.e., economic cost = cost per line \* 12 \* (SLB lines + residential lines + MLB lines)). Once these changes are made, the spreadsheet performs the calculations for support amounts. The results are shown in Table 2.

<sup>4</sup> NASUCA Reply at 12.

<sup>5</sup> NASUCA Reply at 12.

<sup>6</sup> See note 2, *supra*.

Table 2.  
FCC Staff Analysis of NASUCA Study Including MLB Lines

(in millions)

Restated NASUCA Forward-Looking  
Support at \$5.00 SLC

76 price cap, non-rural with UNE Zones	\$712	L1= NASUCA default plus MLB
Additional 105 study areas	\$157	L2=USAC data
Total	\$869	L3=L1+L2

Restated NASUCA Forward-Looking  
Support at \$6.50 SLC

76 price cap, non-rural with UNE Zones	\$485	L4= NASUCA default plus MLB
NASUCA Factor Recomputed	68.12%	L5=L4 / L1
Additional 105 study areas	\$107	L6=L2 x L5
Total	\$593	L7 = L4+L5

For the \$5.00 SLC cap, the NASUCA default scenario including MLB calculates a support amount of \$712 M, to which is added another \$157 M of support for 105 study areas not included in the model. For the \$6.50 SLC cap, the NASUCA default scenario including MLB calculates a support amount of \$485 M, to which is added another \$107 M of support for 105 study areas not included in the model. The \$107 M is derived using a modified NASUCA factor computed in the same manner as the original factor.<sup>7</sup> A total of \$593 M in support is calculated.

### Results

Removing NASUCA's assumptions regarding traffic-sensitive costs and structure sharing from the NASUCA preferred scenario raises the amount of support from \$336 M to \$516 M. Including the MLB lines raises support from \$516 M to \$593 M.

<sup>7</sup> NASUCA Reply at 12.

## APPENDIX B

Companies Reaching ATS Target Rates in 2000 Annual Access Filing		
Company (TRP Name)	Date ATS Rate Reached*	Approximate Access Lines†
BellSouth (bstran)	8/1/2000	23,711,051
Cincinnati Bell (cbtcan)	6/16/2000	1,024,941
Citizens Group 4 (ctc4an)	8/17/2000	309,044
Iowa Telecommunications (coitan)	7/27/2000	166,290
Sprint Nevada (cenvan)	7/27/2000	879,230
Sprint North Carolina (ucncan)	7/27/2000	1,490,285
Sprint Southeast (ucsean)	7/27/2000	767,102
Valor Oklahoma (vaokan)	7/27/2000	121,454
Valor Texas (vctxan)	7/27/2000	142,348
Valor Texas (vatxan)	7/27/2000	175,610
Verizon Alabama (coaln)	7/27/2000	125,572
Verizon California (gtcaan)	7/27/2000	4,180,621
Verizon East – South (batran)*	7/27/2000	21,312,646
Verizon Florida (gtflan)	7/27/2000	2,302,687
Verizon Kentucky (cokyan)	7/27/2000	102,126
Verizon Missouri (gtmoan)	7/27/2000	95,715
Verizon Nevada (convan)	7/27/2000	38,685
Verizon North Carolina (concan)	7/27/2000	140,159
Verizon Pennsylvania (coptan)	7/27/2000	114,782
Verizon Pennsylvania (gtpaan)	7/27/2000	557,794
Verizon Virginia (covaan)	7/27/2000	596,299
Verizon Virginia (gtvaan)	7/27/2000	32,128
Total Lines*		58,391,579 (35% of total nationwide access lines)

\* The dates are based on those reported by the price cap companies at line 475 of the TGT-1 form in their 2002 annual access tariff review plan (TRP) filings.

† Approximate access line counts for the price cap LEC companies are based on these companies' 2002 annual access TRP filings, CAP-1 form, line 130. The line count information is annualized in the TRP filing. We have adjusted the annualized line count information to represent the average number of lines in use on a monthly basis. Based on the 2002 TRP filings, the price cap companies have approximately 163,372,660 monthly total lines.

\* As reported by Verizon in its April 10, 2003 *ex parte* filing, the former Bell Atlantic entity reached the ATS target rate in the 2000 annual filing. Line counts for the former Bell Atlantic entity are based on the 2002 annual access filing. Letter from Richard T. Ellis, Director - Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, Federal Communications Commission, CC Docket Nos. 96-262, 94-1, 99-249, and 96-45 (filed Apr. 10, 2003) (Verizon Apr. 10 *Ex Parte* Letter).



Companies Reaching ATS Target Rates in 2002 Annual Access Filing		
Company (TRP Name)	Date ATS Rate Reached <sup>†</sup>	Approximate Access Lines <sup>†</sup>
SWBT (swtran)	7/2/2002	14,490,907
Sprint Indiana (utinan)	7/2/2002	269,421
Sprint Midwest (utmwan)	7/2/2002	1,010,581
Verizon East – North (nxtran) <sup>‡</sup>	7/2/2002	16,423,404
Verizon Illinois (gailan)	7/2/2002	704,829
Verizon Kentucky (gtkyan)	7/2/2002	457,694
Verizon Michigan (gamian)	7/2/2002	795,676
Verizon Minnesota (comtan)	7/2/2002	255,338
Verizon Wisconsin (gtwian)	7/2/2002	400,562
Total Lines:		34,808,412 (21% of total nationwide access lines) (96% at target rates)

<sup>\*</sup> To determine which companies reached their target ATS rates in the 2002 annual access filing, we identified the companies that responded “No” at line 475 of the 2002 TRP form TGT-1, asking whether the ATS target rate was met in prior filings. We then compared these companies’ proposed ATS rates at line 1120 of the TGT-3 TRP form, with the original target ATS rate at line 470 of the TGT-1 TRP form. Those companies with a proposed ATS rate lower than the target ATS rate met the target as of the effective date of the 2002 annual access filing.

<sup>†</sup> Approximate access line counts for the price cap LEC companies are based on these companies’ 2002 annual access TRP filings, CAP-1 form, line 130. The line count information is annualized in the TRP filing. We have adjusted the annualized line count information to represent the average number of lines in use on a monthly basis. Based on the 2002 TRP filings, the price cap companies have approximately 163,372,660 monthly total lines.

<sup>‡</sup> As reported by Verizon in its April 10, 2003 *ex parte* filing, the former NYNEX entity reached the ATS target rate in the 2002 annual filing. Line counts for the former NYNEX entity are based on the 2002 annual access filing. Verizon Apr. 10 *Ex Parte* Letter.

Companies Not Yet at Their Target Rates		
Company (TRP Name)	Likely to Reach ATS Rate in 2003 Filing? <sup>‡</sup>	Approximate Access Lines <sup>†</sup>
Aliant (lmean)	No	278,372
Citizens Group 1 (ctc1an)	No	881,794
Citizens Group 2 (ctc2an)	No	142,834
Citizens Group 3 (ctc3an)	No	23,134
Frontier Minnesota & Iowa (vitcan)	Yes	202,657
Frontier Rochester Tier II (rtcsan)	No	267,188
Nevada Bell (ptnvan)	No	362,684
SNET (snctan)	Yes	2,164,403
Sprint Northwest (utnwan)	No	162,537
Sprint Ohio (utohan)	Yes	631,095
Verizon Arizona (coazan)	No	8,347
Verizon Hawaii (gthian)	No	709,498
Verizon Idaho (gtidan)	No <sup>*</sup>	136,322
Verizon Micronesia (gtmcan)	No	21,011
Total Lines:		5,991,876 (4% of total nationwide access lines)
Total Lines Likely to Reach ATS Target Rate in 2003:		2,998,155 (2% of total nationwide access lines) (98% at target rates after 2003 filing)

<sup>‡</sup> For purposes of this analysis, we expect that companies with 2002 annual access tariff ATS rates less than \$0.001 above their target rates are likely to reach the ATS target rates in their 2003 annual access tariff filings.

<sup>†</sup> Approximate access line counts for the price cap LEC companies are based on these companies' 2002 annual access TRP filings, CAP-1 form, line 130. The line count information is annualized in the TRP filing. We have adjusted the annualized line count information to represent the average number of lines in use on a monthly basis. Based on the 2002 TRP filings, the price cap companies have approximately 163,372,660 monthly total lines.

<sup>\*</sup> Although the Verizon Idaho entity's 2002 ATS rate is less than \$0.001 above its target rate, Verizon claims that it is not likely to reach the ATS target rate in the 2003 annual filing. Verizon Apr. 10 *Ex Parte* Letter.