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

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for	)	CC Docket No. 00-256
Regulation of Interstate Services of	)	
Non-Price Cap Incumbent Local Exchange	)	
Carriers and Interexchange Carriers	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Access Charge Reform for Incumbent	)	CC Docket No. 98-77
Local Exchange Carriers Subject to	)	
Rate-of-Return Regulation	)	
	)	
Prescribing the Authorized Rate of Return For	)	CC Docket No. 98-166
Interstate Services of Local Exchange Carriers	)	

AT&T COMMENTS ON MAG SFNPRM

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April 23, 2004

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AT&T COMMENTS ON MAG SFNPRM

Pursuant to the Commission's Report and Order and Second Further Notice of Proposed Rulemaking, FCC 04-31, released February 2, 2004, published in 69 Fed. Reg. 12814 (March 18, 2004) ("Second MAG Order" and "SFNPRM"), and Section 1.415 of the Commission's rules, 47 C.F.R. § 1.415, AT&T Corp. ("AT&T") submits these comments on: (1) the incentive regulation plan for rate-of-return ("ROR") carriers proposed by CenturyTel ("CenturyTel plan"), and (2) the rate-of-return carrier tariff option proposed by ALLTEL, Madison River and TDS ("ALLTEL plan"). Because these two proposals each contain a feature that would permit a rate-of-return carrier to elect to move some, but not all, of its study areas to alternative regulation, the Commission also seeks comment on the "all-or-nothing" rule. AT&T supports each of these plans with the modifications noted herein.

Most critically, the traffic sensitive rates of rate-of-return carriers are too high, probably include implicit support and, at minimum, undermine the ability of nationwide interexchange carriers ("IXCs") that are required to maintain averaged toll rates to compete with the RBOCs whose rates need only reflect their own, much lower access costs. In addition, "streamlined tariffs" have substantially curtailed the ability of access customers to obtain overearnings refunds and has thus largely left rate-of-return regulation bereft of an enforcement mechanism.

AT&T believes that both of these issues are best addressed in the context of comprehensive intercarrier compensation reform, including access reform. As a prelude to broader reform and to address these two issues, AT&T (as part of the Rural Choice Coalition) filed a petition for reconsideration of the 2001 *MAG Order* when the Commission failed to require adjustments to the rate-of-return carriers' traffic sensitive access rates. In 2003, AT&T also filed a petition for forbearance of Section 204(a)(3), so as to restore the ability of access customers to obtain refunds when rate-of-return carriers overearn.

Given that the Commission has not acted on either of AT&T's petitions, nor has it yet updated the record in intercarrier compensation reform, the next best alternatives to reduce the disparity between incumbent local exchange carriers' ("LECs")' traffic sensitive rates and to create some sort of check on rate-of-return LECs' overearnings lie in the CenturyTel and ALLTEL proposals on which the Commission now invites comments. The CenturyTel proposal for price cap regulation addresses AT&T's two concerns by capping traffic sensitive rates at levels more closely aligned with those of existing price cap carriers. With the modifications AT&T proposes, such as making the CenturyTel plan mandatory rather than optional for larger rate-of-return carriers and enforcement of the "all-or-nothing" rule, the CenturyTel proposal is an acceptable temporary solution.

Similarly, ALLTEL's proposal should be mandatory for all of the remaining rate-of-return carriers (other than average schedule companies) that choose not to opt for the CenturyTel plan. At least, under ALLTEL's proposal, the deleterious effects of Section 204(a)(3) are mitigated by the stability of rates over a two-year period, and the inherent uncertainties of setting rates based on projections of cost and demand are replaced by a system that ensures that if a carrier's units costs go down, the new rates in the subsequent tariff period will reflect these efficiencies. Further, prior to adopting the ALLTEL proposal, the Commission should reallocate certain costs that are currently recovered through traffic sensitive rates (specifically, revenues associated with the former residual transport interconnection charge, information surcharge and marketing expense) to common line to reflect cost-causation and to bring the traffic sensitive rates of smaller ROR carriers closer to those LECs that will operate under incentive regulation.

INTRODUCTION AND SUMMARY

In October 2000, four incumbent local exchange carrier ("LEC") associations submitted the Multi-Association Group ("MAG") plan, a proposal addressing various issues, including access charge reform and universal service support for rate-of-return carriers.[1] On November 8, 2001, the Commission released the *MAG Order*, which modified the Commission's rules to reform the interstate access charge and universal service support

[1] Petition for Rulemaking of the LEC Multi-Association Group, RM No. 10011 (filed Oct. 20, 2000).

system for LECs subject to rate-of-return regulation. Specifically, the *MAG Order* undertook a number of steps to foster efficient pricing in the market for access services provided by ROR carriers by rationalizing the access rate structure and driving per-minute rates towards lower, more cost-based levels, while furthering universal service goals.[2] In particular, the Commission aligned the interstate access rate structure more closely with the manner in which costs are incurred for *common line and line ports*, and created a new universal service support mechanism, Interstate Common Line Support ("ICLS") to replace the implicit support in interstate access charges with explicit support that is portable to all eligible telecommunications carriers ("ETCs").[3] ICLS ensures that rate-of-return carriers will recover their common line revenue requirements, including their authorized rate-of-return.[4]

Despite these reforms, the carrier access charges of ROR LECs remain significantly above those of the price cap companies and further reform to drive greater efficiency into the system is still needed. This is because the *MAG Order* failed to undertake

[2] *See MAG Order and FNPRM*, 16 FCC Rcd. 19616, ¶ 1 (2001).

[3] *See id*. at 19617, ¶ 3.

[4] In implementing these general goals, the Commission took the following specific steps. It: (1) adopted the MAG proposal to increase the Subscriber Line Charge ("SLC") caps for rate-of-return carriers to the levels established for price cap carriers; (2) modified the Commission's rules to allow SLC deaveraging; (3) phased out the inefficient Carrier Common Line Charge ("CCL") as of July 1, 2003, when SLC caps were scheduled to reach their maximum levels; (4) shifted the non-traffic sensitive costs of local switch line ports to the common line category, and reallocated the remaining costs contained in the Transport Interconnection Charge ("TIC") among all the access categories; (5) declined to prescribe a single, target rate for per-minute charges; (6) created ICLS to convert some implicit support in the access rate structure to explicit support that is available to all ETCs; (7) rejected MAG proposals to impose new requirements on interexchange carriers regarding optional calling plans, minimum monthly fees, and pass-through of savings from lower access rates; (8) streamlined the rules for the introduction of new switched access services by extending to rate-of-return carriers rules similar to those governing price cap carriers; and (9) terminated

(footnote continued on following page)

necessary reforms to reduce rates and create an explicit support mechanism for the *traffic sensitiv*e *costs of local switching and transport*. Rather than "create" an *explicit* "support mechanism" for these costs – as the members of the Rural Choice Coalition ("RCC")[5] urged[6] – the *MAG Order* merely maintained the existing *implicit* subsidy for these costs implemented through toll rate averaging and rate integration, contrary to statutory directives and court rulings.

As AT&T explained in its comments on the *MAG NPRM* and in the RCC's petition for reconsideration of the *MAG Order*, the best course of action for the Commission to comply with the dictates of section 254(e) and sustain the ability of nationwide IXCs to comply with 254(g) would be for the Commission to require ROR LECs to reduce their traffic sensitive rates to $0.0095 per minute, the level of the target traffic sensitive rate for the smaller price cap LECs under the *CALLS Order*[7] and to provide explicit support to the ROR LECs to recover the balance of their traffic sensitive revenue requirement. The Commission declined to take this action and petitions for reconsideration of the *MAG Order* on this and

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(footnote continued from previous page)

the pending proceeding for prescription of the authorized rate-of-return, which was set at 11.25% in 1990.

[5] The members of the RCC Coalition are AT&T, General Communication, Inc. ("GCI") and Western Wireless.

[6] *See, e.g.,* AT&T Comments on MAG Plan NPRM (filed Feb.26, 2001) at 6-8 ("AT&T Comments"); Letter of John Nakahata to Jane E. Jackson and Katherine Schroder (filed Aug. 28, 2001) at 3-6 ("Aug. 28, 2001 Nakahata Letter"); Letter of John Nakahata to Jane E. Jackson and Katherine Schroder (filed Sept. 27, 2001) at 4-6 ("Sept. 27, 2001 Nakahata Letter"). The RCC's petition for reconsideration of the *MAG Order*, filed Dec. 28, 2001, remains pending.

[7] *Access Charge Reform,* Sixth Report and Order, 15 FCC Rcd. 12962, ¶ 162 (2000) ("CALLS Order").

other points have remained unresolved for more than two years. Adoption of the CenturyTel proposal for the larger ROR LECs and the ALLTEL proposal for the smaller ones appears to be the next best solution pending broader intercarrier compensation reform.[8]

As CenturyTel notes, most ROR LECs have interstate traffic sensitive access rates above 1.5 cents per minute as compared to an average price cap rate of 0.66 cents per minute. The CenturyTel plan contains a number of features that, with certain modifications, could be incorporated into a much-needed plan for further access reform for ROR carriers by July 1, 2004. Most importantly, the CenturyTel plan recognizes the need to initiate a price cap system that will immediately lower traffic sensitive rates for access customers, while allowing ROR carriers to recover, on a revenue-neutral basis, the balance of their traffic sensitive ("TS") revenue requirement through a "TS Additive" to ICLS. Removing implicit subsidies from the traffic sensitive access charges of ROR carriers and recovering them in an explicit manner through the Universal Service Fund ("USF") are critical modifications necessary to sustain local competition, universal service and nationwide geographic rate averaging of long distance services. For special access, a productivity or X-factor should be adopted to ensure that revenue growth tracks underlying cost growth and that consumers benefit from carriers' increased efficiencies.

As noted above, the ALLTEL plan should be mandatory for all rate-of-return LECs that choose not to opt for the CenturyTel plan so as to bring some stability to rates over a two-year period and to ensure that efficiencies are reflected in the next rate period.

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[8] *Developing a Unified Intercarrier Compensation Regime*, 16 FCC Rcd. 9610 (2001) ("Intercarrier Compensation NPRM").

I. BECAUSE ACCESS CUSTOMERS ARE NOT ENTITLED TO REFUNDS WHEN RATE-OF-RETURN CARRIERS OVEREARN, THE BROADEST RANGE OF RATE-OF-RETURN LECS MUST BE REQUIRED TO ADOPT INCENTIVE REGULATION.

As the Commission is well aware, the rate-of-return regulatory system is broken and harms consumers nationwide, at least in part because court decisions have eviscerated key accountability provisions. A key element of a rate-of-return regulation system had been the ability of a ROR carrier's customers to obtain refunds when the ROR carrier charges interstate access rates that result in substantial overearnings – that is, overearnings greater than the prescribed rate-of-return by either 0.4% in any individual access service category or 0.25% across all access service categories.[9] Because a ROR LEC can always file new tariffs to *raise* rates if it is underearning, but would not have an incentive to file new lower rates when it is *overearning*, the ability of access customers to obtain overearnings refunds provided a critical backstop. However, as a result of judicial interpretation of the "deemed lawful" provision of Section 204(a)(3) of the Communications Act, as amended,[10] this overearnings protection has been eliminated whenever an ROR LEC files tariffs on a "streamlined" basis.[11] "Streamlined" tariffs – which permit as little as seven days to review proposed rate changes – are "deemed lawful" unless they are suspended and investigated before taking effect.[12] Once such a tariff takes effect – that is, once it has been

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[9] *See* 47 C.F.R. § 65.700(a), (b).

[10] *See* 47 U.S.C. § 204(a)(3).

[11] *Id.*

[12] *Id.*

"deemed lawful" – refunds for overearnings are unavailable as a matter of law, no matter how much the carrier then overearns.[13]

As Western Wireless explained in its petition seeking *elimination* of ROR regulation, customers of ROR LECs have been powerless to seek financial redress while ROR carriers reap interstate overearnings of hundreds of millions of dollars – *hundreds of millions of dollars in addition* to the generous 11.25% return that the FCC allows.[14] For this same reason, AT&T filed a petition requesting the Commission to forbear from enforcing Section 204(a)(3).[15] As discussed in Western Wireless's petition, in the recent 2001-2002 monitoring period, "a total of 30 LECs earned a combined total of almost $160 million in excess of the permissible maximum earnings level."[16] Those carriers "achieved annualized earnings ranging from 11.73% to as much as 54.34% for special access, and from 11.82% to as much as 35.30% for switched traffic sensitive access."[17] Because of the "deemed lawful" provision, AT&T explained, "those LECs' overearnings are immunized from damages

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[13] *See ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 411 (D.C. Cir. 2002).

[14] *See Elimination of Rate-of-Return Regulation of Incumbent Local Exchange Carriers; Federal-State Joint Board on Universal Service*, Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers, RM No. 10822, CC Docket No. 96-45, at 28-29 (filed Oct. 30, 2003) ("Western Wireless Petition") (noting that ROR carriers' interstate *overearnings* were more than $218 million in 2001-2002, $92 million in 1999-2000, and $121 million in 1997-1998).

[15] *See AT&T Petition Pursuant to 47 U.S.C. Section 160(c) of the Communications Act for Forbearance from Enforcement of Section 204(a)(3) of the Communications Act, As Amended*, WC Docket No. 03-256, at 1 (filed Dec. 3, 2003) ("AT&T Petition").

[16] AT&T Petition at 11.

[17] *Id.*

recovery to the extent that those amounts are attributable to unsuspended streamlined tariff filings."[18]

Without overearnings refunds, the current ROR regulatory system provides no disincentive against ROR carriers – or their agents (such as NECA) – overforecasting revenue requirements and underforecasting demand when justifying new rates. As the Commission recognized long ago, "a regulator may have difficulty obtaining accurate cost information as the carrier itself is the source of nearly all information about its costs."[19] Consequently, there is no longer any means for accountability or consumer protection.

To remedy this "one-way bias" in favor of the LECs,[20] the Commission should grant AT&T's petition requesting forbearance from enforcement of Section 204(a)(3), under which "streamlined" tariff filings are "deemed lawful" and, as a result, out of the reach of customers seeking recourse for these carriers' overearnings. Alternatively, the Commission must grant the Western Wireless Petition and replace the broken ROR system with an alternative regulatory framework that removes these inherent flaws. One way of doing this is to adopt the CenturyTel plan, with the minor modifications suggested herein, and mandate its adoption by the larger ROR carriers.

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[18] *Id.* at 12.

[19] *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd. 2873, 2890, ¶ 31 (1989) ("*AT&T Price Cap Order*").

[20] Comments of General Communication, Inc. on Western Wireless Petition at 8.

II. THE SWITCHED ACCESS RATE LEVELS PROPOSED IN THE CENTURYTEL PLAN SHOULD BE ADOPTED EFFECTIVE JULY 1, 2004.

CenturyTel proposes a five-year plan under which ROR carriers could elect a modified form of price cap regulation at the study area, rather than holding company, level (*see* Section III.A, *infra*). Under CenturyTel's proposal, average traffic sensitive ("ATS") target rates would be established. These target traffic sensitive rates in electing study areas would depend on line density at the holding company level, excluding lines acquired from mandatory price cap carriers. The plan would set the target rates at the *lesser* of: (1) $0.0125 per minute, or the actual rate for carriers with a line density of less than 15 lines per square mile; or (2) $0.0095 per minute, or the actual rate for carriers with a line density of at least 15, but less than 19, lines per square mile; or (3) the current levels up to a maximum ATS rate of $0.0095 per minute for carriers with a line density higher than 19 lines per square mile for carriers newly electing the plan.[21] CenturyTel would have the Commission set the productivity factor, or X-Factor, at GDP-PI for carriers electing price caps under this plan, which would have the effect of *freezing* all rates at the target levels.[22] The plan would contain a low-end adjustment set at 10.25% to ensure reasonable earnings opportunities. Finally, the CenturyTel plan would permit a rate-of-return carrier to elect price caps for some study areas and remove those study areas from the NECA pools, while leaving its other study areas in the

[21] CenturyTel *Ex Parte* Letter (filed Dec. 23, 2002), CC Nos. 96-45, 98-77, 98-166, 00-256, at 2 ("CenturyTel *Ex Parte*"). Under the *CALLS Order* (¶ 162), the $0.0095 rate is available to "primarily rural [] LECs," *i.e.*, those with a line density of less than 19 lines per square mile at the holding company level.

[22] CenturyTel *Ex Parte* at 2.

NECA pools subject to rate-of-return regulation.[23] CenturyTel proposes that rate-of-return carriers be able to choose alternative regulation at any annual or semi-annual tariff filing to be effective for the remainder of the five-year plan.[24]

Although AT&T had originally advocated that all ROR carriers' traffic sensitive rates be reduced to $0.0095 per minute (and the RCC has a petition for reconsideration of the *MAG Order* pending on this and other issues), due to the critical need to move forward with some sort of incentive regulation for the ROR carriers, AT&T supports the ATS target rates that CenturyTel proposes, pending broader intercarrier compensation reform for all carriers. AT&T believes that, assuming that larger ROR LECs are *required* to adopt these ATS rates, the existence of these rates will tend to substantially ameliorate the rate differentials that exist between ROR carriers and price cap companies, and thus reduce the pressure on nationwide long distance carriers to broadly deaverage toll rates to meet long distance competition from the RBOCs who have much lower in-region originating access costs. Because the CenturyTel proposal would rationalize traffic sensitive access cost recovery, the Commission should use it to remove implicit subsidies and establish a TS Additive to ICLS. These changes should be fully implemented by July 1, 2004.

At the outset, it should be noted that removal of implicit subsidies from access charges is required by the 1996 Act. As the Fifth Circuit explained in *Alenco Communications Inc. v. FCC*, 201 F.3d 608, 615-616 (5th Cir. 2000) (citations omitted):

[23] CenturyTel *Ex Parte* at 4.

[24] CenturyTel *Ex Parte* at 6.

> "The FCC must see to it that both universal service and local competition are realized; one cannot be sacrificed in favor of the other. The Commission therefore is responsible for making the changes necessary to its universal service program to ensure that it survives in the new world of competition. . . . [T]he old regime of implicit subsidies – that is, 'the manipulation of rates for some customers to subsidize more affordable rates for others' – must be phased out and replaced with explicit universal service subsidies – government grants that cause no distortion to market prices – because a competitive market can bear only the latter. . . . Indeed, the Act requires that all universal service support be explicit. *See* 47 U.S.C. § 254(e). Finally, the program must treat all market participants equally – for example, subsidies must be portable – so that the market, and not local or federal government regulators, determines who shall compete for and deliver services to customers. Again, this principle is made necessary not only by the economic realities of competitive markets but also by statute. *See* 47 U.S.C. § 214(e)(1)."

As the Fifth Circuit has held three times now, "the plain language of § 254(e) does not permit the FCC to maintain any implicit subsidies."[25] Averaging access rates into nationwide toll rates clearly constitutes an implicit subsidy because, as the Fifth Circuit has made clear, "the implicit/explicit distinction turns on the difference between direct subsidies from support funds and recovery through access charges and rate structures."[26]

Retaining implicit subsidies in carrier access rates is incompatible with a competitive environment and the continuing disparity between rural and non-rural carriers' access rates creates significant pressure on interexchange carriers to geographically deaverage toll rates, in a manner that conflicts with the requirements of Section 254(g) of the Act.

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[25] *COMSAT Corp. v. FCC*, 250 F.3d 931, 938 (5th Cir. 2001); *Alenco Comm. v. FCC*, 201 F.3d 608, 623 (5th Cir. 2000); *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 425 (5th Cir. 1999) ("*TOPUC I*").

[26] *Alenco*, 201 F.3d at 623.

First, by definition, implicit subsidies are inherent in any access charge system in which the averaged rates charged to customers in lower cost areas subsidize the below-cost averaged rates charged to customers in higher cost areas. These subsidies must be eliminated, per the Act's directives. Transferring LEC revenue requirements to the USF protects a LEC from cream-skimming because it ensures that per-line support for high-cost areas will remain available, support which would be drained away if left implicit in access rates and a new entrant wins the LEC's high-volume customers in the lower cost areas. Second, a long distance carrier with nationally averaged rates will rapidly lose customers in low-cost areas (where its averaged rates are significantly higher than the regional carrier's) if it is required to continue to serve customers in high-cost areas (where its rates are significantly below costs). Not only will local entry into high-cost areas be stymied absent a portable subsidy, but interexchange carriers cannot hope to compete in a national long distance market when pitted against carriers with lower overall access costs because formidable regional competitors, namely the RBOCs, will take advantage of this easy arbitrage opportunity.

The high switching and transport costs of ROR LECs should be borne by the whole industry, not just by IXCs that pick up and deliver traffic through the ROR LECs. Placing the burden solely on IXCs serving rural areas penalizes those IXCs for doing so, and places them at an artificial competitive disadvantage when competing in the lower cost territories against the RBOCs that originate traffic only in those lower cost areas, or wireless carriers that originate calls over their own networks outside of the access charge system.

As described with greater specificity below, to implement statutory directives, the Commission needs to adjust access rates to reflect removal of implicit subsidies, convert such subsidies into explicit support and establish a competitively neutral recovery mechanism for their recovery.

III. THE COMMISSION SHOULD REQUIRE LARGER RATE-OF-RETURN LECS TO ADOPT A MODIFIED VERSION OF THE CENTURYTEL INCENTIVE REGULATION PROPOSAL, AND IT SHOULD ENFORCE THE "ALL-OR-NOTHING" RULE.

A. Incentive Regulation Should Be Mandatory For Larger Rate-of-Return LECs, And Optional For All Other Rate-of-Return LECs.

Under CenturyTel's proposal, incentive regulation is permissive only, *i.e.*, a ROR carrier could elect incentive regulation but is not required to do so. *SFNPRM* ¶ 30. The Commission also tentatively concludes that any alternative regulation plan it adopts would be optional on the part of ROR LECs because its "experience over the years in attempting to develop incentive regulation for smaller companies has led us to the view that it would not be possible to devise a plan suitable for mandatory imposition on all rate-of-return carriers." *SFNPRM* ¶ 86.

AT&T strongly urges that the Commission make incentive regulation *mandatory* for *larger* rate-of-return LECs. The purpose of incentive regulation is to "foster competition and efficient pricing in the market for interstate access service, and to create universal service mechanisms that will be secure in an increasingly competitive environment." *FNPRM* ¶ 3. The larger rate-of-return LECs (*e.g.*, those with at least 50,000 lines) have the scale to benefit from the efficiency incentives inherent in price caps. Indeed, optional participation would undermine the Commission's goals. LECs would have an incentive to opt into incentive regulation only when their costs are at a cyclical peak, and they would also have an incentive to engage in inefficient "gold-plating" of their networks prior to opting-in, in order to ensure maximum possible revenue requirements under the incentive regulation plan. *See also Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd. 6786, ¶ 335 n.450 (1990) ("*LEC Price Cap Order*"). These activities clearly would deprive access customers, as well as end-user customers, of the full spectrum of efficiencies that incentive regulation aims to achieve. For these reasons, participation in incentive regulation, as a general rule, should be mandatory.[27]

As the Commission points out, however, there are wide variations in operating conditions among rate-of-return LECs, and certain rate-of-return LECs may not thrive under incentive regulation. *See FNPRM* ¶ 227. Empirical evidence, however, demonstrates that the Commission's concerns are, at best, limited to those carriers that serve a very small number of lines. Smaller price cap carriers have generally earned rates of return far in excess of 11.25% – the authorized rate-of-return for carriers under ROR regulation. *See* Appendix A-1. For example, Frontier Tier 2 Companies earned 38.49% in 2003 and serve approximately

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[27] The case for mandatory participation is further buttressed by the fact that numerous carriers that operate under *inter*state rate-of-return regulation successfully operate under state incentive regulatory regimes for *intra*state access services. For example, according to ALLTEL Form 10-K for the fiscal year ended December 31, 2003, at 16, it has elected intrastate alternative regulation for certain of its local exchange subsidiaries in Alabama, Arkansas, Florida, Georgia, Kentucky, Missouri, Nebraska, North Carolina, Pennsylvania, South Carolina and Texas. ALLTEL continues to evaluate alternative regulation for other states where its local exchange subsidiaries are regulated under rate-of-return. Similarly, TDS Telecom explains in its Form 10-K, for the fiscal year ending December 31, 2003, at 34, that it has also elected alternative forms of regulation for its subsidiaries in several states and will continue to evaluate whether to pursue alternative regulation for the remaining subsidiaries. Roseville Telephone Company d/b/a SureWest also operates under an incentive regulation plan in California. California Public Utility Commission, Decision 96-120-74. Commonwealth Telephone Enterprises, Inc.'s 10-K for the period ending December 31, 2003, at 27, states that it is regulated in Pennsylvania under an alternative regulatory plan which limits rate increases to "inflation less two percent." Moreover, about 29% of ALLTEL's lines and 27% of CenturyTel's lines operate under traditional *inter*state price cap regulation, and these price cap study areas have achieved interstate rates of return ranging from 13.43% to 47.17% in 2003. *See* Appendix A-4.

270,397 lines, across 25 study areas. Valor's two New Mexico study areas earned 20.42% and 18.45% in 2003, with 48,995 and 47,453 lines, respectively. *Id.* In fact, even very small price cap LECs have thrived under price cap regulation. The Citizens Telecommunications Company (Tariff 5) earned 40.37% in 2003 and serves only 10,371 lines. *Id.* There is no reason why similarly sized carriers operating under the CenturyTel plan would not enjoy similar success. Thus, voluntary participation in incentive regulation should be limited to those LECs that serve fewer than a specified threshold of lines (*e.g.*, 50,000) at the holding company level. Particularly because the ROR LECs' traffic sensitive revenue requirement will be supplemented on a revenue neutral basis by the TS Additive, there is no reason to delay making incentive regulation under the CenturyTel plan mandatory for the larger carriers.[28]

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[28] Although the CenturyTel proposal is not specific on this point, to the extent that a smaller LEC (less than 50,000 lines) voluntarily elects to opt into incentive regulation, that decision should be permanent. Allowing LECs to move in and out of incentive regulation would substantially undermine the incentive to succeed within the incentive regulation environment. Instead, LECs would have an incentive to "try out" incentive regulation to determine whether higher profits could easily be achieved, and in cases where increased profits are not easily achieved, LECs would have the incentive to return to rate-of-return regulation. In addition, allowing LECs to move in and out of incentive regulation would allow them to "game" the system. *See, e.g., ALLTEL Corporation; Petition for Waiver of Section 61.41 of the Commission's Rules and Applications for Transfer of Control*, Memorandum Opinion and Order, 14 FCC Rcd 14191, ¶ 18 (1999) ("*ALLTEL Waiver Order*"). This Commission has already recognized that under an optional system, LECs have incentives to "fatten up" – *i.e.*, increase costs – before opting-in to incentive regulation where it could then "slim down" – *i.e.*, decrease costs – to maximize profits under incentive regulation. *See id.; see also NRTA v. FCC*, 988 F.2d 174, 179 (D.C. Cir. 1993) ("NRTA") ("permanent-choice [rules] aimed at preserving cost incentives . . . are central to price cap [*i.e.*, incentive] regulation"). That behavior "would not serve the public interest." *Id.* Accordingly, to provide maximum incentives for LECs to succeed under incentive regulation, a decision to opt-in to incentive regulation should be, as a general rule, permanent.

There is an increasingly urgent need to require larger rate-of-return LECs to participate in incentive regulation (while requiring a permanent opt-in rule for smaller LECs). Properly designed incentive regulation, which includes protections for consumers as discussed herein, could provide hundreds of millions of dollars in consumer benefits annually. *See FNPRM* ¶ 218. Serious reform is now long overdue, and should be implemented promptly.

B. The Commission Should Retain – And Enforce – The "All Or Nothing" Rule.

The Commission should *not* accept CenturyTel's proposal to eliminate the "all-or-nothing" rule contained in Section 61.41(c)(2) and (3) of its rules, so as to allow ROR carriers to elect price cap regulation on a study area basis rather than at the holding company level. *See SFNPRM* ¶¶ 80, 83. In 1993, the D.C. Circuit explained that "it seems quite obvious that dual regulation . . . has a key feature in common with regulated-unregulated dual status: a firm can escape the burden of costs incurred in its unregulated *or* price cap business by shifting them to the rate-of-return affiliate, which can pass them on to ratepayers." *See NRTA*, 988 F.2d at 179-180. The Court went on to affirm the Commission's "all-or-nothing" rule, which was designed to guard against such anticompetitive behavior by prohibiting LECs from owning facilities that are not subject to the same type of rate regulation. *See id*. at 181. Those rules are at least as essential today for protecting the public interest as they were when first adopted in 1990. *See, e.g., LEC Price Cap Order* ¶¶ 271-278.

LECs continue to have substantial incentives to engage in price-inflating cost-shifting between incentive regulation affiliates and rate-of-return affiliates. By shifting costs from price cap affiliates to rate-of-return affiliates, LECs can – as they could when the Commission first adopted its "all-or-nothing" rule – increase profit margins for incentive regulation affiliates, while continuing to receive the same return for rate-of-return affiliates. In addition, LECs would have incentives to "game" the system through sequential mergers and acquisitions. *See, e.g.*, *NRTA*, 988 F.2d at 179 ("successive mergers or acquisitions [that] enabled a firm to shift back and forth between rate-of-return and price cap [would create] . . . a risk of . . . sequential cost shifting"). These competitive concerns are only enhanced by changes in the telecommunications business since 1990. With potential competition, LECs now have additional incentives to lower costs through cost-shifting strategies in order to foreclose competitive entry. For example, a LEC that obtains artificially high profits through a cost-shifting strategy could use those excess profits to subsidize its retail services in a study area where competitors have entered, thereby implementing a price squeeze against those new entrants.

The competitive concerns associated with eliminating the all-or-nothing rule are *not* speculative. As the Commission explained when it first adopted the all-or-nothing rule, "the record in this proceeding, like the records developed in other proceedings before the Commission, demonstrates that LEC holding companies have both the means and the motive to shift costs improperly from affiliates under one regulatory system to affiliates under another system, to the detriment of ratepayers." *LEC Price Cap Order* ¶ 272. LECs continue to have substantial incentives to engage in improper cost shifting and continue to have the means to implement such strategies. And given the size and complex ownership structures of today's LECs, it would be virtually impossible to detect this type of anticompetitive behavior without additional (and cumbersome) accounting guidelines that would allow the Commission and interested parties to monitor LEC accounts for cost-shifting. Moreover, as a practical matter, given the large number of ROR LECs, even with enhanced accounting safeguards, the personnel resources to conduct audits of these carriers' interstate access rates simply do *not* exist.

In this regard, it is important to note that the Commission's jurisdictional accounting regulations clearly are insufficient to monitor and protect against the unlawful cost-shifting and gaming strategies that dual regulation LECs would be motivated to implement. When the Commission previously addressed this same issue in 1990, it explained that "[w]hile state regulation may be adequate to detect and prevent improper inter-affiliate and intra-affiliate cost shifts from the interstate category to the intrastate category, it is neither designed nor able to detect such cost shifts within the interstate jurisdiction." *Id.* ¶ 274. The D.C. Circuit agreed with that assessment, noting that such jurisdictional separation rules are "of little relevance for cost shifting entirely within the federal domain." *See NRTA*, 988 F.2d at 180. In addition, the Commission has noted that it did "not wish to create new administrative burdens for the Commission associated with monitoring affiliate transactions and taking appropriate enforcement action if necessary." *See e.g., ALLTEL Waiver Order,* ¶ 38. And in any event, "[s]tructural separation does not cure the incentive to shift costs; it only makes cost shifting [more] detectable." *Id.* Thus, any claims that existing or new accounting separation rules could be used (or adopted) to avoid anticompetitive behavior by LECs that operate under dual regulation should be rejected.

As noted in the *FNPRM* (¶ 268), some parties favor abolishing the all-or-nothing rule on the ground that the rule limits a carrier's ability to choose between the most appropriate form of regulation. *See also SFNPRM* ¶ 86. That argument makes no sense. As the Commission and the D.C. Circuit have explained on numerous occasions, incentive regulation is superior to rate-of-return regulation for ensuring efficient provision of access services. *See, e.g., LEC Price Cap Order* ¶¶ 271-279; *NRTA*, 988 F.2d at 178-181. The only circumstances where incentive regulation would not be "appropriate" are those where a LEC could not obtain sufficient cost savings under incentive regulation to make continued operations sufficiently profitable. But empirical evidence shows that this situation will arise, if ever, only very infrequently. An analysis of a representative sample of carriers illustrates that fact. From 1996 through 2003, a representative sample of small price cap (*i.e.*, incentive regulation) carriers have reduced switched access rates dramatically (many by more than 75%). *See* Appendix A-2. By contrast, even the largest carriers that currently operate under rate-of-return regulation have decreased their traffic sensitive access rates by only 33% to 54%, *see* Appendix A-3, indicating that there is substantial room for additional savings on the part of rate-of-return LECs. There is thus no merit to LEC claims that the Commission's all-or-nothing rule deters them from choosing the "appropriate" form of regulation. Moreover, if the Commission adopts a low-end adjustment (*see* Section III.C, *infra*), that would undermine any LEC claims that incentive regulation should not be made mandatory for the larger ROR companies. In all events, in the few instances where incentive regulation would contravene the public interest, the Commission may approve a waiver of the all-or-nothing rule to allow a particular company to elect incentive regulation for some but not all of its study areas.

Although the Commission in the *Second MAG Order* (¶¶ 1, 10-15) allowed ROR carriers to bring newly-acquired price cap companies back to ROR regulation without a waiver, *prudently* it did not modify the "all-or-nothing" rule to allow carriers to operate both price cap and ROR study areas without a waiver. Adoption of CenturyTel's proposal would be tantamount to a blanket waiver of the all-or-nothing rule for all ROR LECs in that it would allow them to elect incentive regulation on a study areas basis and, because of the possibilities of cost shifting, this feature of the CenturyTel plan should *not* be adopted. Indeed, rather than repealing the all-or-nothing rule, the Commission should fully *enforce* it. Larger rate-of-return LECs are of sufficient scale to respond effectively to incentive regulation, and it is no longer in the public interest to shelter these LECs from full application of the all-or-nothing rule, both when it mandates price cap regulation for the larger ROR LECs, and when smaller ROR LECs opt for incentive regulation.

If the Commission nonetheless decides to allow ROR LECs to elect price cap regulation in some, but not all, of their study areas (which it should *not*), then there needs to be further constraints against cost-shifting. For example, at a minimum, a ROR carrier should be required to elect incentive regulation for all *contiguous* study areas. This would at least tend to reduce the possibility of shifting the cost of shared investment (*e.g.*, an access tandem) that serves multiple study areas.

C. A Low-End Adjustment Is Inconsistent With Other Key Features Of The CenturyTel Plan.

The CenturyTel plan proposes a low-end adjustment ("LEA") set at 10.25% to ensure reasonable earnings opportunities. In AT&T's view, there should be no low-end adjustment given that under the CentruyTel plan traffic sensitive rates would be frozen, as would USF support. The LEA is inconsistent with these key features of the CenturyTel plan because an LEA implies the ability to adjust either access rates or support levels. If the Commission nonetheless allows some form of LEA, any additional revenue the ROR LEC derives should be funded through the USF rather than carrier-paid access rates.

To the extent a LEA is permitted, the need for a low-end adjustment should be determined at the tariff filing entity level (as is done for LECs operating under price cap regulation), which could be at the holding company level rather than the study area level. Permitting low-end adjustments at lower than the filing entity level encourages LECs not to consolidate their study areas so as to increase their ability to obtain such an adjustment and to qualify for greater support under the local switching support ("LSS"), high-cost loop support ("HCLS") programs and the TS Additive proposed under the CenturyTel plan. Moreover, the proposed 10.25% threshold for a LEA is overly generous because it is well above the LECs' current cost of capital.[29]

D. The Commission Should Reform The USF To Accommodate Fund Growth.

CenturyTel's plan would permit an electing rate-of-return carrier to move its traffic sensitive charges to a target rate on a revenue-neutral basis by allowing a rate-of-return carrier to recover the difference between the target rate and its existing revenue requirement through a TS Additive to ICLS; the plan would freeze the TS Additive on a study area basis for the duration of the plan. The plan would also freeze ICLS and Long-Term Support ("LTS") on a per-line basis for electing carriers for the plan's duration, and freeze LSS on a study area basis for the plan's duration. The $650 million fund of interstate CALLS support

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[29] As AT&T has previously shown, the LECs' cost of capital in 1999 was in the 8%-9% range, and the authorized ROR should have been prescribed at the midpoint of that range. *See* Responsive Submission of AT&T Corp. to Prescription Proceeding Direct Case Submissions and Reply Comments on the Notice of Proposed Rulemaking, *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, (filed March 16, 1999) at iv, 28-31. Given the decline of interest rates since then, the LECs' current cost of capital is likely lower.

would not be available to the new price cap carriers.[30] High-cost loop support would be frozen on a per-line basis, subject to adjustment for GDP-PI.[31]

In response to SFNPRM (¶ 91), it is clear that the TS Additive that CenturyTel proposes will *increase* the size of the USF. If the Commission does not implement the Joint Board's recommendation to limit all components of high-cost support to a single connection per household,[32] then this increment, as well as the other components, can increase as wireless carriers gain ETC status for complementary lines. Even with implementation of the primary line restriction, the sustainability of the federal USF is jeopardized by the continued decline of the interstate and international retail revenue assessment base.[33] That is why AT&T advocates that the Commission reform the contribution mechanism to one that is based on a hybrid of telephone numbers and capacity-based special access connections.[34] With reform of the contribution mechanism, the USF will be able to accommodate many revisions to intercarrier compensation reform, including CenturyTel's proposal.

As for freezing HCLS on a per-line basis and growing it by the GDP-PI, as CenturyTel proposes, the Rural Task Force ("RTF") made a similar proposal for rural study

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[30] *Id.* CenturyTel proposes this revision as a redefinition of "price cap carrier," for the purposes of Part 54, Subpart J, in section 54.800.

[31] *Id.* CenturyTel proposes these revisions as amendments to sections 36.631 and 36.603. The rural growth factor would continue to apply to the portion of the high-cost fund that supports other rural LECs. All rural LECs would remain eligible to receive safety net and safety valve support. *Id.*

[32] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Recommended Decision (rel. Feb. 27, 2004) ¶¶ 56-87.

[33] *See* Comments of AT&T Corp., *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, *et al*. (filed Feb. 28, 2003) at 10-20.

[34] *Id*. at 4-10.

areas subject to competition from new ETCs. The FCC chose not to adopt that part of the RTF recommendation.[35] If the Commission were to make CenturyTel's proposal mandatory for the larger ROR carriers, as AT&T advocates, it would provide incentives for greater competitive entry in these study areas because anticompetitive implicit subsidies would have been removed from access rates. It would also make CenturyTel's proposal on HCLS consistent with the original RTF proposal, which AT&T had supported. Accordingly, if the Commission makes the CenturyTel plan mandatory for larger ROR LECs, it should freeze HCLS on a per-line basis and grow it by GDP-PI with competitive entry.

E. The Commission Should Adopt A Productivity Factor To Constrain Special Access Pricing.

The CenturyTel proposal is incomplete in that it addresses traffic sensitive pricing only and does not address special access. Special access, which is used extensively by wireless carriers, Internet service providers, business customers, as well as traditional long distance carriers, has become increasingly important in recent years. Among companies in the NECA traffic sensitive pool, for instance, interstate special access revenues have grown dramatically – from $59.6 million in 1997 to $314.9 million in 2003[36] and are projected to increase further to $383 million for the July 2003-June 2004 tariff year.[37] Special access has also become immensely profitable for local exchange carriers, providing the NECA companies with a 17.08% rate-of-return in 2003, substantially above the returns for other

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[35] *Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-45 & 00-256, FCC 01-157 (rel. May 23, 2001) ¶¶ 123-131 ("RTF Order").

[36] NECA Rate of Return Reports, Form FCC 492, March 29, 1996 and March 31, 2004, Line 1(C).

[37] NECA TRP filing, Transmittal No. 988, June 17, 2004, RORREV-1, Line 600.

access services.[38] Conventional price cap regulation, which has applied to regulating the interstate rates of medium to large size LECs since 1990, should be adopted for special access under the CenturyTel plan.

Ever since price cap regulation was first adopted, the Commission has relied on productivity (X-factor) adjustments to ensure that ratepayers benefit from ongoing gains in LEC productivity and increased operating efficiencies. During the initial phase of its price cap proceedings, the FCC determined that any form of regulation that is based on the costs of production must take productivity gains into account. *See Price Cap Further Notice*, 3 FCC Rcd. 3195, ¶ 363 (1988). The FCC found that the GNP-PI (the predecessor of GDP-PI) automatically reflects certain productivity gains in the economy, but does not necessarily reflect the productivity gains experienced by carriers, and thus concluded that its price cap formula should include a productivity adjustment. *See AT&T Price Cap Order* ¶ 198. The Commission affirmed this conclusion in the *LEC Price Cap Order* (¶ 75) when it adopted the initial productivity offsets of 3.3% and 4.3% (*id.* ¶¶ 100-101). These offsets were subsequently revised upwards in the Commission's 1995 and 1997 price cap orders. *See Price Cap Performance Review for Local Exchange Carriers,* First Report and Order, CC Docket No. 94-1, 10 FCC Rcd. 8961, ¶¶ 210-217 (1995); Fourth Report and Order in CC Docket No. 94-1, 12 FCC Rcd. 16642, ¶¶ 133-143 (1997).

One of the fundamental objectives in the Commission’s price cap proceedings has been to establish productivity factors that “provide a reliable measure of the extent to

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[38] NECA Rate of Return Reports, Form FCC 492, March 29, 1996 and March 31, 2004, Line 8. Rates of return in 2003 were 12.35% for Common Line, 13.47% for Switched Traffic Sensitive, and 13.29% for total Interstate Access.

which changes in LECs' unit costs have been less than the change in the level of inflation" and "pass through ongoing unit reductions to consumers."[39] In light of the Commission's longstanding policy, an X-factor should be adopted as part of any price cap mechanism for special access.[40]

There is ample evidence that unit costs for special access services have been declining. NECA data on special access rates and returns from 1995 to the present are presented and analyzed in Appendix B. Based on the reduction in rates that occurred during this time, accompanied by increasing rates of return, AT&T has calculated a historical X-factor of 6.05%. This estimate is based on the rates for Voice Grade and High Capacity (DS1) services, which represent 63% of NECA's anticipated special access revenue for the 2003-04 tariff period. The Commission should obtain similar data for the other NECA services, such as DS-3 service, as well as data from other carriers, and use them to determine the appropriate X-factor. This could be accomplished by extending the calculations detailed in Appendix B to include the non-NECA rate-of-return LECs.[41]

[39] *Price Cap Performance Review for Local Exchange Carriers,* Fourth Report and Order in CC Docket No. 94-1, ¶ 5.

[40] There does not appear to be any need to establish X-factors for other services under the CenturyTel plan. CenturyTel's proposal to reduce traffic sensitive rates to their $0.0095 and $0.0125 per minute targets and freeze associated support payments on a study area basis would provide adequate protection to ratepayers. Similarly, it appears that common line revenues would effectively be capped on a per-line basis under the CenturyTel plan, in which case the X-factor would implicitly equal the inflation rate. This is similar to the revenue per line ("RPL") mechanism that AT&T supported as appropriate for common line revenues in its comments on the *MAG FNPRM*, filed Feb. 14, 2002, at 4-5.

[41] If the CenturyTel plan is adopted on July 1, 2004, special access rates should be adjusted to a level that provides an 11.25% return and then capped at that level pending the completion of a further proceeding to determine the X-factor.

IV. SMALLER RATE-OF-RETURN CARRIERS SHOULD BE REQUIRED TO ADOPT EITHER THE CENTURYTEL OR ALLTEL PROPOSALS.

For smaller ROR carriers only, *i.e.*, those with less than 50,000 lines at the holding company level, AT&T supports ALLTEL's proposal or the "Rate-of-Return Carrier Tariff Option." *SFNPRM* ¶ 83. As proposed, this option would extend the current section 61.39 small carrier tariff option to all rate-of-return carriers, not just those serving 50,000 or fewer lines.[42] However, as noted above, AT&T believes the CenturyTel plan should be made mandatory for ROR LECs (other than average schedule companies) serving more than 50,000 lines, and the 61.39 option should continue to be available only to carriers serving 50,000 lines or fewer.[43] These smaller carriers should have the option of choosing the CenturyTel plan or remaining under 61.39 rate-of-return regulation, as many smaller carriers currently are. The ALLTEL plan is superior to conventional rate-of-return regulation under section 61.38 because it would reflect productivity gains from the prior tariff period without the inherent uncertainties associated with projecting cost and demand. In particular, under the ALLTEL plan if a carrier's unit costs go down in the prior period, the new rates in the subsequent tariff period would reflect these lower unit costs. Thus, adoption of the ALLTEL

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[42] ALLTEL *et al*. *Ex Parte* Letters, CC Docket Nos. 96-45, 98-77, 98-166, 00-256 (filed Jan. 31, 2003) at 3 and May 9, 2003 *Ex Parte* Letter (amending proposal to include all ROR carriers rather than just rural ROR LECs) ("ALLTEL *et al*. *Ex Parte* Letters"). As noted above, the Commission should make the CenturyTel plan mandatory for ROR carriers serving more than 50,000 lines at the holding company level.

[43] NECA could compute the rates for average schedule companies from the data filed by other ROR LECs under 61.39.

plan would reflect in the ROR regulation system what the Commission had recognized long ago for price cap carriers – that rates based on historical actuals rather than projections – would likely result in more efficient rates. *AT&T Price Cap Order* ¶ 308; *Transport Rate Structure and Pricing*, 10 FCC Rcd. 12979, ¶ 8 (1995).

Under the ALLTEL proposal, electing rate-of-return carriers would file tariffs for a two-year period, with rates based on historical costs and demand. Initial traffic sensitive rates would be established using costs and demand for the previous calendar year, while rates for succeeding tariff periods would be based on the actual costs and demand of the two preceding years. Thus, efficiencies achieved during the two-year tariff period would be reflected in the form of lower rates in the next two-year tariff period.[44]

V. THE COMMISSION SHOULD REALLOCATE THE RESIDUAL TRANSPORT INTERCONNECTION CHARGE, INFORMATION SURCHARGE AND MARKETING EXPENSE PRIOR TO ADOPTING THE ALLTEL PLAN.

In order to further rationalize the access cost structure of carriers that may elect 61.39 regulation, the Commission should act on at least three aspects of the RCC's petition for reconsideration of the *MAG Order*, by reallocating non-traffic sensitive costs (specifically revenues associated with the former residual transport interconnection charge, information surcharge and marketing expense) to the common line elements. This would tend to reduce the TS revenue requirements of the smaller ROR LECs that may elect to remain under ROR regulation per the ALLTEL proposal. As such, it would bring these smaller carriers' traffic sensitive rates closer to those of the larger carriers that would be subject to the CenturyTel

[44] ALLTEL *et al*. *Ex Parte* Letters at 4-5.

proposal. This would further the potential for competitive entry in these areas, as well as help sustain nationwide average long distance rates.

A. Transport Interconnection Charge

The Commission should reallocate the revenues associated with the former residual Transport Interconnection Charge ("TIC") from local switching to common line. As the *MAG Order* (¶ 99) recognized, the TIC is not a cost-based rate element and "as a per-minute charge assessed on all switched access minutes, adversely affects the development of competition in the interstate access market by "unduly increase[ing] the cost of competitive entry." *Id.* While there was a basis in the record and Commission precedent for shifting recovery of TIC costs to transport, special access and common line, there was no such basis with respect to local switching. In addition, in the *1997 Access Charge Reform Order* for price cap LECs, the Commission had addressed the TIC for price cap carriers by shifting some of its recovery to the Common Line basket, determining that it "should err, if at all, on the side of NTS recovery of these costs."[45] The Commission should similarly reallocate the revenues associated with the residual TIC from local switching to common line.

B. Information Surcharge

As part of its alternative, comprehensive universal service and access reform plan for rate-of-return LECs, the members of the RCC Coalition proposed transferring the recovery of the information surcharge into the common line elements.[46] The information

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[45] *Access Charge Reform*, 12 FCC Rcd. 15982, ¶ 233 (1997) ("*1997 Access Reform Order*"); *see also* Sept. 27, 2001 Nakahata Letter at n.19.

[46] *See* "Rural Consumer Choice Plan: Securing Universal Service and Promoting Choice for Rural America" (Aug. 9, 2001), attached as Exhibit D to the RCC's Petition for Reconsideration of the *MAG Order* (filed Dec. 28, 2001).

surcharge is "a rate element by which carriers recover the costs of white pages directory expenses."[47] AT&T had previously filed a petition to revoke the information surcharge waivers, on which the FCC had received full comment but upon which the Commission has never acted.[48]

Shifting the recovery of the information surcharge to common line would be consistent with the Commission's actions in the *CALLS Order*, in which the Commission noted: "We also find that the elimination of the information surcharge is consistent with the Commission's policy that non-traffic-sensitive costs be recovered by a non-traffic sensitive charge."[49] Accordingly, the Commission should transfer information surcharge costs to common line.

C. Marketing Expense

As the Commission tentatively concluded in 1998, marketing costs "should be recovered through the common line recovery mechanism."[50] In reaching that tentative conclusion, the Commission noted that in the *1997 Access Reform Order*, it had found that "price cap LECs' marketing costs that are not related to the sale or advertising of interstate switched access services are not appropriately recovered from IXCs through per-minute interstate switched access charges," and that therefore "recovering these expenses from end users instead of from IXCs is consistent with principles of cost-causation to the extent

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[47] *CALLS Order* ¶ 142, n.301.

[48] *AT&T Petition for Revocation of Information Surcharge Waivers*, CCB/CPD 98-61 (filed Oct. 9, 1998).

[49] *CALLS Order* ¶ 161.

[50] *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation,* CC Docket No. 98-77, Notice of Proposed Rulemaking, 13 FCC Rcd. 14238, ¶ 86 (1998).

that LEC sales and advertising activities are aimed at selling retail services to end users, and not at selling switched access services to IXCs."[51] The Commission should adopt its initial tentative conclusion and direct that retail marketing costs (which can be readily identified in Account 6610) be reallocated to common line for recovery.

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[51] *Id*. ¶ 84. *See also 1997 Access Reform Order* ¶¶ 319-320; Comments of AT&T, CC Docket No. 98-77 (filed Aug. 17, 1998) at 15; Comments of MCI, CC Docket No. 98-77 (filed Aug. 17, 1998) at 21.

CONCLUSION

For the reasons stated above, by July 1, 2004, the Commission should adopt and implement a modified version of the CenturyTel Plan and make it mandatory at the holding company level for all rate-of-return LECs serving more than 50,000 lines. The Commission should also require those LECs (other than average schedule companies) with less than 50,000 lines at the holding company level to either elect the CenturyTel plan or operate under a modified version of the ALLTEL plan.

Respectfully submitted,

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April 23, 2004