

**Attachment 1: Spreadsheet Showing Corrected
Calculation of ICLS True-Up for 2004**

| Calculation of PRTC Monthly ICLS, Attributing LTS Revenue Only to First Half of 2004 | | | | | | | | | |
|--|---------------|-------------------------|---------------|--------------------------|-----------------|-------------|---------------|---------------|----------------------|
| ILEC SAC | Data Period | CCL Revenue Requirement | SLC Revenue | Access Surcharge Revenue | Line Port Costs | CCL Revenue | Actual LTS | Correct ICLS | Correct Monthly ICLS |
| 633200 | 1st Half 2004 | \$ 10,837,006 | \$ 6,200,216 | \$ 750 | \$ 26,068 | \$ - | \$ 7,035,342 | \$ - | \$ - |
| 633200 | 2nd Half 2004 | \$ 10,837,006 | \$ 6,200,216 | \$ 750 | \$ 26,068 | \$ - | \$ - | \$ 4,609,972 | \$ 768,329 |
| 633201 | 1st Half 2004 | \$ 66,052,035 | \$ 40,871,839 | \$ 188,963 | \$ 317,313 | \$ - | \$ 37,549,872 | \$ - | \$ - |
| 633201 | 2nd Half 2004 | \$ 66,052,035 | \$ 40,871,839 | \$ 188,963 | \$ 317,313 | \$ - | \$ - | \$ 24,673,921 | \$ 4,112,320 |

| Calculation of Per-Line Support with Correct PRTC 2004 Lines (Line Counts from USAC/Telcordia) | | | | | | | | | |
|--|----------|--------|--|---------------------------|----------------------|-------|---------------------------------|--------------------------------|-----------------------------------|
| Data As Of | ILCE SAC | Zone | Residential & Single Line Business Lines | Multi-Line Business Lines | Company Monthly ICLS | Share | Zone's Monthly Share of Support | Residential ICLS Rate Per Line | Multi-Line Business Rate Per Line |
| 31-Mar-04 | 633200 | zone 1 | 157,326 | 27,822 | \$ - | 1 | \$ - | \$ - | \$ - |
| 30-Jun-04 | 633200 | zone 1 | 153,800 | 11,955 | \$ - | 1 | \$ - | \$ - | \$ - |
| 30-Sep-04 | 633200 | zone 1 | 152,686 | 11,822 | \$ 768,329 | 1 | \$ 768,329 | \$ 4.86 | \$ 2.16 |
| 31-Dec-04 | 633200 | zone 1 | 150,758 | 11,460 | \$ 768,329 | 1 | \$ 768,329 | \$ 4.93 | \$ 2.23 |
| 31-Mar-04 | 633201 | zone 1 | 803,187 | 125,111 | \$ - | 1 | \$ - | \$ - | \$ - |
| 30-Jun-04 | 633201 | zone 1 | 888,512 | 121,142 | \$ - | 1 | \$ - | \$ - | \$ - |
| 30-Sep-04 | 633201 | zone 1 | 882,025 | 118,190 | \$ 4,112,320 | 1 | \$ 4,112,320 | \$ 4.43 | \$ 1.73 |
| 31-Dec-04 | 633201 | zone 1 | 869,769 | 115,668 | \$ 4,112,320 | 1 | \$ 4,112,320 | \$ 4.49 | \$ 1.79 |

| Calculation of Centennial Support with Actual Centennial 2004 Lines (Line Counts As Submitted to USAC) | | | | | | | | | |
|--|----------|--------|--|---------------------------|-----------------------|-------------------------------|----------------------|---------------------------------------|--|
| Data As Of | ILCE SAC | Zone | Residential & Single Line Business Lines | Multi-Line Business Lines | Residential Rate/Line | Multi-Line Business Rate/Line | Monthly ICLS Support | Quarterly Eligible & USE Cert Support | |
| 31-Mar-04 | 633200 | zone 1 | 51,783 | 5,064 | \$ - | \$ - | \$ - | \$ - | |
| 30-Jun-04 | 633200 | zone 1 | 53,897 | 5,224 | \$ - | \$ - | \$ - | \$ - | |
| 30-Sep-04 | 633200 | zone 1 | 56,030 | 5,641 | \$ 4.86 | \$ 2.16 | \$ 284,767 | \$ 854,302 | |
| 31-Dec-04 | 633200 | zone 1 | 60,469 | 3,880 | \$ 4.93 | \$ 2.23 | \$ 306,580 | \$ 919,741 | |
| 31-Mar-04 | 633201 | zone 1 | 270,804 | 48,813 | \$ - | \$ - | \$ - | \$ - | |
| 30-Jun-04 | 633201 | zone 1 | 283,135 | 48,423 | \$ - | \$ - | \$ - | \$ - | |
| 30-Sep-04 | 633201 | zone 1 | 288,187 | 57,502 | \$ 4.43 | \$ 1.73 | \$ 1,376,313 | \$ 4,128,939 | |
| 31-Dec-04 | 633201 | zone 1 | 302,973 | 38,148 | \$ 4.49 | \$ 1.79 | \$ 1,428,634 | \$ 4,285,902 | |
| Annual Total: | | | | | | | | \$ 10,188,885 | |

| Corrected True-Up Amount (With Correct ICLS Received in 2004) | | | | |
|---|-------------------|---------------------|----------------|-----------------|
| SACCODE | ICLS Paid In 2004 | ICLS Owed per above | Annual True-Up | Monthly True-Up |
| 639001 | \$ 10,078,638 | \$ 10,188,885 | \$ 110,247 | \$ 18,375 |

Attachment 2: Excerpts from *LTS Order* Terminating
LTS Program as of July 1, 2004

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 Universal |) | CC Docket No. 96-45 |
| Service |) | |
| |) | |

**REPORT AND ORDER AND
 SECOND FURTHER NOTICE OF PROPOSED RULEMAKING**

Adopted: February 12, 2004

Released: February 26, 2004

Comment Date: 30 days from publication in the Federal Register

Reply Comment Date: 45 days from publication in the Federal Register

By the Commission: Commissioners Cops and Adelstein issuing separate statements.

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III. REPORT AND ORDER ON FURTHER NOTICE OF PROPOSED RULEMAKING

A. All-or-Nothing Rule

1. Background

6. Section 61.41 of the Commission's rules provides that if a price cap carrier is in a merger, acquisition, or similar transaction, it must continue to operate under price cap regulation after the transaction.¹¹ In addition, when rate-of-return and price cap carriers merge or acquire one another, the rate-of-return carrier must convert to price cap regulation within one year.¹² Furthermore, if an individual rate-of-return carrier or study area converts to price cap regulation, all of its affiliates or study areas must also convert to price cap regulation, except for its average schedule affiliates.¹³ Finally, LECs that become subject to price cap regulation are not permitted to withdraw from such regulation or participate in NECA tariffs.¹⁴ These regulatory requirements collectively are referred to as the all-or-nothing rule, and were affirmed by the United States Court of Appeals for the D.C. Circuit.¹⁵

7. The all-or-nothing rule addresses two concerns about mergers and acquisitions involving price cap companies.¹⁶ First, a LEC could attempt to "game the system" by switching back and forth between rate-of-return regulation and price cap regulation.¹⁷ A price cap carrier could increase earnings by opting out of price cap regulation, building a larger rate base under rate-of-return regulation in order to raise rates, and then, after returning to price cap regulation, cutting costs back to an efficient level. The Commission reasoned that it would not serve the public interest to allow a carrier to "fatten up" under rate-of-return regulation and "slim down" under price cap regulation, because rates would not decrease in the manner intended under price cap regulation.¹⁸ The second concern motivating the all-or-nothing rule is that a LEC with affiliates under both forms of regulation could attempt to shift costs from its price cap affiliate to

¹¹ 47 C.F.R. § 61.41(c)(1).

¹² 47 C.F.R. § 61.41(c)(2).

¹³ 47 C.F.R. §§ 61.41(b), 69.605 ("[a] telephone company that was participating in average schedule settlements on December 1, 1982, shall be deemed to be an average schedule company except that any company that does not join association tariffs for all access elements shall not be deemed to be an average schedule company.").

¹⁴ 47 C.F.R. §§ 61.41(d), 61.41(a)(3).

¹⁵ See *National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C.Cir. 1993).

¹⁶ See *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Order on Reconsideration, 6 FCC Rcd 2637, 2706, para. 148 (1991) (*LEC Price Cap Reconsideration Order*); see also *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, 14199, para. 18 (1999) (*ALLTEL Order*).

¹⁷ See *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2706, para. 148.

¹⁸ *Id.*

is correct that the price cap mechanism facilitated certain pricing relaxation for price cap carriers, it does not follow that the cost-based standards of rate-of-return regulation cannot be used to accomplish the same ends. Rate-of-return regulation was the basis on which cost-based access rates were established in 1984 when the access charge structure was implemented, and it was the basis for all incumbent LEC tariff review until 1991. The tariff rates will be subject to the tariff review process and parties may also file complaints pursuant to section 208 of the Act.¹³²

C. Consolidation of Long Term Support and Interstate Common Line Support

54. In this section, we adopt the Commission's tentative conclusion in the *MAG Further Notice* that LTS should be merged into the ICLS mechanism.¹³³ In the *MAG Order*, the Commission retained the existing LTS mechanism solely to provide stability to the NECA common line pool during the transition to a more efficient access charge regime. At this time, we find that merging LTS into the ICLS mechanism will provide administrative simplicity by eliminating a duplicative and obsolete mechanism, without affecting the total support received by rate-of-return carriers or negatively affecting carriers that choose to participate in the NECA pool.

1. Background

55. The LTS mechanism is a legacy of the transition to a competitive interstate long distance market after the breakup of AT&T. In the *1983 Access Charge Order*, the Commission created an access charge regime that included SLCs—monthly flat rate charges assessed on end users to recover a capped portion of interstate common line costs—and CCL charges, which are per-minute charges imposed on IXCs to recover any residual interstate common line costs.¹³⁴ The NECA common line pool was developed as a means of permitting LECs to recover their interstate common line revenue requirements while maintaining a nationwide average CCL charge.¹³⁵ The nationwide average CCL charge, in turn, permitted IXCs to more easily provide their services at nationwide deaveraged rates.¹³⁶ The Commission initially prescribed mandatory

¹³² *Id.*

¹³³ *MAG Further Notice*, 16 FCC Rcd at 19724-26, paras. 272-76. The Commission tentatively concluded that the merger would occur on July 1, 2003, but in order to provide adequate notice of our action here, we conclude that the merger will occur on July 1, 2004.

¹³⁴ *MTS and WATS Market Structure*, CC Docket No. 78-72, Third Report and Order, Phase I, 93 FCC.2d 241, 243-44, paras. 3-5, 279-97, paras. 124-96 (1983) (*1983 Access Charge Order*).

¹³⁵ *Id.* at 327-29, paras. 312-18, 333-36, paras. 339-49. Pooling carriers charge rates set by NECA, pool their interstate access revenues, and recover their costs from the pools, including a return on investment. *MAG Order*, 16 FCC Rcd at 19624, para. 20. The Commission concluded that a common tariff and pooling arrangement covering the CCL charge was necessary because LEC-specific CCL rates could generate significant pressures on IXCs to deaverage interstate toll rates. *1983 Access Charge Order*, 93 FCC 2d 241, para. 314.

¹³⁶ *1983 Access Charge Order*, 93 FCC 2d at 328, para. 314. Toll rate averaging and rate integration are longstanding Commission policies that Congress codified in the 1996 Act. See 47 U.S.C. § 254(g).

pooling to achieve these goals, but recognized that pooling had some negative effects.¹³⁷ In 1987, the Commission eliminated mandatory pooling, but created the LTS mechanism to permit carriers remaining in the pool to maintain their nationwide average CCL charges.¹³⁸ The LTS mechanism, as originally designed, required LECs that had left the common line pool to make payments into the pool sufficient for the pool to charge the nationwide average CCL rate of non-pooling carriers.¹³⁹

56. In 1997, the Commission concluded that the existing LTS mechanism was not explicit, portable, and competitively neutral, as required the 1996 Act.¹⁴⁰ The Commission concluded, however, that LTS continued to provide important benefits and should be retained in a modified form.¹⁴¹ Specifically, the Commission relied on the LTS mechanism's usefulness in reducing disparities among CCL charges imposed by LECs: "LTS payments serve the public interest by reducing the amount of loop cost that high cost [rate-of-return carriers] must recover from IXCs through CCL charges and thereby facilitating interexchange service in high cost areas, consistent with the express goals of section 254."¹⁴² To comply with the Act, the Commission concluded that LTS contributions must be removed from the access rate structure and recovered instead through the universal service fund.¹⁴³ The Commission also modified LTS by fixing each carrier's LTS at its 1997 level plus growth based on nationwide average loop costs.¹⁴⁴ As a result of these and other reforms, a nationwide average CCL charge was no longer

¹³⁷ See *1983 Access Charge Order*, 93 FCC 2d at 327, para. 312, 328, para. 317. For example, pooling limited LEC flexibility in cost recovery, established economically inefficient cost and price distortions, and reduced incentives for LECs to contain costs. See *MTS and WATS Market Structure Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72 and 80-286, Report and Order, 2 FCC Rcd 2953, 2956-58 paras. 23, 33 (1987) (*1987 Access Charge Order*). The Commission has also recognized that the pool provides additional benefits to pooling carriers, including the pooling of risk and tariff agency services. See *MAG Order*, 16 FCC Rcd at 19726, para. 276.

¹³⁸ *1987 Access Charge Order*, 2 FCC Rcd at 2956-58, paras. 23-26, 32-33.

¹³⁹ *Id.*

¹⁴⁰ *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 9164-65, para. 756 (1997) (*Universal Service First Report and Order*).

¹⁴¹ *Id.* at 9165 para. 757.

¹⁴² *Id.*; see *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Access Charge Reform*, CC Docket No. 96-262, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, *Transport Rate Structure and Pricing*, CC Docket No. 91-213, *End User Common Line Charge*, CC Docket No. 95-72, *Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63, paras. 74, 76 (*Universal Service Fourth Order on Reconsideration*).

¹⁴³ *Universal Service First Report and Order*, 12 FCC Rcd at 9165-66, paras. 757-59.

¹⁴⁴ *Id.* at 8942, para. 306. Beginning in 2000, the annual growth was based on inflation. See 47 C.F.R. § 54.303(a)(4).

possible, though LTS and the common line pool continued to reduce disparities among CCL charges.¹⁴⁵

57. In the *Universal Service Fourth Order on Reconsideration*, the Commission declined to eliminate the requirement that carriers participate in the NECA common line pool in order to be eligible for LTS.¹⁴⁶ At that time, several petitioners argued that requiring pool membership as a condition of eligibility for LTS was unnecessary in light of the decision to remove LTS from the access rate structure and would hamper the ability of LTS recipients to pass savings from new efficiency gains on to their customers.¹⁴⁷ The Commission concluded that maintenance of the existing LTS program was warranted to avoid disruption to rate-of-return carriers until it undertook comprehensive access charge and universal service reform for such carriers.¹⁴⁸ In support of this conclusion, the Commission repeated its conclusion in the *Universal Service First Report and Order* that LTS reduced CCL charges and thereby facilitated interexchange service in high cost areas.¹⁴⁹ The Commission also cited its desire not to “undermine the pool’s usefulness in permitting participants to share the risk of substantial cost increases related to the CCL charge by pooling their costs and, thereby, charging an averaged CCL rate close to that charged by other carriers. This operation of the pool, like LTS payments, serves section 254’s goal of facilitating interexchange service in high cost areas.”¹⁵⁰

58. In the *MAG Order*, the Commission undertook comprehensive access charge and universal service reform for rate-of-return carriers. As noted above, the Commission created a new explicit universal service mechanism, ICLS, to replace implicit support provided by CCL charges.¹⁵¹ This support mechanism provides each incumbent rate-of-return carrier with its allowable common line revenues to the extent they cannot be recovered through end user charges and, at the present time, LTS.¹⁵² In this respect, ICLS is specifically designed to preserve incumbent rate-of-return carriers’ ability to provide affordable, quality services to rural consumers while allowing carriers to recover their common line revenue requirements through a

¹⁴⁵ In October 1997, the Commission granted a request for waiver by NECA, permitting the NECA pool to charge a CCL rate other than the average CCL rate charged by price cap carriers. *Access Charge Reform*, CC Docket No. 96-262, *Price Cap Performance Review for LECs*, CC Docket No. 94-1, *Transport Rate Structure*, CC Docket No. 91-213, Second Order on Reconsideration and Memorandum Opinion and Order, 12 FCC Rcd 16606, 16334-36, paras. 86-89 (1997). Under the conditions of the waiver, the NECA common line pool was permitted to compute the CCL rate as the per-minute amount necessary to recover the difference between revenues from SLCs, LTS, and special access surcharges and the pool’s common line revenue requirement. *Id.* at 16335-36, para. 89.

¹⁴⁶ *Universal Service Fourth Order on Reconsideration*, 13 FCC Rcd at 5361-63, paras. 74-76.

¹⁴⁷ *Id.* at 5360, para. 69.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 5362, para. 74.

¹⁵⁰ *Id.*

¹⁵¹ *MAG Order*, 16 FCC Rcd at 19667-69, paras. 128-31.

¹⁵² *Id.* at 19668-69, para. 130, 19673-74, para. 142.

more efficient rate structure.¹⁵³ The Commission concluded that ICLS should be available to all rate-of-return carriers that would otherwise have recovered interstate common line revenues through CCL charges, and not limited only to participants in the common line pool.¹⁵⁴

59. The Commission concluded that its action to eliminate the CCL charge in the *MAG Order* negated the primary reason for LTS's existence.¹⁵⁵ The Commission considered immediately merging LTS into the ICLS mechanism, but concluded that LTS should be retained temporarily in order to ensure the stability of the NECA common line pool during the transition to the new access rate structure.¹⁵⁶ Accordingly, the Commission retained the LTS mechanism and adopted rules providing that carriers leaving the pool and foregoing LTS would be ineligible for increased ICLS to make up for the lost LTS.¹⁵⁷ The Commission also issued a notice seeking comment on its tentative conclusion to merge LTS into ICLS effective July 1, 2003, after the completion of the *MAG Order's* access charge reforms.¹⁵⁸ The Commission explained that, during the interim, LTS would serve to reduce ICLS amounts for carriers but would not affect the total support levels or revenue recovery for rate-of-return carriers, provided they remained in the pool.¹⁵⁹

60. In response to the *MAG Further Notice*, the Commission received comments both supporting and opposing its tentative conclusion. AT&T, CUSC, and GCI support the Commission's tentative conclusion.¹⁶⁰ NECA and Western Alliance argue that the merger of LTS into ICLS should be delayed pending "longer-term" analysis of the effects of the *MAG*

¹⁵³ *Id.* at 19667-69, paras. 128-31.

¹⁵⁴ *Id.* at 19672, para. 138.

¹⁵⁵ *Id.* at 19672-73, paras. 139-41, 19724-26, paras. 272-76.

¹⁵⁶ *Id.* at 19672-73, paras. 139-41. The Commission ordered a graduated phase-out of the CCL charge between January 1, 2002, and July 1, 2003, contemporaneous with increases to the residential and single-line business SLC caps. *Id.* at 19644-45, para. 65. This phase-out of the CCL charge prevented a spike in ICLS during the gradual phase-in of increased SLC caps. *Id.*

¹⁵⁷ *Id.* at 19672-73 paras. 139-40.

¹⁵⁸ *Id.* at 19724-26, paras. 139-41. In an order released on June 13, 2002, the Commission amended its rules governing LTS. *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent LECs and IXCs*, CC Docket No. 00-256, Federal-State Joint Board on Universal Service, CC Docket 96-45, Order and Second Order on Reconsideration in CC Docket No. 00-256, 17 FCC Rcd 11593, 11594-97, paras. 4-10 (rel. June 13, 2002) (*June 2002 MAG Reconsideration Order*). The amended rules capped LTS support for certain carriers that would otherwise exceed their common line revenue requirements due to increased SLC revenues as a result of the *MAG Order* reforms.

¹⁵⁹ *MAG Order*, 16 FCC Rcd at 19672-73, paras. 139-41. Because ICLS is reduced by the amount of LTS that a carrier receives or, for carriers that have left the NECA common line pool, the amount of LTS that they would have received had they remained in the pool, a pooling carrier that currently is eligible for both ICLS and LTS will receive less total support if it chooses to leave the pool. 47 C.F.R. § 54.901(a). Due to caps on other revenue sources, such a carrier likely would not be able to recover the lost universal service support from other sources.

¹⁶⁰ AT&T Comments at 23 n.20; CUSC Comments at 8-9; GCI Comments at 18.

Order reforms and other pending proceedings.¹⁶¹ NTCA contends without elaboration that merging LTS into ICLS will diminish the viability of the common line pool, which provides benefits to small rural carriers that participate in it.¹⁶² NRTA, OPASTCO, and USTA, the other members of MAG, have not adopted an official position on the issue of merging LTS into ICLS.¹⁶³

2. Discussion

61. We adopt the Commission's tentative conclusion in the *MAG Order* that LTS should be merged into the ICLS mechanism. First, merging LTS into ICLS would promote administrative simplicity. LTS and ICLS duplicatively provide support directed to the rate-of-return carriers' interstate common line costs.¹⁶⁴ ICLS is narrowly tailored to individual carriers' support requirements under the current interstate access rate structure, acting as the residual source of revenue for rate-of-return carriers and ensuring that they can recover their common line revenue requirements while providing service at an affordable rate. LTS, on the other hand, normally provides each carrier with a fixed level of support grown annually by inflation and may bear little relevance to a particular carrier's support requirements. In most cases, LTS will not be sufficient to ensure that a carrier will recover its common line revenue requirement under the current rate structure.¹⁶⁵ Although LTS effectively served the purposes it was designed to serve, it was not designed to meet the requirements of the rate-of-return access charge rate structure in place after the *MAG Order*. Eliminating LTS will make the interstate access rate structure and universal service mechanisms simpler and more transparent.

¹⁶¹ NECA Comments at 10-15; Western Alliance Comments at 10-12; NECA Reply at 8-10.

¹⁶² NTCA Comments at 6; *see also* NTCA Reply at 6-7 (supporting NECA's comments).

¹⁶³ *See* Letter from Colin Sandy, Associate Attorney, NECA, to Marlene H. Dortch, Secretary, FCC, dated March 14, 2003, Attachment (memorializing ex parte presentation by NECA, NRTA, NTCA, OPASTCO, and USTA).

¹⁶⁴ We find that Innovative's and CUSC's concerns regarding LTS and ICLS are misplaced. Innovative neither opposes nor supports the Commission's tentative conclusion, but raises concerns, based on language in the *MAG Order*, that a rate-of-return carrier may receive less support under the ICLS mechanism than it had previously received under LTS. Innovative Comments at 5-6. That would only occur, however, if the carrier would otherwise recover higher revenues than permitted by its common line revenue requirement, a situation that has been remedied by the Commission's amendment of the LTS rules in June 2002. *See June 2002 MAG Reconsideration Order*, 17 FCC Rcd at 11596-97, para. 8. CUSC argues that the current coexistence of LTS and ICLS permits rate-of-return carriers to receive double support for the common line. CUSC Comments at 8-9. Although LTS and ICLS perform duplicative functions, the two mechanisms are complementary with respect to the amount of support provided. Because a carrier's ICLS is reduced by any LTS received, the carrier would not recover more combined support than it would receive if ICLS or LTS were the sole sources of support for the interstate common line. *See MAG Order*, 16 FCC Rcd at 19673, para. 141.

¹⁶⁵ In other cases, LTS would have permitted some carriers to earn more than their common line revenue requirements had the Commission not amended its rules to limit support in a manner consistent with the ICLS rules. *See June 2002 MAG Reconsideration Order*, 17 FCC Rcd at 11596-97, para. 8.

62. Moreover, even proponents of retaining LTS acknowledge that the Commission's elimination of the CCL charge obviates LTS's primary historical purpose.¹⁶⁶ As the history of LTS makes plain, the Commission's primary concern in developing and retaining LTS over the years has been to reduce disparities in CCL charges among LECs. In its original incarnation, LTS was specifically designed to guarantee that all carriers would charge a nationwide average CCL charge.¹⁶⁷ When the Commission later amended its LTS rules to comply with the 1996 Act rather than eliminating LTS, the Commission continued to focus solely on the public interest served by LTS in reducing the disparities in CCL charges among rate-of-return carriers (though the mechanism no longer guaranteed the maintenance of a nationwide average CCL rate).¹⁶⁸ Having outlived its primary purpose as of July 1, 2003, when the CCL charge was completely phased out, we conclude that LTS should be discontinued in the interest of administrative simplicity.

63. LTS's secondary role as an incentive for continued participation in the NECA common line pool also is no longer a valid reason to maintain LTS as a discrete support mechanism. LTS is only available to carriers that participate in the common line pool.¹⁶⁹ Removing LTS as an artificial incentive for pool participation will give each carrier the freedom to choose to set rates outside of the NECA pool without sacrificing the universal service support that ensures affordable service for its customers. We recognize that NECA has made great strides in providing common line pool participants with increased flexibility in setting individual end user rates and that it anticipates further innovation in this respect.¹⁷⁰ Carriers will undoubtedly regard such flexibility as a tremendous value in making their determinations whether to continue participating in the pool. Nonetheless, we find that each individual carrier is in the best position to decide whether pool participation promotes its particular best interests. We conclude that the decision whether to participate in the pool should be left to each individual carrier based on the pool's inherent administrative benefits for that carrier without additional regulatory inducements.

64. We do not believe that eliminating LTS as an incentive for pool membership will risk or undermine the important benefits for carriers that elect to remain in the NECA common

¹⁶⁶ See, e.g., NECA Comments at 13 ("As the FNPRM points out, however, the principal rationale for providing LTS funding to NECA pool participants (i.e., assuring nationwide comparability of NECA pool CCL rates) will no longer apply following elimination of the CCL charge."). No commenter contends that LTS serves any purpose other than encouraging participation in the NECA common line pool. See NECA Comments at 10-15; NTCA Comments at 6; Western Alliance Comments at 10-12; NTCA Reply at 6-7.

¹⁶⁷ 1987 Access Charge Reform Order, 2 FCC Rcd at 2957, para. 33 ("The long term support mechanism allows [pooling] carriers to maintain the nationwide averaged CCL rate that would have existed had the mandatory full common line pool been retained.")

¹⁶⁸ Universal Service First Report and Order, 12 FCC Rcd at 9165, para. 757.

¹⁶⁹ 47 C.F.R. § 54.303.

¹⁷⁰ NECA has introduced rate-banding and plans to allow pooling carriers to disaggregate their SLCs as means for carriers to set their prices competitively, and notes that pooling carriers may file their tariffs separately in any event. NECA Comments at 14.

line pool. We recognize the continued benefits of pooling identified by NECA and other commenters, including the reduction of administrative burdens associated with tariff-filing and *protection against the effects of short-term revenue fluctuations*.¹⁷¹ We anticipate that many, if not most, carriers will continue participating in the common line pool because of such benefits. In this regard, we note that the NECA traffic-sensitive pool remains viable despite no comparable regulatory incentive for participation. Based on examination of the record, however, we cannot conclude that the benefits of pooling warrant continued use of universal service support to induce carriers to participate in the pool if they are not otherwise inclined to do so.¹⁷²

65. Moreover, the regulatory concerns which justified the use of LTS to induce pool participation no longer hold. In the past, a non-pooling carrier might not recover its common line revenue requirement if it underprojected its costs or overprojected its demand in developing its access charge tariffs. The NECA common line pool spread that risk among all carriers, reducing the likelihood that any one carrier would suffer a major shortfall in revenue. Eliminating the CCL charge renders irrelevant this primary risk-pooling benefit of the common line pool. While the pool formerly ensured that an individual carrier would not suffer if CCL charge revenues were insufficient to recover its common line revenue requirements, the ICLS mechanism now ensures that no individual carrier will fail to recover its common line revenue requirement.

66. Finally, we note that we have taken a more measured approach by deferring implementation of this change for an additional year beyond that originally proposed by the Commission in the *MAG Further Notice*. The Commission adopted a cautious approach to access charge and universal service reform in the *MAG Order*, in recognition of the unique needs and broad diversity of rate-of-return carriers. The Commission had previously retained LTS pending comprehensive reform to the access rate structure. Absent any specific concern, we conclude that the elimination of the LTS mechanism should not be further deferred.¹⁷³

¹⁷¹ See *MAG Order*, 16 FCC Rcd at 19726, para. 276; see also *Regulatory Reform for LECs Subject to Rate of Return Regulation*, CC Docket No. 92-135, Notice of Proposed Rulemaking, 7 FCC Rcd 5023, 5030 (1992); *MTS and WATS Market Structure*, CC Docket No. 78-72, *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 80-286, Memorandum Opinion and Order on Reconsideration, 3 FCC Rcd 4543, 4560 n. 108 and accompanying text (1988).

¹⁷² To the contrary, some commenters supporting the retention of LTS argue that LTS itself does not provide a significant incentive for pool participation. These commenters argue that, for the low-cost carriers most likely to leave the pool, "availability or non-availability of LTS is not likely to be a significant factor in reaching a decision as to whether to exit the pool." NECA Comments at 14; Western Alliance Comments at 11 ("Those carriers having relatively low common line costs are unlikely to be influenced to a significant degree by the availability or non-availability of LTS."); NTCA Reply at 7.

¹⁷³ NECA generally asserts that the *MAG Order* carried out "extraordinary changes in universal service support and access charge mechanisms," but offers no specific concerns to justify deferring the merger of LTS into ICLS. NECA Comments at 10-15.

The reformed access rate structure adopted in the *MAG Order* possesses greater inherent stability than the prior rate structure.¹⁷⁴

67. In order to effectuate this decision, we amend our rules to provide that LTS shall not be provided to any carrier beginning July 1, 2004. We note that overall support will not be reduced because our existing rules will operate to automatically increase ICLS by an amount to match any LTS reduction. For that reason, no further action by the Commission is necessary to implement the merger of LTS into ICLS.

IV. SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

A. Alternative Regulation and the All-or-Nothing Rule

68. In this further notice of proposed rulemaking, we seek additional comment on incentive regulation and on the all-or-nothing rule. CenturyTel and a group of carriers (ALLTEL, Madison River and TDS) filed separate alternative regulation proposals as *ex parte* filings in response to the 2002 notice.¹⁷⁵ 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 incentive regulation. We therefore will address the remaining all-or-nothing issues not resolved above in conjunction with our evaluation of the two incentive regulation plans before us.

1. Background

a. All-or-Nothing Rule

69. Section 61.41 of the Commission's rules sets forth certain requirements governing elective entry into price cap regulation and restricting the ability of price cap carriers to leave price cap regulation. We describe these provisions in Section III.A, *supra*. That section also describes the issues raised in the *MAG Further Notice* concerning the modification or elimination of the all-or-nothing rule and the general tenor of the comments we received in response to the notice.

b. Alternative Regulation

70. The traditional regulatory model for incumbent LECs has long been rate-of-return regulation.¹⁷⁶ LECs subject to rate-of-return regulation establish tariff rates targeted to achieve

¹⁷⁴ For example, an individual carrier's common line revenues will no longer be threatened by fluctuating minutes of use or inaccurate cost projections that may result in insufficient CCL charge revenues because each carrier will recover its precise common line revenue requirement from ICLS.

¹⁷⁵ See CenturyTel, Inc., Ex Parte in CC Docket Nos. 96-45, 98-77, 98-166 and 00-256 (filed Dec. 23, 2002); ALLTEL Communications, Inc., Madison River Communications LLC and TDS Telecommunications Corporation, Ex Parte in CC Docket Nos. 96-45, 98-77, 98-166 and 00-256 (filed Jan. 31, 2003); letter from Stephen Kraskin, Esq., counsel for ALLTEL Communications, Inc., Madison River Communications LLC and TDS Telecommunications Corporation, to Marlene H. Dortch, Secretary, FCC, dated May 9, 2003 (Kraskin letter) (amending plan to reflect availability to all rate-of-return carriers rather than just to rural rate-of-return carriers).

¹⁷⁶ See *MAG Order*, 16 FCC Rcd at 19622-24, paras. 16-20.

Attachment 3: March 2, 2004 *Mattey Letter*