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
	)	
	)	

COMMENTS OF VERIZON[1]

The Commission should eliminate the last vestiges of the all-or-nothing rule so that rate-of-return carriers can elect alternative price cap regulation on a study area basis. The Commission has waived this rule on numerous occasions, and the concerns about cost-shifting and "gaming" the system that could occur if carriers had some areas under price caps and others under rate-of-return have been shown to be unrealistic. The Commission should adopt its tentative conclusion that if these carriers adopt price cap regulation, they cannot elect into the CALLS plan for purposes of obtaining universal service fund support. The CALLS fund was designed to replace implicit support not recovered under the CALLS plan for carriers electing CALLS. Adding new carriers and study areas would dilute the fund and threaten the viability of CALLS. Any alternative price cap regulation plan for rate of return carriers should be an *optional* alternative regulation plan that benefits both consumers and carriers.

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[1] The Verizon Telephone Companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Corp. These companies are listed in Attachment A.

I. The Overly Restrictive All-or-Nothing Rule Should Be Eliminated.

The Commission should eliminate the all-or-nothing rule for rate-of-return carriers, including carriers that become affiliated with price cap carriers through mergers or acquisitions.[2] In the *Order*, the Commission modified the all-or-nothing rule to permit acquired price cap lines to be returned to rate-of-return regulation, and it solicited comments on the need to further modify or alter the all-or-nothing rule. *Notice,* ¶¶ 10, 85. The current factual record supports the prompt elimination of the all-or-nothing rule altogether, which was adopted fourteen years ago only "out of an abundance of caution." *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 272 (1990). None of the potential regulatory abuses that the Commission raised in adopting this rule have occurred where the Commission has granted waivers of the rule. In fact, the rule creates regulatory burdens without any offsetting benefits. The Commission has allowed the uncertainty surrounding the all-or-nothing rule to linger for too long.[3]

By way of example, under the all-or-nothing rule, Verizon's ownership stake in Puerto Rico Telephone Company ("PRTC") would force PRTC to transition from rate-of-return

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2 *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122, ¶ 10 (2004) ("Notice"). The all-or-nothing rule requires carriers to operate all affiliates and study areas under the same regulatory approach; either price caps or rate-of-return. 47 C.F.R. § 61.41; *id.,* ¶¶ 6-9. Part of that rule requires rate-of-return properties acquired by a price cap carrier to be converted to price caps within one year of acquisition.

3 *ALLTEL Corporation Petition for Waiver of Section 61.41, et al,* Memorandum Opinion and Order, 17 FCC Rcd 27694, ¶ 21 (2002) ("ALLTEL Wavier") ("We anticipate that these issues will be resolved before Puerto Rico Telephone must file its annual access filing for 2003"); *see also Valor Telecommunications, LLC Petition for Waiver of Section 61.41 of the Commission's Rules,* Memorandum Opinion and Order, 17 FCC Rcd 25544, ¶ 8 (2002) ("Valor Waiver").

regulation to price caps even though the operational characteristics of PRTC and economic realities in Puerto Rico clearly suggest that price caps would be harmful to PRTC and to Puerto Rico consumers. Recognizing these considerations, the FCC has granted PRTC a temporary waiver to continue to operate as a rate-of-return carrier pending completion of this proceeding. *Notice,* n.40. Without permanently granting the waiver or eliminating the rule, PRTC would be forced to convert to price caps. This conversion would substantially reduce vital access revenues, could result in substantial rate increases for end-user customers, and could risk a further decline in Puerto Rico's subscribership level, which is already far below the national average.

In evaluating the continued need for this rule, the FCC should place significant weight on the real-world experience of carriers operating under waivers of the all-or-nothing rule, including Valor, PRTC, and ALLTEL.[4] The Commission adopted the all-or-nothing rule out of a concern that carriers could have an incentive to shift costs from price cap areas to rate of return areas. *Notice,* ¶ 12. None of the carriers operating under waivers have been accused of shifting costs between affiliated companies. Moreover, the Commission has more than adequate regulatory checks to prevent any potential misconduct.

In particular, the Commission's accounting and separations rules (Parts 32 and 36), and cost allocation rules (Part 64) for rate-of-return study areas serve as substantial checks on any potential transgressions. What is more, federal and state tariffing rules – requiring cost support and detailed documentation under rate of return – provide federal and state regulators, industry watch groups, and competing carriers with both the information and a venue to challenge any

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[4] *ALLTEL Waiver; Valor Waiver.*

misconduct.[5] For example, PRTC operates independently of other Verizon affiliates, maintaining separate books and tariffs. Any shift in costs from Verizon to PRTC would be easily detectable, and any sizable increase in PRTC's costs from year-to-year would immediately attract considerable scrutiny from regulators and competitors. In addition to these overlapping regulatory checks, competitive pressures from CMRS carriers, cable providers, CLECs, long distance providers, and VoIP providers further constrain the ability (and incentive) of carriers to shift costs. The FCC should thus affirm its tentative conclusion that "existing accounting and regulatory processes should permit parties and the Commission to detect cost shifting by … rate-of-return carriers." *Notice,* ¶ 92.

The Commission also had a concern that carriers could attempt to "game the system" by switching back and forth between rate-of-return and price caps. *Notice,* ¶ 7. The assumption underlying this concern – that carriers will "gold plate" their networks while under rate-of-return and then later "slim down" under price caps – is an myth that the Commission rejected five years ago when it found that "virtually no carriers, rate-of-return or others, are in fact attempting to 'gold-plate' their networks at the expense of consumers." *Implementation of Section 402(b)(2)(a) of the Telecommunications Act,* Report and Order, 14 FCC Rcd 11364, ¶ 13 (1999).

The Commission should complete the process begun in the *Order,* and eliminate the all-or-nothing rule, which would provide certainty to the industry and flexibility to carriers. The rule currently requires carriers to file waiver petitions when they acquire or merge with carriers under

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5 The incentive to shift costs has also been greatly reduced by regulatory actions subsequent to the adoption of the all-or-nothing rule. The Commission's pricing flexibility rules prevent price cap carriers from taking advantage of the low-end adjustment mechanism, and the Commission has eliminated the sharing obligation altogether.

different regulatory regimes, which causes regulatory burdens and injects uncertainty in the consideration of the economics of potential transactions. Elimination of the rule will allow carriers to pursue the optimal regulatory structure in each study area. The Commission should make it clear that elimination of this rule applies to all price cap carriers and rate-of-return carriers that come together as the result of mergers and acquisitions, including those transactions, such as Verizon's purchase of PRTC, that occurred prior to the rule change. There would be no basis to discriminate among carriers and apply a beneficial rule change only to a limited subset. Rate-of-return carriers, and price cap carriers acquiring rate-of-return properties, should be able to determine on a study-area basis whether alternative regulation/price caps would be advantageous. Moreover, the elimination of the all-or-nothing rule would avoid significant universal service complications if rate-of-return properties were forced into price caps as a result of a purchase by a price cap carrier, which could reduce universal service support for the acquired properties.

In particular, the Commission should eliminate Section 61.41(c), which requires a price cap carrier that acquires a rate-of-return carrier to convert the rate-of-return areas to price caps within one year. The current rule, "limit[s] a carrier's ability to choose the most appropriate and efficient form of regulation, to the detriment of both the carrier and its customers." *MAG FNPRM,* 16 FCC Rcd 19613, ¶ 268 (2001); *Notice,* ¶ 94. A price cap carrier reviewing the financials of a rate-of-return carrier could not know if it would be permitted to maintain the *status quo* if it purchased the carrier, which would affect is willingness to enter into a transaction that could be beneficial to both the carrier and the customers. In the *Order,* the FCC recognized the need to allow rate-of-return carriers to revert acquired price cap study areas to rate-of-return. The same basic principle should also allow price cap carriers to maintain rate-of-return regulation for acquired properties. Price cap carriers that acquire exchanges or study areas operating on a rate-of-return basis should not be forced to reverse that decision if the economic realities of the acquired properties do not support the transition to price caps. What is more, the selling carrier's explicit decision to bypass price cap regulation based on operational characteristics deserves substantial weight in deciding to allow an acquiring carrier to maintain the *status quo* for the rate-of-return exchanges.

II. The Commission Must Reaffirm that CALLS Will Not Accommodate New Carriers.

The FCC's tentative conclusion that "new carriers or carrier study areas may not elect [the CALLS] plan" is proper because the "CALLS plan was not designed to be open to new carriers or new study areas." *Notice*, ¶ 93. The Commission correctly highlights the fact that "no provision [was made] for how the universal service component of the CALLS plan would address future expansion to new carriers." *Id.*

Under CALLS, the Commission replaced implicit charges with an explicit universal service mechanism – Interstate Access Support (IAS) – that "provide[d] support for a portion of the difference between permitted common line revenues and the benchmarks."[6] The FCC later explained that it "ensure[d] that a substantial portion of the gap between SLC revenues and allowable CMT revenues [would] be covered by support, while minimizing the risk that the support amount will be too large." *Access Charge Reform,* Order on Remand, 18 FCC Rcd 14976, ¶ 31 (2003). The FCC set a ceiling of $650 million on the size of the IAS based upon an estimate of the implicit common line support that would not be recovered under the CALLS plan for those carriers electing CALLS. The Commission believed that this amount would be sufficient

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[6] *See generally 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, 15 FCC Rcd 12962, ¶ 196 (2000) ("*CALLS Order*").

to replace "a *specific amount* of access charges" that had previously been used to recover portions of the interstate loop costs of the carriers that were subject to the CALLS plan. *CALLS Order*, ¶ 185 (emphasis added). Adding a new carrier or study area under CALLS without increasing the IAS ceiling would result in a significant reduction in explicit IAS support each carrier would receive; such a dilution would threaten the viability of CALLS.[7]

In particular, adding new carriers and/or study areas to CALLS may affect the ability of carriers to eliminate implicit support. Even though all implicit support is not recovered under IAS, that mechanism was designed to provide carriers with sufficient funding to eliminate carrier common line charges and presubscribed interexchange carrier charges in the majority of jurisdictions.[8]

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[7] Moreover, the IAS fund has already been expanded beyond those carriers that elected CALLS because IAS is portable to competitors. The increasing number of competitive eligible telecommunications carriers receiving per line IAS support has already reduced the amount of support available to price cap carriers. Currently, competitive eligible telecommunications carriers are drawing over $15 million from the ISA fund. Universal Service Monitoring Report, December 22, 2003; Table 3.27.

[8] As of June 2003, the total presubscribed interexchange carrier charges for the industry was only approximately $81 million, and the remaining carrier common line charges were approximately $1.3 million. Telcordia, Summary of June 16 Annual Filing TRPs, updated through June 23, 2003. Because the final increase in the SLC cap occurred last year, price cap carriers will not have any additional explicit revenues to offset further reductions in implicit support mechanisms. As a result, a significant reduction in explicit IAS support – due to an increase in number of carriers under CALLS – could prevent carriers from eliminating implicit charges, and could result in an increase in implicit charges, directly contrary to the stated goals of CALLS. *CALLS Order,* ¶ 23. The increase in implicit charges could grow further due to the resulting inability of carriers to de-average SLCs within study areas. *CALLS Order,* ¶ 113; 47 C.F.R. § 69.152(q). The Commission has explained that flexibility in assessing SLCs, including de-averaging, allows carriers to minimize the cost recovery of through the "inefficient subsidy of PICC and CCL charges." *SLC Cost Order,* 17 FCC Rcd 10868, ¶ 28 (2002). Yet carriers are only free to de-average SLCs within study areas once implicit charges are eliminated. *Id.,* ¶ 19. The dilution of IAS could reverse the substantial successes under CALLS in reducing implicit charges.

In short, the IAS mechanism cannot be further stretched without jeopardizing the Commission's stated intention that IAS will provide "a sufficient amount of explicit universal service support to replace the implicit support that has been removed from access charges, and should ensure affordable and reasonably comparable rates." *CALLS Order,* ¶ 202. The Commission should clarify that the CALLS and IAS cannot accommodate new carriers or new study areas during the duration of the five-year term.[9]

III. The Commission Must Ensure That Alternative Regulation is Optional.

In considering the alternative regulatory proposals suggested by ALLTEL and CenturyTel, the Commission should acknowledge that any alternative regulation proposal for rate-of-return carriers must be optional, because all carriers do not necessarily have sufficient economies of scale to benefit from the assumed efficiency incentives in those plans. *Notice,* ¶ 86. Rate-of-return carriers vary considerably with regard to access to resources, number of lines served, as well as service costs. Accordingly, a one-size-fits-all approach cannot work for all carriers.

There is neither a specific line count nor a particular line density at which carriers are guaranteed to be able to succeed under alternative regulation. Any attempt to force carriers

[9] If the Commission determines that new carriers or study areas should be included under CALLS, a means to either extend interstate common line support ("ICLS") to those carriers and/or study areas acquired by price cap carriers, or increase the $650 million IAS ceiling based upon the amount of ICLS support that the new carrier or study area received must be adopted. Such an approach, however, could adversely affect rate-of-return carriers like PRTC that rely heavily on ICLS. If PRTC's ICLS support were added to the IAS ceiling, PRT would only receive a pro rata portion of its current funding under the IAS distribution methodology. The reduction of interstate funding to Puerto Rico would be particularly problematic in light of the low subscribership levels and the high operational costs of serving the island. This inability of CALLS to incorporate effectively new carriers and study areas underscores the need to eliminate the all-or-nothing rule, and to block new carriers from electing CALLS.

above a certain size under alternative regulation would be arbitrary and could not ensure that all carriers could operate efficiently under the alternative regulation plan. For example, mandating alternative regulation could adversely affect service quality and network investment.[10] Therefore, the Commission should reaffirm its finding that it is "extremely difficult to establish a mandatory alternative regulatory plan for all rate-of-return carriers," and that carriers must be free to elect into any alternative regulation based on their own independent business judgment. *MAG Order*, ¶ 227.

Conclusion

For the foregoing reasons, the Commission should eliminate the all-or-nothing rule, clarify that CALLS cannot accommodate new carriers or study areas, and find that rate-of-return alternative regulation must be optional.

Respectfully submitted,

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[10] The Commission cautioned in the *MAG Order* that the "design of an alternative regulation plan must also address the incentives an alternative regulation plan gives rate-of-return carries to reduce investment in plant and equipment, or to reduce expenditures on maintaining service quality, in order to increase profits at the expense of maintaining adequate investments or service quality." *MAG Order,* 16 FCC Rcd 19613, ¶ 223 (2001).

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.