Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers	)	**CC Docket No. 00-256**
	)	
Federal-State Joint Board on Universal Service	)	**CC Docket No. 96-45**
	)	

MCI COMMENTS

MCI, Inc. (MCI) hereby submits its comments on the Second Further Notice of Proposed Rulemaking (Notice) in the above-captioned docket.

In the Notice, the Commission seeks comment on proposals to transition rate of return LECs to a form of incentive regulation. Under the first proposal, submitted by Century Telephone, Inc., the Commission would establish a set of target rates, analogous to the existing target rates established for price cap LECs by the CALLS plan, that would be applicable to rate of return carriers that elected to convert to price cap regulation. To the extent that an incumbent LEC's existing ATS rates were above the target rate, LECs that reduced their ATS rates to the target rates could obtain additional universal service support, i.e., the "ATS additive."

The Century proposal provides a reasonable starting point for adapting the price cap rules for today's rate of return carriers. However, the Century proposal should not be adopted without certain modifications.

Mandatory Application of Price Cap Regulation

Most importantly, price cap regulation should be mandatory, at least for all rate of return LECs that either directly or though holding companies control 100,000 lines or more. Mandatory application of price cap regulation, at least to the larger holding companies that collectively operate the majority of rate of return lines, is essential because of the uncertainty surrounding the enforceability of rate of return regulation. Since the D.C. Circuit's decision in ACS v. FCC,[1] many rate of return carriers have taken the position that section 204(a)(3) of the Communications Act may preclude the award of damages even in those instances where the carrier has overearned, i.e., has violated its rate of return prescription. If those rate of return LECs' interpretation of section 204(a)(3) were to be confirmed, then rate of return regulation will have collapsed because the rate of return prescription would be unenforceable: rate of return carriers would apparently be able to retain all of their earnings, even if those earnings exceeded the amount permitted by the prescribed rate of return.

Mandatory application of price cap regulation to the larger holding companies is also necessary because of the growing risk of improper cost allocation by those companies. In recent years, the larger rate of return carriers have increasingly begun to operate in markets outside their core, regulated local exchange businesses, by providing Internet access services or operating as CLECs outside their service areas. In the absence of detailed scrutiny of rate of return carriers' books, there can be no assurance that the costs associated with those carriers' growing competitive operations are excluded from the reported revenue requirement.

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[1] ACS of Anchorage, Inc. v. FCC, 290 F.3d 403 (D.C. Cir. 2002).

Moreover, there is ample evidence that larger holding companies can operate successfully under price cap regulation, even when those lines are spread across several study areas or the study areas qualify as "rural." Both Valor, which controls approximately 550,000 access lines spread across four states,[2] and Iowa Telecom, which controls 285,000 access lines,[3] voluntarily elected price cap regulation in 2000. And Citizens, which operates many rural study areas, has operated successfully under price cap regulation for several years. These companies' experience shows that larger holding companies such as CenturyTel, which controls 2.4 million access lines,[4] ALLTEL, which controls 3.1 million access lines,[5] and TDS, which controls over 700,000 access lines,[6] could achieve increased productivity and operate successfully under an incentive regulation scheme.

The Commission should not adopt Century's proposal for study area-by-study area elections. Not only is mandatory application of price cap regulation to the larger holding companies essential because of concerns over the implications of section 204(a)(3), but study area-by-study area elections are unnecessary in light of the economies of scale and scope available to the larger holding companies. Even assuming that price cap regulation were inappropriate for certain study areas if operated on a standalone basis, concerns about "lumpy" investment patterns or variability in demand are much less relevant when those same study areas are operated as part of a large holding company. Furthermore, study area-by-study area election raises additional concerns about cost shifting. Even relatively small shifts in the allocators used to

[2] Valor Comments, CC Docket No. 96-45, February 4, 2002.
[3] Iowa Telecom Comments, CC Docket No. 96-98, May 9, 2001.
[4] CenturyTel Form 3Q2003 Form 10-Q
[5] ALLTEL 3Q2003 Form 10-Q.

distribute holding company-level costs among the various LECs can cause significant changes in the revenue requirement (and rates) charged by any LECs that the holding company elects to leave under rate of return regulation.

If the Commission does permit study area-by-study area election, which it should not, the Commission should place limits on carriers' ability to elect rate of return status. For example, the Commission should place strict limits on the types of study areas that may be left under rate of return regulation, e.g., those with extremely low line density or line count, and should in addition cap the percentage of a holding company's lines that may be left under rate of return regulation, e.g., to no more than 5 percent of a holding company's lines. By limiting the number of study areas that may be left under rate of return regulation, the Commission could more readily determine in the short 15-day interval available for tariff review whether the holding company was attempting to shift costs to those study areas.

Furthermore, the rate of return option should only be available for a limited time. For example, the Commission could require the rate of return study areas to convert to incentive regulation within three years; this approach would allow the holding companies sufficient time to prepare those study areas for price cap regulation.

X-Factor and Sharing

Although the Century proposal does not specifically address the X-factor applicable to special access services, it appears that Century's intent is that the X-factor applicable to special access services would also be set equal to GDP-PI, i.e., effectively freezing special access rates at current levels. That approach would yield a significant windfall for any rate of return carrier converting to price cap regulation. Due to the

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[6] TDS 3Q2003 Form 10-Q.

steady growth in demand for special access circuits, rate of return carriers have been seeing declines in excess of GDP-PI in the per-unit cost of providing special access services. Those cost declines should continue to be passed through to customers after the adoption of incentive regulation through the application of a 6.5 percent X-factor.

The Commission should also adopt a sharing mechanism, at least for an initial transition period. Because the Commission cannot be certain that the X-factors selected in this proceeding are accurate for current rate of return LECs generally or for individual LECs, the Commission should adopt a "backstop" sharing mechanism modeled on the sharing plan adopted in the LEC Price Cap Order. Specifically, the Commission should require incumbent LECs to share 50 percent of any earnings between 12.25 percent and 16.25 percent, and 100 percent of any earnings above 16.25 percent.[7] Any sharing amounts allocated to the common line, switching, and transport baskets could be used in the first instance to reduce the carrier's permitted draw from the ICLS fund.

At a minimum, such a sharing regime should be in effect for five years, after which the Commission would evaluate whether sharing should be retained or eliminated. Given that rate of return carriers have been operating without efficiency incentives, there is a substantial likelihood that they should be able to achieve significant efficiency gains during the first few years of incentive regulation. A portion of those efficiency gains should be shared with ratepayers. As the Commission explained in the LEC Price Cap Order, a sharing mechanism would ensure that "consumers receive their fair share of the productivity gains that will occur, just as they would in an industry with keener

[7] Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6801 (1990) (LEC Price Cap Order).

competition."[8] The factors that led the Commission to eliminate sharing for the larger price cap LECs simply do not apply to today's rate of return LECs.[9]

Treatment of PRTC

The conversion of Verizon's Puerto Rico Telephone Company (PRTC) to price cap regulation is long overdue. Verizon's PRTC should be required to convert to price cap regulation under the rules applicable to Verizon, including the 0.55 cents per minute target rate and the rules governing the Interstate Access Support fund. The suggestion in the Notice that the CALLS plan "was not designed to be open to new carriers or study areas" is incorrect, at least where Verizon's acquisition of PRTC is concerned.[10] One of the new rules adopted in the CALLS Order, Section 54.801(c), specifically provides that if a price cap LEC acquires exchanges from a rate of return LEC, those exchanges become eligible for Interstate Access Support (the support mechanism available to CALLS LECs) "beginning with the next support recalculation."[11] Moreover, in determining that the $650 million fund size was "sufficient," the Commission placed great weight on the "negotiated nature of the $650 million estimate."[12] In light of its reliance on the negotiated nature of the fund size, the Commission must presume that the potential for PRTC to draw from the fund – and the resulting redistribution of support among participating ILECs – is reflected in the $650 million cap. All parties to the

[8] Id.

[9] The Commission eliminated sharing for today's price cap carriers only because (1) many years of experience with price cap regulation allowed it to find that the X-factor was "reliable;" (2) the X-factor included a consumer productivity dividend; and (3) there was no significant evidence of variation in the productivity gains achievable by individual price cap LECs. None of those factors apply to today's rate of return LECs. Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order, released May 21, 1997, ¶¶ 154, 157-158.

[10] Notice at ¶ 93.

[11] 47 C.F.R. § 801(c).

[12] CALLS Order at ¶ 202.

CALLS negotiations were aware that GTE had acquired PRTC and were aware that the all-or-nothing rule required PRTC to convert to price cap regulation.

For the reasons stated herein, the Commission should apply price cap regulation on a mandatory basis to all rate of return carriers that control, either directly or through affiliates, 100,000 lines or more.

Respectfully submitted,
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