

**D.T.C. 10-2**

**Comcast Phone of Massachusetts, Inc.**

**Response to DTC-Comcast 1-1**

**EXHIBIT B (Part I)**



LEXSEE 93 FCC 2D 241

In the Matter of MTS and WATS Market-Structure; (Part 1 of 2)

CC Docket No. 78-72, Phase I

**RELEASE-NUMBER:** FCC 82-579

FEDERAL COMMUNICATIONS COMMISSION

*93 F.C.C.2d 241; 1983 FCC LEXIS 596; 53 Rad. Reg. 2d (P & F) 479*

February 28, 1983 Released; Adopted December 22, 1982

**ACTION:**

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THIRD REPORT AND ORDER

**JUDGES:** BY THE COMMISSION: COMMISSIONERS QUELLO, FOGARTY, DAWSON, RIVERA AND SHARP ISSUING SEPARATE STATEMENTS; COMMISSIONER JONES CONCURRING AND DISSENTING IN PART AND ISSUING A SEPARATE STATEMENT.

**OPINION:**

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## I. INTRODUCTION

## A. Outline of the Plan

1. When this Commission initiated this proceeding to determine an optimal market structure for the MTS-WATS market, we concluded that it would also be necessary to prescribe the compensation that exchange carriers should receive for the origination or termination of all interstate and international services of all carriers. We recognized that it would be impossible to determine [\*243] "access" compensation for services of carriers that compete with MTS or WATS without correcting existing disparities in access compensation among services offered by AT&T and its telephone company partners.

2. We subsequently invited comments upon a tentative plan for carrier's carrier access charges that would allocate exchange plant costs among four service categories on the basis of relative use. We hoped that such a plan would eliminate discrimination or preferences in rates that were charged to end users of all services that we regulate. Comments in this and other proceedings and other developments led us to conclude that the tentative plan would not produce a correct solution to the discrimination problem. The recovery of fixed costs through [\*3] usage charges produces discrimination among MTS users that is a primary cause of the inter-service disparities. The comments in this proceeding reveal a fairly broad consensus that this is the case.

3. We have accordingly concluded that a substantial portion of fixed exchange plant costs that are assigned to interstate services should ultimately be recovered through flat per line charges that are assessed upon end users. We are adopting access charge computation rules that will accomplish that result. n1 Those rules incorporate exceptions for pay telephones, the portion of a local dial switch that is sometimes described as non-traffic sensitive, and "private line" facilities used for services that are not close substitutes for MTS. Certain other fixed costs assigned to interstate services

for customer premises equipment, inside wiring, and a Universal Service Fund will not be recovered through end user charges and will continue to be recovered through carrier's carrier charges. The Universal Service Fund will be designed to preserve universal service by enabling high cost local exchange companies to establish local exchange rates that do not substantially exceed local exchange rates [\*\*4] charged by other local exchange companies.

n1 The rules are contained in Appendix A. Appendices B and D list persons who filed comments in response to the *Second and Fourth Supplemental Notices*. Appendices C and E contain summaries of those comments. Appendix F contains supplemental information with respect to the "bypass" phenomenon and Appendix G contains supplemental information with respect to the universality of service.

4. A transitional plan is necessary for several reasons. Immediate recovery of high fixed costs through flat end user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund. Such a result would not be consistent with the goals of the Communications Act. Some transitional adjustments are also necessary to avoid anomalous effects of existing disparities in interstate costs in different areas and to establish access charges for competing carriers that reflect existing inequalities in the quality of access arrangements. The transitional plan will also enable us to [\*244] adjust rules in the future if unexpected developments demonstrate that changes [\*\*5] are warranted.

5. This combination of factors has led us to adopt rules that incorporate two transitions. Some fixed costs in addition to any high cost or Universal Service Fund costs will be recovered through carrier's carrier charges during a 5-year transition period. A substantial portion of those costs will initially be assessed to AT&T as a charge for premium access. The remaining costs will be assessed to end users and will be recovered through a combination of usage and flat charges during a 7-year transition period. Before the end of the fifth year of the 7-year transition, we will evaluate the rules and policies adopted in this *Report and Order* and, if necessary, will make adjustments needed to promote the expressed goals of this proceeding. A minimum charge will be assessed upon all end users. The remainder of the costs may be recovered through usage charges until the usage charge for any line equals a cap or maximum. We are giving the exchange carriers considerable discretion to devise a combination of minimum, usage and maximum charges. This will give the carriers discretion as to how rapidly to phase in flat charges. It will enable carriers to respond quickly to any [\*\*6] bypass threat where this a problem, while allowing for a more gradual phase-in where it is not. We are, however, imposing some limits upon carrier discretion. A minimum charge cannot be less than \$2 per month for residential customers and \$4 per month for business customers and the business minimum cannot exceed 200% of the residential minimum. Maximum charges will assure that customers do not pay more through end user charges for interstate use of a line that is used for local exchange and interstate services than they would pay for a line that is dedicated to a particular interstate service.

6. We are also prescribing rules for the computation of carrier's carrier charges for access services other than exchange plant. Although the tentative plan we described in 1980 would have limited the definition of access to facilities that are used in common by exchange and interexchange services, we have expanded the definition of access to correspond with the *Modified Final Judgment* in the AT&T antitrust case. n2 We have established nine different elements for such carrier's carrier charges and are prescribing rules for the computation of each element charge that are tailored to the nature [\*\*7] of each service. We have established two elements for the use of local dial switches, three elements for operator services, and two elements for other switching and transmission facilities. We have also established a Billing and Collection element and a Special Access [\*245] element that consists primarily of the use of a variety of "private line" facilities.

n2 See *Modified Final Judgment in United States v. American Telephone and Telegraph Co.*, Civil Nos. 74-1698 and 82-0192, -- F.Supp. --, 47 *Fed. Reg.* 40, 392 (D.D.C. 1982). (hereinafter "MFJ").

7. We have decided that we should neither compel all exchange carriers to join in pooled uniform charges for all access elements nor permit unrestricted deaveraging. We are mandating the creation of an exchange carrier association that will collect and distribute the carrier's carrier portion of the non-traffic sensitive charges and file tariffs and administer revenue pools for companies that choose to join in the association's common tariffs for other access elements.

8. We are directing AT&T to prepare the initial association tariffs in order to ensure that access charges will be in place on January [\*\*8] 1, 1984.

#### B. Background: The Origins and Purpose of the Access Charge Proceeding

9. This proceeding began in February, 1978 with the issuance of a *Notice of Inquiry and Proposed Rulemaking* (the "Initial Notice"), 67 FCC 2d 757 (1978), to determine the MTS-WATS market structure that would best serve the public interest. To resolve this fundamental question, we have issued four subsequent notices of inquiry. n3 Each represented a refinement in our understanding of the issues requiring resolution. In the *Third Supplemental Notice*, we concluded that a general policy of open entry in the domestic MTS/WATS market, including Hawaii, would be in the public interest. While tentatively reaching the same conclusion for the Alaska submarket, we decided to give further consideration to issues relating to that submarket. In light of the conclusions reached in the *Third Supplemental Notice*, we determined that future proceedings in this docket would be restricted to consideration of two issues. In Phase I of the docket, we would develop a system of access charges by which local telephone companies would receive compensation for the use of their plant [\*\*9] to complete competitive interstate telecommunications offerings. In Phase II we would determine the appropriate market structure for MTS/WATS in the Alaskan submarket.

n3 *Supplemental Notice of Inquiry and Proposed Rulemaking ("First Supplemental Notice")*, 73 FCC 2d 222 (1979), *Second Supplemental Notice of Inquiry and Proposed Rulemaking ("Second Supplemental Notice")*, 77 FCC 2d 224 (1980); *Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking ("Third Supplemental Notice")*, 81 FCC 2d 177 (1980); and *Fourth Supplemental Notice of Inquiry and Proposed Rulemaking ("Fourth Supplemental Notice")*, 90 FCC 2d 135 (1982).

10. We recently resolved Phase II of the docket by affirming our tentative conclusion that an open entry policy in the Alaskan interstate MTS/WATS market would be in the public interest. See *Second Report and Order* in CC Docket No. 78-72, FCC No. 82-515, released November 30, 1982. Today we resolve Phase I by adopting rules that will determine the rates interexchange carriers and end [\*246] users will pay for access to local telephone [\*\*10] company facilities used to complete interstate service offerings. We believe that through these rules we shall achieve the competitive market structure that is the explicit goal of both this proceeding and of the MFJ.

11. As we have noted above, this phase of the proceeding was instituted to determine, first, whether the existing methods of compensation for exchange plant used in interstate telephone service should be replaced by a tariffed access charge framework and, second, if so, what the structure of such tariffs should be. The entry of the MFJ has effectively mooted the first question. Currently, approximately 80% of revenues for this plant are covered by the Bell System's Division of Revenues process. This private contractual agreement has transferred revenues of almost \$7 billion per year within the Bell System. On the date of divestiture, the system will no longer exist. The MFJ requires the termination of this system and its replacement by a generalized tariffed offering of access service.

12. While it would theoretically be possible to maintain the private settlements mechanism (which is equivalent to the Division of Revenues plan) to compensate non-Bell telephone companies, [\*\*11] we believe that, even absent this *Report and Order*, some generalized access charge tariff scheme would result. We now decide that the public interest requires that the basic structure of such access tariffs be set by this Commission. We expect access tariffs to be filed in 1983 and require that such access tariffs be in conformance with the rules adopted herein.

13. The plan described in this *Report and Order* is, of course, limited to basic, or regulated, services. The plan is also limited to interstate and foreign services subject to our jurisdiction. We have assumed, for purposes of the proceeding, that the existing *Separations Manual* correctly identifies the costs assignable to those interstate and foreign services. Some commenting participants, e.g., Satellite Business Systems, have argued that non-traffic sensitive access costs should no longer be allocated between the intrastate and interstate jurisdictions. They propose that a single charge should recover the entire revenue requirement associated with non-traffic sensitive facilities. They claim that such a charge should fall within federal jurisdiction, despite the Supreme Court's decision in *Smith v. Illinois Bell Telephone*, 282 U.S. 133 (1930). [\*\*12] In this proceeding we need make no determination as to whether *Smith* requires jurisdictional separations of NTS plant. As we said in the *Fourth Supplemental Notice*, 90 FCC 2d at 154, it is the separations process that determines what costs must be recovered from the interstate jurisdiction by means of an access charge. That process is currently being investigated by a Joint Board and is beyond the scope of this docket. In the *Order Requesting Further Comments* ("Joint Board Order" hereinafter), the Joint Board specifically invited parties to comment on whether separation of NTS costs by jurisdiction is [\*247] required, and on the desirability of a discretionary assignment of 100 percent to either jurisdiction. n4 47 Fed. Reg. 54479, 54517 (December 3, 1982).

n4 A decision to assign 100% to either jurisdiction would, of course, require changes in the access charge rules we are adopting.

14. Finally, we have limited our consideration here to the provision of that portion of interstate and foreign service which we consider to be "access" service. We had earlier used the term "access" to describe the use of [\*\*13] certain exchange plant necessary to originate and terminate interexchange services. We have; however, decided to expand the scope of our access charge rules to conform to the boundaries established by MFJ. In the *Fourth Supplemental Notice* we suggested that it might be desirable to expand our access charge plan to encompass all services or facilities that will be included in access charges of the divested Bell Operating Companies ("BOCs") and invited "interested persons to submit suggestions for accomplishing that purpose." *90 FCC 2d at 153*. We have concluded that such a course would be desirable because disparities would be likely to arise in the future if independent telephone companies and the undivested BOCs n5 are compensated through some other mechanism for services or facilities that are included in divested BOC access charges. The access rules we prescribe will therefore cover all services and facilities that are classified as exchange access for purposes of the MFJ. We are, however, adopting less detailed rules for the computation of charges for access elements that we might have excluded from our plan if the MFJ did not exist. For non-access [\*\*14] interstate facilities and services, we have assumed that any questions concerning apportionment or allocation will be resolved in the *Interim Cost Allocation Manual* or a successor to that *Manual*. n6

n5 Cincinnati Bell Inc. and Southern New England Telephone Company.

n6 The *Interim Cost Allocation Manual* or "ICAM" was adopted in *Amer. Tele. and Tele. Co., 84 FCC 2d 384, recon. denied, 86 FCC 2d 667 (1981), affirmed sub nom. MCI Telecommunications Corp. v. FCC ("ICAM"), 679 F.2d 408 (D.C. Cir. 1982)*, to establish rules for the apportionment of AT&T costs among the MTS, WATS, private line and ENFIA service categories. We expect to provide guidance in separate proceedings to enable AT&T to reflect access charges in ICAM cost apportionments.

15. Although Phase I of this docket is a part of a larger proceeding to determine and encourage an optimal structure for a market that includes MTS and WATS, we have not limited this phase to the apportionment of access costs among competing interexchange carriers. The *Initial Notice* said that we expect to prescribe "divisions" for [\*\*15] all interstate services of all carriers. *67 FCC 2d at 759*.

16. We reiterated this view in the *Second Supplemental Notice*. We explained that subsequent events had confirmed our preliminary conclusion that it will not be possible to establish access compensation for the MTS-WATS equivalent services of the new interexchange [\*248] carriers without correcting existing disparities in access compensation that is paid directly or indirectly by users of services offered by the telephone company partnership. AT&T had proposed access charges for MTS-WATS equivalent services that purported to establish parity with the access compensation for MTS and WATS that the BOCs receive through the Bell System division of revenues process. Carriers that provided the MTS-WATS equivalent services claimed that the proposed charges would create unlawful discrimination because the charges would be much higher than the charges that customers of Foreign Exchange ("FX") service pay for access service at the foreign exchange or "open" end. Those carriers alleged that the access they received was identical with the access FX customers received. The affected carriers eventually [\*\*16] entered into an agreement known as "ENFIA" that established an intermediate rate for MTS-WATS equivalent (or "Execunet/SPRINT type") access for an interim period. n7 This Commission concluded that allowing the negotiated rate for an interim period would serve the public interest.

n7 See *Exchange Network Facilities (ENFIA), 71 F.C.C. 2d 440 (1979)*.

17. The *Second Supplemental Notice* concluded (*77 FCC 2d at 230-231*):

The history of the ENFIA negotiations demonstrates that it would be impossible to prescribe any charges for the origination and termination of services that are functionally equivalent to MTS or WATS without determining the appropriate relationship among origination and termination services for MTS-WATS, functional equivalents of MTS-WATS, and FX-CCSA open ends. That history also indicates that there is no basis for assuming that the present relationship is appropriate.

18. That *Notice* also concluded that "the discrimination problem" is not confined to differences in access compensation among MTS, WATS, FX, CCSA and MTS-WATS equivalent services and described a tentative access charge plan that included [\*\*17] the origination and termination of private line services. *Id. at 231*. Some comments that were filed in response to the *Second Supplemental Notice* questioned the inclusion of private line services other than FX and CCSA in an access charge plan. n8

n8 *E.g.*, American Satellite Co. Comments, p. 7; ARINC reply, p. 9.

19. Private line services are not as distinct from an engineering or an economic perspective as they are sometimes perceived to be. A private line between two customer locations is normally routed in much the same manner as are telecommunications that use the switch that is used also for local exchange service. The access portion of the private line service consists primarily of the provision of lines or loops that connect a customer terminal with the interexchange [\*249] portion of the facilities. The exchange carrier uses the right-of-way that it was granted for the purpose of providing local exchange service to place that line between the customer location and the interexchange facility.

20. Private line and message services not only employ similar facilities, but are also frequently used by customers to satisfy the same [\*\*18] telecommunications needs. The interchangeability factor necessarily requires that at least some private line access service be included in an access compensation scheme that is designed to establish parity among all services that are reasonably interchangeable with MTS. We have specifically established such parity with MTS for the "open end" of FX and CCSA services.

21. It would be possible to distinguish private line service that is a close substitute for MTS from private line service that is not. We could possibly accomplish our original purpose by limiting access charge rules to access for MTS, WATS, MTS-WATS equivalents, FX, CCSA and other private line service that is a close substitute for MTS, limiting the scope of access to the use of equipment, facilities, or right-of-way used in common with local exchange services.

22. As already noted, however, we have decided, in response to the MFJ, to expand the scope of access to include all tariffed services and facilities that the BOCs will provide for the origination or termination of interstate calls. The decree definition of access service -- and thus the conforming definition of access service relied upon in this *Report and Order* [\*\*19] -- includes some services and facilities that we might exclude in designing access charges for the sole purpose of establishing parity among MTS and all telephone company or "other" carrier services that are close substitutes for MTS.

23. The provision of an origination-termination service could be viewed as providing an interexchange carrier with access to exchange facilities. The service could also be viewed as providing an end user or subscriber with access to interexchange services through exchange facilities that interconnect with interexchange facilities. n9 The earlier notices in this proceeding viewed access services as [\*250] services that a local carrier provides to a long haul carrier. These notices assumed that the local carrier would receive access compensation from a long haul carrier. Most of the earlier notices assumed that a carrier's carrier charge would be the mechanism for access compensation. The *Fourth Supplemental Notice* invited comment upon some additional alternatives that could result in a combination of end user and carrier's carrier charges. We have decided to prescribe such a combination. Terms such as access, access service and access charges will [\*\*20] be used in this *Third Report and Order* to encompass both end user and carrier's carrier charges.

n9 When a divested BOC provides interstate access to another carrier, "interexchange" will usually be synonymous with a service that is described as inter-LATA for purposes of the MFJ and the "exchange" facilities will correspond to intra-LATA facilities. The geographic scope of access services provided by other local exchange telephone companies may be different. Such differences are most likely to be reflected in the access element we have described as Common Transport. The formula we have adopted for the computation of access charges will enable carriers to devise charges for the "common transport" that a particular carrier provides. Adapting access charge rules to access service that a divested BOC provides to itself or another carrier for an intra-LATA transmission that is interstate for purposes of the Communications Act may require a special approach. We have decided that it would not be appropriate to establish guidelines for such situations before a final determination of LATA boundaries.

24. The inequities between existing forms of compensation for the identical use [\*\*21] of such access plant by different interstate services make these forms an inappropriate model for the development of access tariffs. We have decided that a single, uniform and nondiscriminatory structure for interstate access tariffs covering those services that make identical or similar use of access facilities is required by the Communications Act. While we have provided considerable flexibility for telephone companies within our access rules, we believe that the development of the competitive interstate telecommunications market requires certain uniform principles covering both BOC and independent telephone company access tariffs.

25. The amount of money that will have to be recovered through the access tariffs is immense. The revenue requirement for interstate NTS exchange plant alone will be approximately 8.5 billion dollars in 1984, the first year of our plan. An additional amount of approximately 2.5 to 3 billion dollars will be required to recover the costs of traffic sensitive plant for the first year. Based upon the assumption that 100 million lines will be in use in 1984 (an assumption we consider to be reasonably accurate), this translates into a total revenue requirement [\*\*22] per access line of approximately \$8.50 per month for NTS costs and \$3.50 to \$3.00 per month for traffic sensitive costs. In its first year the plan would assign \$4.00 per line per month or \$4.3 billion overall in interstate NTS costs to be recovered directly from the end user by his or her local telephone operating company. Of this amount a minimum of \$2.00 for residential subscribers and \$4.00 for business subscribers would have to be recovered through the use of a flat charge. The remainder of the \$4.00 per line revenue requirement could be recovered, at the carrier's option, through traffic sensitive charges. The maximum amount that could be charged any customer directly would be no greater than the interstate costs of obtaining a private access facility dedicated to interstate use. NTS costs over \$4.00 per line -- approximately \$4.2 billion -- will continue to be collected in the first year of the plan through carrier's carrier charges. Of this amount, \$1.4 [\*251] billion will be paid by AT&T and its partners in the form of a charge for premium access. n10 The costs related to the Universal Service Fund, terminal equipment (CPE) (\$1.4 billion in 1984) and inside wiring (\$1.6 [\*\*23] billion in 1984) will either be removed from the carrier revenue requirement through deregulation or will continue to be paid in subsequent years through carrier's carrier charges. The remaining amount collected through a carrier's carrier charge in the first year plus any additional amounts added in subsequent years will be converted to customer charges over a five year period. Over the same five year period the maximum end user charge that may be charged any specific customer for interstate access for message service will be reduced at the rate of 10% per year.

n10 Some independent telephone companies will continue to participate in joint rate offerings with AT&T after access charges become effective. Therefore, the premium will in fact be paid by an interexchange partnership. Section 69.207 describes that partnership as "the carriers that offer MTS and WATS...."

26. The plan is designed to move swiftly and surely from the present reliance on additions to the price of interstate toll minutes as the mechanism for recovery of these costs towards a pricing plan which recognizes that non-traffic sensitive costs covering plant dedicated to individual end users neither increase [\*\*24] nor decrease as a result of usage made of that plant. We are taking this important step because we view this new direction as the only means of satisfying our goals of universal service, nondiscrimination, network efficiency, and prevention of uneconomic bypass.

27. Economics teaches us that, except in certain circumstances involving market failure, prices equal to the cost of producing another increment of a good, i.e., equal to the marginal cost of production, are optimal. n11 Provision of telephone services involves two marginal costs. One varies with the traffic level. The other varies with the number of access lines demanded. For this reason, efficient pricing requires both usage sensitive and non-usage sensitive charges for recovery of access costs. n12

n11 See, for example, Francis M. Bator, "The Simple Analytics of Welfare Maximization," *The American Economic Review*, pp. 25-59, March 1957.

n12 See also P.R.G. Lazard and A.A. Walters, *Micro-Economic Theory*, McGraw-Hill Co., New York, 1978, p. 176.

28. The costs imposed upon the nation's telecommunications system, and ultimately upon the general public, by our present usage sensitive method of recovering [\*\*25] these NTS costs pose a substantial danger to the long term viability of our nation's telephone systems. New technologies and radical improvements in older technologies make available alternatives to the traditional telephone network. Telecommunications is substitutable for a wide variety of other goods and services produced by our society. Prices based upon the true cost characteristics of telephone company plant are necessary both to make a decision on whether use of the alternative technologies [\*252] is appropriate and to make a decision on whether to substitute telecommunications for other activities.

29. As telecommunications plays a larger and larger role in fundamental U.S. industries, the problems resulting from inappropriate pricing grow. Computer technology and communications have grown so similar that the Commission has redrawn its traditional definition of communications. n13 Access pricing that does not reflect cost can turn computer technologies from directions that would enhance the productivity of this essential U.S. industry and all of the industries that depend on computers and communications toward simple avoidance of non-cost based telecommunications prices. [\*\*26] Investment may be misdirected as a result.

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n13 See Amendment of Section 64.702 of the Commissions's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384 (1980) (Final Decision), reconsideration, 84 FCC 2d 50 (1980), further reconsideration, 88 FCC 2d 512 (1981), *aff'd sub nom. CCIA v. FCC*, 693 F.2d 198 (D.C. Cir. 1982).

30. The possibility of users, particularly the nation's largest telecommunications users, abandoning the network for less efficient alternatives, *i.e.*, "uneconomic bypass", has been cited by many participants as a major justification for the movement toward cost based customer access charges. Bypass is a growing phenomenon. n14 We also recognize that the elimination of preferential rates covering NTS access plant for large users is certain to increase significantly the incentives of these users to bypass the local phone network. We could attempt to eliminate bypass through our facility authorization authority, but have determined that this is not a good solution. See Part III. A., *infra*.

n14 Our staff has conducted a preliminary survey of the current status of bypass services. The results of that survey are set forth for informational purposes of Appendix F of the *Report and Order*.  
[\*\*27]

31. Despite the uncertainty surrounding the precise size and threat of uneconomic bypass, a delay in the institution of a system of access charges that does not recover most fixed costs through usage rates is not justified. If we delayed making a change now, it is likely that circumstances would quickly force such changes upon us. In such a case, however, we would be unable to afford the luxury of the gradual transition needed to satisfy our objective of maintaining affordable service. Moreover, as a result of bypass, delay might mean higher long run costs for those who were required to remain on the network, and even for those who were able to use bypass services.

32. Moreover, were we to delay instituting the smooth movement towards a rational pricing system until a sufficient number of large users had initiated constructing alternative bypass systems, it could well be too late for any remedial action. Usually uneconomic bypass is uneconomic only before the construction of bypass facilities starts. Once a large telecommunications user has committed significant capital to building a private bypass system, the maintenance of that [\*253] system is no longer uneconomic. Consequently, [\*\*28] we believe that prompt action is essential to preserve the public interest.

33. We believe it is important to state explicitly that this decision does not, in any way, constitute a judgment that subsidizing the costs of basic telephone services for certain customers or for all customers is improper. Our decision is, rather, based upon the more limited judgment that an attempt to generate revenues for such subsidization through a permanent bundling of NTS costs into interstate toll rates would be a harmful and, ultimately, futile approach -- one that could lead to the deterioration of a nationwide telephone network providing a variety of services to a wide variety of consumers.

34. In the *Second Supplemental Notice* we had described a plan for imposing usage based charges for access to the local network upon both private line and public switched services. We had first thought that such an approach would assure full, fair competition in the MTS/WATS market and also avoid unlawful preferences or discrimination between private line users and users of switched services. Comments filed in response to that *Notice* caused us to question whether the plan might have the fundamental flaw [\*\*29] of encouraging heavy users of private line service to bypass the local network. Our concern has been heightened by the terms of the MFJ that require AT&T to divest itself of its operating companies (other than Cincinnati Bell and Southern New England). For the first time AT&T itself could have a significant incentive to bypass local exchange facilities if such bypass would be profitable.

35. Responding to these concerns, in the *Fourth Supplemental Notice* we introduced an alternative approach that we believed could achieve our primary goals of promoting competition and eliminating discrimination while avoiding the potential problems of the original plan. Instead of creating an access rate structure for private line services like the usage-based MTS/WATS rate structures, we considered the possibility of treating facilities used for access to the public switched network like private line facilities. Specifically, we discussed the possibility of assigning the costs of non-traffic sensitive subscriber plant directly to the customers using it. Thus the costs of private line facilities would continue to be directly assigned, removing one potential incentive for heavy users of such services [\*\*30] to bypass local facilities. Every customer of interstate switched services would, however, pay a flat monthly charge reflecting the cost of the non-traffic sensitive subscriber plant dedicated to his use in connection with these services. The plan we adopt today will ultimately point toward this result. In order to avoid the adverse effects that could accompany such a departure from the traditional way in which end users have paid for their use of interstate services, the plan provides for the

gradual introduction of these end user access charges. This plan, like the tentative plan of the *Second Supplemental* [\*254] *Notice*, still imposes a carrier's carrier charge upon all interexchange carriers for the use of the remainder of local telephone company plant upon which they rely to complete their interstate service offerings.

## II. COMMISSION AUTHORITY TO ADOPT ACCESS CHARGE RULES

36. Most comments that have been filed in response to the various notices we have issued in this proceeding do not discuss the scope of this Commission's statutory authority to prescribe access charges for the origination and termination of interstate and foreign services. Almost all of the participants [\*\*31] have assumed that this Commission does have the power to prescribe some kind of access service compensation arrangement.

### A. Section 201(a) Authority

37. After noting that the division of revenues and settlements "have traditionally been industry devised" (67 FCC 2d at 759), the *Initial Notice* said (*id.*) that "[i]t may be timely to exercise our jurisdiction under Section 201(a) of the Communications Act to establish the divisions of charges." The carriers that provide local exchange service receive most of their access compensation through the division of revenues and settlements procedures that have been devised to divide revenues from joint rate services among the members of the telephone company partnership. Section 201(a) authorizes this Commission to replace the industry-devised contractual arrangement with a Commission-devised formula.

38. Section 201(a) provides in pertinent part: It shall be the duty of every common carrier... in accordance with the orders of this Commission, in cases where the Commission, after opportunity for hearing, finds such action necessary or desirable in the public interest, to establish physical connections with [\*\*32] other carriers, to establish through routes and charges applicable thereto and the divisions of such charges, and to establish and provide facilities and regulations for operating such through routes.

39. After we received comments in response to the *Initial Notice* and considered filings that were provoked by AT&T's initial ENFIA tariff, we tentatively concluded that a system of carrier's carrier access charges should be established to replace the existing combination of carrier's carrier charges, end user charges, and contractual "divisions" and "settlements." That conclusion was announced in the *Supplemental Notice* and a tentative plan for carrier's carrier access charges was described in the *Second Supplemental Notice*. n15

n15 Several different methods have been used in the telecommunications and transportation industries to compensate participating carriers when two or more carriers participate in the transmission or transportation. The ultimate customer or end user could be billed separately for the service each carrier provides, but the end user usually pays one of the carriers and that carrier transmits money to the other carrier. The end user may pay a combination or end-on-end rate that is equal to the combined separate charges of the participating carriers. The end user may pay a joint rate and the carriers may divide joint rate revenues in accordance with an agreed or prescribed formula. Sometimes one of the carriers offers the service to the public and pays a charge to a connecting carrier for the use of the other carrier's facilities. We have used the term "carrier's carrier" charge to describe such an arrangement and have used the term "end user" to distinguish the ultimate user from a carrier or an enhanced service provider that obtains service as a customer of another carrier. The carrier's carrier charge arrangement produces essentially the same result as the remission of a "local" rate by a carrier that collected a combination rate charge. Changes in a carrier's carrier charge are not, however, automatically and instantaneously reflected in the rate that an end user pays.

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[\*255] 40. Western Union comments that were filed in response to the *Second Supplemental Notice* claimed that Section 201(a) cannot be invoked to replace carrier's carrier access charges with different carrier's carrier charges. Western Union noted that the term "divisions" is normally used to describe the division of joint rate revenues and that it does not maintain any joint rates with the telephone companies. We have concluded that Western Union's claim is incorrect because the language and history of Section 201(a) demonstrate that Congress used the term "divisions" in that particular provision to encompass any arrangement for the compensation of carriers that participate in a through service. n16 That term is at least broad enough to include carrier's carrier charges that compensate an exchange carrier for its participation in a through service that an interexchange carrier offers to the public.

n16 In *St. Louis Southwestern R. Co. v. United States*, 245 U.S. 135, 139 n.2 (1917), the Court defined "through route" as "an arrangement, express or implied, between connecting railroads for continuous carriage of goods from the originating point on the line of one carrier to destination on the line of another." The Court added (*id.*) "Through carriage implies a through rate. This 'through rate' is not necessarily a 'joint rate.' It may be merely an aggregation of separate rates fixed independently by the several carriers forming the through route...." The reports of the House and Senate Commerce Committees on bills that became the Communications Act of 1934 describe Section 201(a) as requiring carriers "to establish with other carriers physical connections, through routes, through rates, and divisions of through rates." Committee on Interstate Commerce, S. Rep. No. 781, 73rd Cong., 2d Sess., p. 4 (1934); Committee on Interstate and Foreign Commerce, H.R. Rep. No. 1850, 73rd Cong., 2d Sess., p. 5 (1934).

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41. Section 201(a) authorizes this Commission to prescribe "devisions" if we find that such action is "necessary or desirable. n17 We have concluded that it is necessary and desirable to establish access charges in lieu of existing access compensation arrangements in order to eliminate existing access compensation disparities and to prevent the development of disparities that might arise if a variety of access compensation mechanisms were used in the future.

n17 See *United Telephone Co. of the Carolinas*, 54 FCC 2d at 289, 290 (1975), affirmed, *United Telephone Co. of the Carolinas v. FCC*, 559 F.2d 720 (D.C. Cir. 1977).

[\*256] B. Section 205 Authority

42. When we issued the *Fourth Supplemental Notice* that invited comments upon some alternative plans that included end user access charges, we expanded the list of Communications Act provisions we might invoke to include Section 205. Section 205(a) of the Act, 47 U.S.C. § 205(a), empowers this Commission to prescribe end user or carrier's carrier charges for any interstate or foreign service.

43. Although the rules we are [\*\*35] adopting will not establish the precise charge for most access elements, we are establishing many of the steps that carriers must follow in order to compute access charges. Our Section 205(a) power to prescribe charges includes the power to prescribe steps in the computation of charges. We have exercised that power in the past in prescribing a rate of return that is to be used in computing charges and in prescribing an allocation of investment and expense among major service categories that is to be used in computing AT&T rates. Those actions were affirmed in *Nader v FCC*, 520 F.2d 182, 204 (D.C. Cir. 1975) and *MCI Telecommunications Corp. v. FCC* ("ICAM"), *supra*.

44. Section 205(a) provides in pertinent part that whenever "the Commission shall be of the opinion that any charge... is or will be in violation of any of the provisions of this Act, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge... " Thus, this Commission must find that existing charges are or will be unlawful and that the new methods for computing charges will be "just and reasonable" in order [\*\*36] to prescribe methods for computing charges pursuant to Section 205(a). n18

n18 Section 205(a) states that the prescription power may be exercised "after full opportunity for hearings, upon complaint or under an order for investigation and hearing made by the Commission on its own initiatives... " Notice and comment rulemaking proceedings are sufficient to satisfy that hearing requirement. *American Tel. & Tel. Co. v. FCC*, 572 F.2d 17, 21-23 (2d Cir.), cert. denied, 439 U.S. 875 (1978). Such proceedings also satisfy the Section 201(a) hearing requirement. *Bell Telephone Co. of Pennsylvania v. FCC*, 503 F.2d 1250, 1264-68 (3rd Cir. 1974), cert. denied, 422 U.S. 1026 (1975).

45. Paragraph 28 of the *Second Supplemental Notice* states that disparities in access service compensation "may also indirectly result in end user rates which violate Section 202(a) of the Communications Act... " 77 FCC 2d at 230. We refrained from using conclusory language in that paragraph in order to afford persons who might wish to defend the *status quo* [\*\*37] an opportunity to do so before we made a final determination with respect to the legality of the existing combination of access service compensation arrangements. We are now prepared to make such a determination.

46. Section 202(a) provides:

It shall be unlawful for any common carrier to make any unjust or unreasonable discrimination in charges, practices, classifications, [\*257] regulations, facilities, or services for or in connection with like communications services,

directly or indirectly, by any means, or device, or to make or give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage.

47. The portion of Section 202(a) that prohibits "unreasonable discrimination" in connection with "like services" was derived from Section 2 of the original Interstate Commerce Act, 24 Stat. 379. Section 2 of the Interstate Commerce Act was designed primarily to eliminate rebates to favored shippers that produced different charges for the shipment of the same quantity of the same commodity at approximately the same time. [\*\*38]

48. The portion of Section 202(a) that prohibits "undue" preferences was derived from Section 3(1) of the Interstate Commerce Act, 24 Stat. 380. Section 3(1) of that Act was designed to remedy disparities in rates to different points that did not reflect actual cost differences. Although Section 3(1) was designed primarily to remedy the locality discrimination problem, the prohibition also encompassed excessive rate differentials for different commodities and shipments of different quantities of the same commodity.

49. In view of the origin of Section 202(a) the unjust discrimination prohibition must be interpreted as imposing a heavy burden upon telecommunications carriers to justify any differential in rates for like services and the undue preference prohibition must be interpreted as imposing a duty upon carriers to maintain rational and reasonable differentials for unlike services.

50. The existing access service compensation arrangements do not produce results that are consistent with those Congressional objectives. This is scarcely surprising in view of the manner in which those arrangements evolved. Neither the carriers nor the regulators viewed access service as a distinct [\*\*39] service before this Commission ordered the telephone companies to provide access service to the new "specialized" carriers. n19 The preexisting access compensation arrangements were by-products of managerial or regulatory decisions that were made for some purpose other than fixing access service compensation. Access service compensation for the new carriers could not be fixed in a manner that established parity with each of the preexisting services offered by the telephone companies or the old "other" carriers.

n19 See *Specialized Common Carrier Services*, 29 FCC 2d 870, 940 (1971), affirmed sub nom. *Washington Utilities and Transportation Commission v. FCC*, 513 F.2d 1142 (9th Cir.), cert. denied, 423 U.S. 836 (1975). See also *Bell System Tariff Offerings*, 46 FCC 2d 413 (1974), affirmed sub nom. *Bell Tel. Co. of Pennsylvania v. FCC*, supra.

51. Comments from the carriers that receive access service compensation generally acknowledge that there is no system. [\*258] Although comments from some carriers and some end users [\*\*40] that indirectly pay access service compensation claim that any discrimination or preference problem can and should be remedied without changing the access compensation for some services, none of the participants has attempted to demonstrate that there is any reasonable or rational relationship to justify the wide disparities among the charges for access that are directly or indirectly levied upon users of the various interstate services that might satisfy the requirements of Section 202(a). It is readily apparent that it would be impossible to do so. Indeed, the current methods of recovering costs of jointly used non-traffic sensitive subscriber plant for MTS, open-end FX, CCSA and WATS services and the ENFIA services are totally different and produce widely differing results even though each service uses the same plant in the same manner. The FX and CCSA services pay local exchange rates for open end access, the MTS/WATS equivalent services must pay the higher ENFIA rates, and MTS and WATS pay even higher access compensation through the settlements and divisions of revenues process. The level of the ENFIA charge has been negotiated to reflect a discount from the MTS access compensation. [\*\*41] It was also designed to produce a rate that is higher than the local exchange rate paid by FX and CCSA customers. Since no one has attempted to justify the disparate rates charged for like access services in this proceeding, we must find them to be unlawfully discriminatory. Moreover, the access compensation differences among services that do use exchange plant differently bear little relationship to actual cost differences. In the absence of any justification for such rate disparities, we must also find that such disparities violate the prohibition of undue preferences. We accordingly conclude that the existing combination of access service compensation arrangements violates Section 202(a) of the Communications Act. n20

n20 That conclusion is reinforced by the observations in a December 17, 1981 MCI filing. That filing was styled as a complaint, but could not be processed as a complaint because it was not directed at any existing tariff. We accordingly decided to incorporate that document as a comment in the access charge phase of this docket.

*See Extension of ENFIA Agreement, 90 FCC 2d 6, 9, n.3 (1982) review pending sub nom. MCI Telecommunications Corporation v. FCC, D.C. Cir. No. 82-1553.* That MCI filing argued that "local exchange service" provided to business customers with PBXs, foreign exchange customers, WATS extension customers, Federal Telephone System customers, value-added carriers, domestic record carriers, international record carriers, time sharers and CCSA customers, was functionally identical to "local exchange service" provided to MCI. MCI requested that the Commission issue an order requiring that unlawful discrimination promptly be eliminated. As a result of this *Report and Order*, any discrimination among interstate services will be eliminated.

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52. Moreover, the existing access compensation arrangements produce results that conflict with Congressional goals other than the elimination of discrimination or preferences that are discussed in Subpart II.D, *infra*. Congress has conferred broad powers upon this [\*259] Commission in Section 4(i) of the Act, 47 U.S.C. § 154(i), to adopt orders and regulations to achieve those goals. Those powers would be sufficient to enable us to adopt the access charge rules we are adopting in this *Report and Order* apart from the powers conferred by Sections 201(a) and 205. n21

n21 In *Nader v. FCC, supra*, the Court observed (520 F.2d at 203): The discretion that must be afforded the Commission in the exercise of its ratemaking power is enhanced by Section 4(i) of the Communications Act 47 U.S.C. § 154(i) (1970), which gives the Commission the power to issue such orders not inconsistent with this chapter, as may be necessary in the execution of its functions.

53. We believe that the procedures for computing access charges that we are prescribing in this [\*\*43] phase of this proceeding are "just and reasonable" or "just, fair and reasonable" for purposes of Section 205(a). Several comments that were filed in response to the *Second Supplemental Notice* urged us to consider the then recent decision in *MCI Telecommunications Corp. v. FCC, 627 F.2d 322 (D.C. Cir. 1980)*, in deciding how to proceed in prescribing new access service compensation arrangements. That court concluded that a Section 205(a) just and reasonable warranty does not require absolute certainty and precision. After noting that WATS tariffs had remained in effect for several years after this Commission concluded that AT&T had failed to demonstrate that existing tariffs are just and reasonable, that Court declared ( *id. at 340*):

[The Communications Act] assumes that rates will be finally decided within a reasonable time encompassing months, occasionally a year or two, but not several years or a decade. The standard of 'just and reasonable' rates is subverted when the delay continues for several years. Rate making theories may change; new information may become relevant; one proceeding may have to take account of [\*\*44] another. But there must be some reasonably prompt decisionmaking point at which the FCC says: 'To the best of our knowledge and expertise at this time, the rates are just and reasonable. Perfect, perhaps not, but just and reasonable, yes.' That is all the statute requires.

54. Thus, a prescribed rate is just and reasonable for purposes of Section 205(a) if it represents the best approximation of a rate that satisfies all statutory requirements that this Commission is capable of devising within a reasonable period of time. We proceeded on that assumption when we adopted an *Interim Cost Allocation Manual* for AT&T services that we described as "far from perfect." *Amer. Tele. and Tele. Co., supra, 84 FCC 2d at 411*. The Court of Appeals for the District of Columbia Circuit affirmed that exercise of our Section 205 prescription powers. *MCI Telecommunications Corp. v. FCC (ICAM), supra*.

55. The rules we are adopting in this order are designed in part as a replacement for ICAM allocations of exchange and certain [\*260] interexchange plant costs. We believe that these rules represent a significant further improvement. In [\*\*45] light of the Court of Appeals interpretation of the Section 205(a) warranty requirement, we can and do warrant that the rules for the computation of access charges and the allocation of access charge revenues that we are prescribing are "just and reasonable." n22

n22 Our decision to adopt the ICAM at that time was based in part upon our desire to comply with the Court of Appeals schedule for the resolution of some questions relating to WATS tariffs. Similar considerations have caused us to conclude that we should not defer the adoption of access charge rules in order to achieve further refinements. The MFJ will cause the filing of BOC access charge tariffs that will become effective on the day of divestiture unless we reject or suspend the tariffs. The public interest would not be served if we allowed BOC access charge tariffs to become effective and implemented a significantly different methodology a few months later. We have decided that we should act now in order to establish Commission access charge rules that can be implemented at the beginning of 1984.

### C. Effect of Dual Regulation Upon Commission Powers

56. A number of participants have asserted that this Commission [\*\*46] cannot prescribe particular types of access charges or cannot prescribe access charges at this particular time because such actions would intrude upon the jurisdiction or prerogatives of state regulatory commissions. One participant has even asserted that this Commission cannot prescribe interstate access charges of any kind because such power is vested in the state commissions. n23

n23 District of Columbia Public Service Commission, pp. 2-4.

57. We believe the latter claim reflects a misconception with respect to the nature of jurisdiction to regulate interstate commerce. Any action of this Commission that establishes or prescribes charges for the origination and termination of interstate services cannot appropriately be described as a "preemption" of state regulation because such charges are appropriately within the federal jurisdiction, not state jurisdiction. Federal rate regulation began with the enactment of the Interstate Commerce Act in 1887. The creation of a federal commission to regulate interstate rail rates was prompted in part by the Supreme Court decision in *Wabash, St. Louis & Pacific Railway Co. v. Illinois*, 118 U.S. 557 (1886), [\*\*47] that held that state legislatures and state commissions cannot regulate rates for interstate railroad shipments because such regulation is precluded by the Commerce Clause of the United States Constitution. The Interstate Commerce Act filled the gap in railroad regulation that was created by the *Wabash* decision. That Act was amended in 1910 to fill a similar gap in telecommunications regulation. The Communications Act of 1934 transferred jurisdiction to regulate interstate and foreign telecommunications rates from the Interstate Commerce Commission to this Commission.

[\*261] 58. The origination or termination of an interstate communication, including the use of a local loop between an end user's home or office and a local switch of a local exchange carrier, is necessarily a part of an interstate communication. n24 It is as much "in commerce" as the interexchange trunk that actually crosses a state line. If the *Wabash* principle is still applicable, the states would not acquire jurisdiction to regulate rates for such interstate access even if this Commission were abolished.

n24 See, e.g., *New York Telephone v. FCC*, 631 F.2d 1059 (2d Cir. 1980).

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59. The Supreme Court's decision in *Smith v. Illinois Bell*, *supra*, supports this view of federal jurisdiction. In *Smith* the Court considered the validity of a state public utility commission prescription of telephone rates based on evidence that made no distinction between the interstate and intrastate uses of jointly used telephone property. The telephone companies and the regulators had been using a "board-to-board" separations methodology to determine toll and local exchange rates. The toll rates reflected transmission costs from one long distance switchboard to another. All the costs we have described as NTS and some of the traffic sensitive exchange plant costs were reflected in local exchange service rates. The Supreme Court concluded that the board-to-board method was improper. The Court said (*id.* at 148):

The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation.

60. We reject [\*\*49] claims in some comments that the *Smith* decision in some way precludes this Commission from establishing any flat rates for interstate access." The Supreme Court did not purport to determine whether state or federal commissions should mandate flat or usage rates or some combination of flat and usage rates for exchange or toll services. Such rate structure questions were not presented in that case and were not discussed in the opinion. The Court merely attempted to ensure that state or federal regulators do not exceed the limits of their respective powers when they determine economic and social policy questions that have been entrusted to their judgment.

n25 See Kansas Corporation Commission, p. 8; California Public Utilities Commission, p. 3; Haviland Telephone Co., p. 6; NARUC Reply, p. 8; Roseville Reply, p. 4.

61. The decision to exclude interstate access from local rates could have been implemented by including the interstate access costs in flat or usage rates regulated by federal regulators without violating any express or implicit directive in the *Smith* opinion. AT&T made the decision to recover the interstate exchange plant costs on a usage basis when it recomputed [\*\*50] its interstate investment [\*262] and expenses in 1943 to reflect some exchange plant costs in inter-

state MTS rates. It had always imposed distance-weighted usage charges upon MTS customers and did not change the pre-existing rate structure when some NTS costs were added to the MTS costs. The NTS exchange plant costs represented a relatively small part of interstate MTS costs at that time. Changes in relative costs and separations allocations during the intervening years have caused NTS costs to become a very significant part of MTS costs. No opinion of this Commission prior to the *Fourth Supplemental Notice* discusses legal, economic or policy implications of recovering the NTS portion of MTS costs through flat or usage charges. Thus, the inclusion of flat charges in an access charge plan does not conflict with precedent. It merely alters a carrier-initiated practice that appears to be the product of historical accident.

62. We accordingly conclude that this Commission's discretion to establish flat or usage charges or some combination of flat and usage charges for interstate access is not inconsistent with past court or Commission decisions.

63. Some comments have expressed [\*\*51] the view that we are required to consult with state regulators through the Joint Board mechanism before we make any final decision to adopt an access charge plan. n26 We received extensive comments with respect to the appropriate role of a Joint Board in response to the *First Supplemental Notice*. We concluded in the *Second Supplemental Notice* that a Joint Board referral of questions with respect to interstate rates and the apportionment of interstate costs among interstate services would not be necessary or desirable. 77 FCC 2d at 236.

n26 See Kansas Corporation Commission Staff, pp. 1-2; Michigan Action Group, p. 6; NARUC, p. 4; Missouri Public Service Commission Staff, pp. 2-3; Michigan Public Service Commission, p. 4; California Public Utility Commission, p. 3; Rural Telephone Coalition, pp. 43-48; REA, p. 2; Haviland Telephone Co., p. 5; Utah Public Service Commission, p. 2; Ketchikan Public Utilities, pp. 3, 10; Rural Coalition Reply, p. 41; NARUC Reply, pp. 8-9.

64. Most who claim that a Joint Board must or should be consulted claim that interstate access charges will affect jurisdictional separations. n27 Section 410(c) of the Communications [\*\*52] Act, 47 U.S.C. § 410(c), requires that this Commission obtain an Initial Decision of a Joint Board composed of three federal and four state commissioners before we adopt any change in separations rules.

n27 We are using the term "separations" to describe the process of apportioning investment and expense between the interstate and intrastate jurisdictions. We are not using the term "separations" to describe the divisions/settlements process that is described in the *Second Supplemental Notice*. *Id.* at 226-228.

65. The Missouri Public Service Commission Staff claims a Joint Board referral is mandatory because the implementation of access charges will affect the results that are produced by any separations formula. We do not believe Section 410(c) requires any Joint Board consideration of decisions that merely indirectly affect separations [\*263] results. Every rate decision by this Commission or any state commission has some effect upon separations results. The regulatory processes would be paralyzed if consultation were required before a state or federal commission adopted any decision that affects separations [\*\*53] results.

66. Most participants who say that interstate access charge questions should be referred to a Joint Board contend that the adoption of access charges rules will affect the final decision in the pending Docket 80-286 proceeding to reexamine separations rules for the apportionment of exchange plant. NARUC and the Rural Telephone Coalition even assert that the outcome of that proceeding will be "foreordained" by any decision to adopt rules for the computation of interstate access charges. See NARUC Reply, p. 9.

67. Such fears are unfounded. We have, of course, asked the Joint Board to consider consistency with access charges in formulating its recommendations for separations changes. *Amendment of Part 67 of the Commission's Rules, 78 FCC 2d 837 845 (1980)*. n28 We have also necessarily made some assumptions with respect to the likely outcome of the pending separations proceeding in order to devise access charge rules that can be implemented in 1984. These actions should not be interpreted as a final decision upon the part of this Commission with respect to questions in Docket No. 80-286 and should not be interpreted as inhibiting the discretion [\*\*54] of the Joint Board in formulating its recommendations. If the final decision in that proceeding departs from our current assumptions in a manner that requires a revision of the access charge rules, we will, of course, revise the rules we are adopting in this *Report and Order*.

n28 Part III of the *Joint Board Order* discusses possible separations changes to achieve consistency with access charges.

68. Some participants have recommended that we either refer access charge questions to the Docket 80-286 Joint Board or defer action on access charges until we make a final decision with respect to separations changes in order to avoid the possibility that access charge rules may have to be revised to fit unanticipated separations changes. We have concluded that such a course would not be desirable under the present circumstances because a delay of a few months in the adoption of access charges would not allow sufficient lead time to enable carriers to prepare access charge tariffs that can be filed on or before October 3. n29 If BOC access charges that are not based upon these rules become effective at the beginning of 1984 and radically different charges were substituted a few [\*\*55] months later, we could expect considerable confusion and disruption. Such a scenario would be likely to create far greater problems than any changes that [\*\*264] might be required to adapt access charges to fit unanticipated separations changes. n30

n29 Access charges must be filed on October 3, 1983, to provide a full 90 days notice before a January 1, 1984 effective date.

n30 Many decisions that affect the computation of access charges will, of course, be made in the separations proceeding. For example, the size of the Universal Service Fund, the characteristics of participating exchange carriers, and the formula that indirectly determines Fund distributions to particular local exchange carriers will be determined in Docket 80-286 after an Initial Decision of that Joint Board.

69. Some participants have suggested that we refer access charge questions to a Joint Board because they hope that such a proceeding would produce a consensus among all regulators that would enable carriers to compute interstate and intrastate access charges in the same manner. It appears doubtful that such a consensus would emerge within a short period of time. Some participants have proposed alternative [\*\*56] methods to achieve unified access charges. SBS has proposed that we preempt state regulation of intrastate access charges and others have suggested that we delegate responsibility for interstate access charges to the state commissions. We rejected somewhat similar suggestions when we adopted the *Second Supplemental Notice*. 77 FCC 2d at 232.

70. Unified access charges conceivably might be achieved without new legislation by assigning 100% of the exchange plant investment and related expenses to one jurisdiction or the other. Such a change in jurisdictional separations would, of course, have to be considered by a Joint Board in the first instance. The Joint Board has recently invited comments with respect to the legality and desirability of a 100% assignment of NTS costs in Docket 80286. See para. 13, *supra*.

71. We believe there is reason to hope that a considerable degree of uniformity will in fact emerge even though this *Report and Order* does not require that state commissions follow this Commission's approach to charging for access. The same considerations that have led us to conclude that our plan is an appropriate strategy for reducing [\*\*57] discrimination may lead many state commissions to reach similar conclusions. Moreover, all commissions will necessarily recognize that administrative efficiency is served when a single approach to structuring access charges for long distance use of local plant is adopted. State commissions that do not choose to recover all costs in precisely the same way will undoubtedly find many of our methodologies helpful. State commissions will also have an incentive to adopt end user charges because failure to adopt a similar approach to the recovery of non-traffic sensitive costs assigned to state toll would increase toll rate disparity. n31

n31 Toll rate disparity describes the condition that occurs when, because of different ratemaking philosophies adopted by the federal and state jurisdictions and other factors, a call of given duration is priced at different levels depending upon whether it is intrastate or interstate. Toll rate disparity sometimes results in a price for a call to a city in the same state that is much higher than the price for a call to a more distant city in another state.

72. Our access charge plan for NTS plant is based upon the [\*\*265] following four principles. [\*\*58] First, it is important to move towards collecting these costs from customers rather than carriers and on a flat rather than on a usage sensitive basis. Second, it is important to accomplish the transition to flat rates in a smooth and measured way. Third, it is vital to ensure that the plan does not threaten the universal character of telephone service. Fourth, the plan should provide for sufficient flexibility so that telephone companies serving dramatically different service areas can adopt transitional approaches that best serve their unique areas.

73. While the precise timing and mechanics of our access charge plan are based upon the interstate telecommunications market, we believe that these same four principles can serve as the basis for appropriate and acceptable state access charge plans. Obviously, the precise minima, maxima and transition periods would reflect not only unique state

usage characteristics but also the level of NTS assignment to state toll service. We stand ready to provide technical or other assistance to state commissions that wish to integrate their access charge plans with the interstate approach. This integration would also be appropriate, technically [\*\*59] feasible and reasonable with respect to traffic sensitive plant.

#### D. *Effect of Section 1 Upon Commission Discretion*

74. Although we are establishing rules for the computation of interstate access charges in order to remedy discrimination and preferences that violate Section 202(a) of the Communications Act, we are also required to consider other policies in designing an appropriate remedy. A variety of different methods could be used to produce access charges that do not result in unreasonable discrimination or undue preferences. We must be guided by Congressional goals expressed in Section 1 of the Act, 47 U.S.C. § 151, in choosing among such methods. We observed in the *First Supplemental Notice* that "[a]ll provisions of the Act must be read in the light of that statement of purpose." 73 FCC 2d at 230.

75. Section 1 provides in relevant part:

For the purpose of regulating interstate and foreign commerce in communications by wire and radio so as to make available, so far as possible, to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate [\*\*60] facilities at reasonable charges, for the purpose of promoting safety of life and property through the use of wire and radio communication,... there is hereby created a commission to be known as the 'Federal Communications Commission,'... which shall execute and enforce the provisions of this Act.

[\*266] 76. The *First Supplemental Notice* said (73 FCC 2d at 230):

The reference to the rapidity and efficiency of service and the adequacy of facilities obviously means that Congress wanted to maintain and enhance the quality of communications services. The reference to reasonable charges demonstrates that Congress was also concerned with the level of rates and expected this Commission to follow policies which would minimize the cost of communications services to ultimate users. This concern with the cost and quality of service demonstrates that economic efficiency is one of the goals of the Act.

77. An efficient communication service could also be defined in a narrower sense as efficient utilization of a network that enables a carrier to provide service at the lowest possible unit cost. Customer choices that affect the utilization of a network are necessarily [\*\*61] influenced by the rate structure. Therefore, the creation of customer incentives that will promote efficient network utilization necessarily must be one of the objectives of any rate structure proceeding.

78. The bypass phenomenon that we discussed in the *Fourth Supplemental Notice* can be viewed as a network utilization problem. Diversion of traffic to bypass facilities that are in fact more costly than the access facilities provided by the local exchange telephone companies obviously would not promote efficient utilization of telecommunications facilities. Therefore, we concluded that discouraging uneconomic bypass must be one of the criteria for the design of an access plan.

79. The *Fourth Supplemental Notice* identified a fourth objective in addition to eliminating discrimination or preferences, promoting efficient network utilization generally, and discouraging uneconomic bypass. We said that an access charge plan should be designed to "limit any substantial setback in the availability of telephone service" (90 FCC 2d at 147) and noted that some options could produce "an increase in the price of access to the public network, and a possible reduction [\*\*62] in the subscriber base." *Id.* at 140.

80. Most participants who filed comments in response to the *Fourth Supplemental Notice* apparently agree that encouraging persons to subscribe to local exchange service must be one of the objectives of this proceeding. This is usually described as the "universal service" objective or goal. The term "universal service" has rarely been defined. Most participants apparently agree that "universal service" has existed on a nationwide basis for several years. In the context of this proceeding a "universal service objective" means avoiding actions that would cause a significant number of local exchange service subscribers to cancel that service.

81. Although interstate access charges will not have any effect upon local exchange service rates, a customer's decision to subscribe to local exchange service will necessarily be affected by the combined fixed charges that a customer must pay to access all services from a [\*267] terminal in his own home or place of business. One could not describe every increase in fixed charges subscribers must pay for local, intrastate toll and interstate access as conflicting with a universal [\*\*63] service objective. Such a conflict would arise only if the magnitude and timing of any increase in the fixed charges were sufficient to cause a significant number of subscribers to cancel service. n32

n32 Appendix G of this *Report and Order* describes and discusses past studies of the effect of rate increases upon demand for local exchange telephone service.

82. Although most participants apparently agree that universal service is one of the goals of the Act, MCI has questioned the existence of such a statutory goal. Comments, p. 5, Reply, pp. 5-6. The term "universal service" does not appear in the Communications Act and the existence of a universal service goal may not be self-evident from the language Congress used to describe its purposes in Section 1.

83. The *First Supplemental Notice* noted that making service "available... to all the people of the United States... at reasonable charges" could mean that "Congress wanted to create conditions in which such services, or some of them, are 'affordable' to all." *73 FCC 2d at 231*. We also said: "While this may be a credible interpretation of Section 1, it does not appear to be the only possible [\*\*64] interpretation." *id.* We have now concluded that the "available... to all" language does contemplate that telephone exchange service should be made available at reasonable rates. Such a universal service goal should also be inferred from the Congressional declaration that "promoting safety of life and property through the use of wire and radio communication" is one of the purposes of the Act. A subscription to local exchange service can be useful for safety purposes.

84. Many of the participants have argued that the relative universality of service affects the value of a telecommunications service for all users of a service. If some persons elected to cancel local exchange service, other customers would not be able to place local or long distance calls to those persons. Even if economic efficiency were the sole goal of the Act, a diminution of universal service might reduce economic efficiency in a broader sense.

85. In addition to those four objectives, we necessarily must consider the competitive effects of alternative rate structures. We concluded in the *Third Supplement Notice* that a competitive interexchange market structure will further the goals of the Communications [\*\*65] Act. If identical access services were offered to all competing interexchange carriers, we could assume that cost-based access charges will lead to an optimal interexchange market structure. This is not the case today and it will not be possible to remedy all inequalities in access service offerings before the initial access charges become effective. Therefore, preserving an opportunity [\*268] for fair competition during a transition period must also be viewed as an objective that will further the goals of the Act.

86. The relative priorities that should be afforded goals or factors that can be inferred from Section 1 is an open question. The priorities question was also discussed in the *First Supplemental Notice*. Paragraph 24 said (*73 FCC 2d at 231*):

Some comments have suggested that we establish relative priorities in this Supplemental Notice which will be observed if some of the explicit or implicit goals of the Act conflict. It would be unwise to assign any priorities at this time. It seems unlikely that Congress intended to give priority to any particular goal under all conceivable circumstances. A public interest determination is necessarily [\*\*66] a balancing process which requires the exercise of judgment, and different goals may take precedence depending on the facts of each case. Therefore, we shall wait until the facts have been developed in the record before we attempt to set priorities for goals in this case.

87. Although those observations related primarily to the entry policy question and a Section 214 public interest determination, we believe that a similar balancing process is required when we exercise our Section 201(a) power to establish through rate divisions or our Section 205 or Section 4(i) powers to prescribe steps in the computation of a charge.

88. An ideal access charge plan would eliminate all discrimination or preferences within or among services, create incentives for the most efficient utilization of all telecommunications facilities, discourage all uneconomic bypass, ensure that no local exchange service subscriber cancels that service, and establish full and fair competition in the interexchange services market. All of those objectives could not be fully accomplished simultaneously and immediately even if we had perfect knowledge. Therefore, we necessarily must exercise judgment and discretion in devising [\*\*67] an access charge plan that takes all of those objectives into account.

89. Neither the language of the Act nor past court or Commission opinions preclude this Commission from striking a reasonable balance. On the contrary, Congress undoubtedly anticipated that an exercise of judgment would be required when it declared that it was creating this Commission in order to achieve multiple purposes "so far as possible." Congress conferred broad discretion upon this Commission in order to enable us to fulfill that mandate.

### III. GUIDELINES FOR RECOVERY OF NTS COSTS

#### A. Alternative Strategies For Reducing Discrimination

90. Exchange plant that an end user or subscriber would need in order to use any local or long distance service is often described as non-traffic sensitive or NTS plant because the cost of providing such [\*269] equipment does not vary with usage. NTS encompasses all equipment that a subscriber would need to access the local exchange switch including terminals and other customer premises equipment, the protection block and drop wire and the line or loop between the customer's premises and a local exchange switch or a manual switchboard.

91. A portion of a local dial [\*\*68] switch is also classified as non-traffic sensitive plant for separations purposes in order to segregate costs of terminating a line in the switch from the costs of switching. We proposed to include such costs in a non-traffic sensitive element in the tentative plan described in the *Second Supplemental Notice*. We subsequently asked a Joint Board to reexamine the classification of local dial switching equipment. n33 Inasmuch as that proceeding may produce new classifications we have decided that it would not be appropriate to include any local dial switching equipment in an NTS access plan at this time.

n33 *Amendment of Part 67 of the Commission's Rules, supra, 78 FCC 2d at 842.*

92. In order to achieve parity between interstate and international services that use the same subscriber line that is used for local exchange service and other services that are close substitutes for such services, an NTS plan must include comparable facilities that are used by such substitute services. Therefore, for purposes of this *Report and Order* NTS also includes portions of various lines on the customer's side of the class 5 or "end office" that are dedicated [\*\*69] to a particular service. These include a WATS access line, an FX or CCSA "closed end" line, or a "private line" terminating in a PBX or other customer premises equipment that may be used for local exchange service. Our NTS plan does not encompass customer side dedicated lines that do not terminate in such equipment.

93. In the *Second Supplemental Notice* we presented a tentative plan to achieve parity among such services by apportioning the total NTS costs among four service categories -- MTS/WATS, FX-CCSA Open End, OCC-ENFIA and Private Line -- on the basis of relative use. This would have represented a substantial departure from the cost apportionment that is presently used to compute private line rates. The *Separations Manual* has generally assigned the entire cost of facilities that are used exclusively for interstate services to the interstate jurisdiction and has usually apportioned the cost of facilities used jointly for interstate and intrastate calling. A usage-based formula has traditionally been used to apportion jointly used NTS facilities between the jurisdictions. For ratemaking purposes all costs of AT&T assigned to the interstate jurisdiction are apportioned [\*\*70] among interstate service categories through the *ICAM*. n34 The costs assigned by the *ICAM* to private line services are, in general, based [\*270] upon the assignment of these costs to the interstate jurisdiction. Thus, the present rates for private line services reflect the "directly assigned" costs of private line loops. Inasmuch as private line customers normally have very high usage per line as compared to MTS customers, a usage cost allocation would produce a per line assignment to private lines that is much higher than the per line cost that is directly assigned under the *Separations Manual*.

n34 *See* footnote 6, *supra*. With some exceptions the other telephone companies concur in AT&T's tariffs for MTS, WATS and private line service.

94. Many of the comments that were filed in response to the *Second Supplemental Notice* contended that it would be unjust, inequitable and unlawful to compel private line customers to pay charges that are based upon a cost assignment that exceeds the actual cost of the line they use. Many of those comments also contended that a usage assignment of such fixed costs would be uneconomic because it would discourage usage by [\*\*71] pricing the facilities in a manner that greatly exceeds the actual costs of the private line loops.

95. Those arguments caused us to reexamine the assumption that discrimination or preferences between private line and MTS users could best be corrected by assigning all NTS costs on a usage basis. The ratemaking principles advanced in those comments would compel the conclusion that the existing MTS rate structure is incorrect because the usage rates for MTS allocate some fixed costs on a usage basis. The same arguments would support the conclusion that the MTS rate structure compels large MTS users to subsidize other MTS users because a large user of that service would pay NTS costs that substantially exceed the cost of the NTS facilities such a customer uses to make MTS calls. That analysis also suggests that the increasing use of private lines for purposes that could be served by MTS reflects an effort to avoid the subsidy that is inherent in the MTS rate structure and that private lines are being used inefficiently to serve purposes that from a network standpoint could be accomplished more economically through MTS.

96. The discrimination or preference problem could not be solved [\*\*72] by maintaining the *status quo*. If one assumes that all users of competing services should pay per minute charges for NTS, total equality could be achieved by apportioning total NTS costs among such services on the basis of minutes of use. If one assumes that all users of competing services should pay per line charges, total equality could be achieved by continuing to assign private line NTS costs on a direct assignment basis and revising the MTS rate structure to include a flat charge for NTS and a reduced usage charge for the other exchange and interexchange facilities that are used to place an MTS call. We described those alternatives as "pure strategies" in the *Fourth Supplemental Notice* because they would produce equality on a per minute or on a per line basis. For convenience, we called the usage apportionment described in the [\*\*271] *Second Supplemental Notice* "Pure 1" and the per line apportionment alternative "Pure 2."

97. Section 202(a) of the Communications Act does not require total equality of rates at all times or under all circumstances. The Act prohibits "unjust or unreasonable" discrimination, "undue or unreasonable" preferences, and subjecting persons [\*\*73] or localities to an "undue or unreasonable prejudice or disadvantage." This necessarily implies that departures from total equality are permissible and may be required to achieve Communications Act goals other than the elimination of discrimination or preferences. The *Fourth Supplemental Notice* accordingly invited comments upon "mixed" strategies that might combine usage and flat charges or usage and fixed cost apportionments. We described two examples of such "mixed strategies" in that *Notice* and invited interested persons to suggest other alternatives. The *Notice* called the two examples "Mixed 1" and "Mixed 2" for convenience. "Mixed 1" would have allocated NTS costs between MTS/WATS and private line service using "equivalent lines." While the charge for private line users would have been a flat rate, each would be required to participate in the "contribution" to the local revenue requirement embodied in an interstate revenue requirement based on the subscriber plant factor. The "Mixed 2" strategy would have continued charging for private line services on a dedicated basis, but would have imposed a new rate structure on MTS. Under this plan, customers would be charged [\*\*74] a usage based rate for recovery of NTS costs up to a cap. After this point, no additional NTS contribution would be required. Thus there would be economically efficient pricing for those calls made after the cap was reached.

98. Our decision to invite comments on alternative plans was based on developments that had occurred since the adoption of the *Second Supplemental Notice* and that suggested that Pure 1 might not be feasible even if we concluded that per minute equality would be ideal. At the time we adopted the *Second Supplemental Notice* we assumed that a reapportionment of costs among service categories would produce a shift from telephone company private line services to MTS that would enhance efficient utilization of the telephone companies network by discouraging the use of service-dedicated lines for purposes that could be served by the use of lines that can be commonly used for multiple services to multiple points. We also assumed that the reallocation of costs would produce a reduction in MTS rates.

99. The comments that were filed in this proceeding in 1980 did not dispute those assumptions, but some of the 1981 comments in the Joint Board proceeding did. Several [\*\*75] of those comments noted that new technologies provide alternatives to the use of any telephone company loop for the origination or termination of interexchange telecommunications. Some asserted that any change in rate structure [\*\*272] that increases telephone company private line charges would cause private line users to shift to such alternative services. Some also asserted that the access compensation that is reflected in MTS rates must also be reduced in order to avoid a shift to alternative technology services that "bypass" all telephone company facilities.

100. The subsequent settlement of the AT&T anti-trust case caused us to conclude that bypass may be an even more imminent possibility than it originally appeared to be. AT&T would have a much greater capability to provide bypass services on a large scale than other entrants in interexchange markets. AT&T would not have any incentive to do so as long it retained a massive investment in local exchange facilities. The divestiture of all of its local exchange facilities would remove that inhibition.

101. The selection of a cost apportionment method necessarily affects the decision to prescribe end user or carrier's carrier access [\*\*76] charges or some combination of such charges. Although some access charge options might be implemented through any of those methods, the Pure 2 alternative necessarily requires flat rates that are assessed upon end users in order to ensure that each end user pays the fixed costs that are attributable to NTS facilities that are dedicated to that particular user. Such a flat end user charge also must be collected by the exchange carrier because the subscriber line that is used for MTS access can be used for other interstate services including open end WATS, FX and CCSA origination and terminations and switched services offered by carriers that compete with AT&T interexchange services. The *Fourth Supplemental Notice* assumed that Pure 1 or Mixed 1 would be implemented through carrier's carrier access charges and Mixed 2 would be implemented through end user charges.

102. Each of the plans received support from at least some of the participants who responded to the *Fourth Supplemental Notice*. Several states and small telephone companies preferred the Pure 1 scheme. Mixed 1 received some support from commenting parties. This approach was supported (at least as an interim measure) [\*\*77] by several participants who were convinced that a Pure 1 approach was overly restrictive. n35 Participants supporting this approach argued that private line users should be expected to contribute to the support of the nationwide system. To some extent the support for Mixed 1 appeared to be based on the perception that this approach represents a relatively small deviation from the current rate structure.

n35 See, e.g., Comments of Florida PSC, Michigan PSC Staff, NARUC, Oregon PUC, Washington, UTC.

103. Pure 2, or some variation of Pure 2, was supported by many of the participants who filed comments in response to the *Fourth Supplemental Notice*. Most of the support for Mixed 2 came from [\*273] those who saw it as the first step toward a Pure 2 approach. However, while the concept of a rate structure combining a flat fee with a usage-based charge to recover NTS costs received considerable support, the Mixed 2 scheme itself was viewed by most participants as unviable. Because many customers make few or no calls in any one period, and because the interstate jurisdiction is assigned NTS costs regardless of the actual use of those facilities, both the charge per unit of [\*\*78] use and the cap would have had to be so great that the benefits of cost-based pricing would have been denied to most consumers. Thus, even those participants supporting a rate structure that combined a usage charge with a flat fee were almost unanimous in recommending that each end user be assessed some flat fee for access to the network regardless of his actual usage.

104. We have decided that none of the access charge options presented in our *Fourth Supplemental Notice* is entirely satisfactory. The access charge plan that we are adopting herein is more complex, and we believe it fair to say more sophisticated, than any of these options. Our new plan, however, incorporates elements of the options in the *Fourth Supplemental Notice* and reflects the ideas and suggestions expressed in many of the comments.

105. The pure strategies that were discussed in the *Fourth Supplemental Notice* do have the advantage of providing for a uniform rate structure for MTS and WATS service on the one hand, and private line services on the other. This is an important advantage because we have found that it is virtually impossible to eliminate discrimination among services while maintaining the [\*\*79] current MTS/WATS structure and encouraging cost-based rates for other services. We have attempted for many years to eliminate unreasonable discrimination among private line, WATS, and MTS services. These attempts have imposed heavy burdens on users, carriers, and on the Commission, but have achieved, at best, mixed results. We conclude that the costs associated with the non-traffic sensitive plant used to provide these services must ultimately be recovered through charges based on the same rate structure.

106. These NTS facilities are essentially identical regardless of the service with which they are associated. Specifically, all of these facilities include access loops and associated wire and CPE that are dedicated to particular customers and allocated to the interstate jurisdiction. We have found in *Part II. B, supra*, that the rate structures for recovering the costs of these similar facilities are very different and result in unlawful discrimination. Only by charging for these facilities on a similar basis can the problems of discrimination be resolved.

107. Although the Pure 1 approach would have the advantage of charging all facilities on the same basis, we must reject the [\*\*80] Pure 1 [\*274] option. Comments by numerous participants have convinced us that bypass is an actual threat and present danger. n36 For this reason, and because of the dynamic economic distortions that Pure 1 would impose on the U.S. economy, we find Pure 1 to be an unacceptable solution. n37

n37 See, e.g., comments of Aeronautical Radio, Inc; American Petroleum Institute; Association of Data Communications Users; AT&T and BOCs; Centel; Executive Agencies of the United States; Florida PSC; IBM; Ketchikan Public Utilities; Nevada PSC; NTIA; Pennsylvania PSC; Rochester Telephone; SBS; Southern New England Tel (SNET); Southern Pacific Communications (SPC); United Telephone System, Inc.; USITA; Western Union.

n37 Such distortions include the misdirection of investment and industry from paths that make the most productive use of communications to paths that respond to non-cost related communication pricing. For example, the development of computer and related technologies could be inhibited by such a rate structure.

108. In the *Fourth Supplemental Notice*, we asked whether large users were likely to abandon the network if they were forced to pay prices equal to those paid [\*\*81] by MTS users (the Pure 1 approach). Numerous comments indi-

cated that bypass is real. Even with today's rate structure, which allows many large users to escape paying the full MTS rate through use of private line or other services, many large corporations and state, local, and federal governments are planning or using facilities that bypass the local loop. Newly available technologies such as digital termination service (DTS) and cellular radio provide valuable new services in their own right, but may also be used to provide uneconomic bypass if access pricing continues to diverge from cost. Alternative means of resolving unlawful discrimination among services (such as the plan proposed in the *Second Supplemental Notice*) would encourage still more bypass.

109. Because users have alternatives to the traditional telephone network, it is increasingly difficult to force heavy users to pay rates that greatly exceed their costs. Such users would abandon the network, leaving the small consumers who have fewer options with the full costs of the network. Indeed, attempts to overrecover costs from those groups most able to escape these charges may backfire and result in inferior service [\*\*82] to large and small users alike.

110. Many participants responded to our expressed concern with the effects of uneconomic bypass by suggesting that we use our powers under Section 214 of the Communications Act, 47 U.S.C. § 214, to deny authorizations to construct facilities that would bypass local telephone company facilities. n38 We reject that suggestion. We noted in the *Fourth Supplemental Notice* that a flat prohibition of bypass services would not be desirable because bypass services can serve functions that are not adequately served by existing telephone company services. We also noted that overpricing of telephone [\*275] company services could lead to the substitution of bypass services that may in fact be more costly to provide than telephone company services that could serve the same purpose. We concluded that access charges should accordingly be designed to avoid this "uneconomic bypass" and invited interested persons to comment upon the compatibility of various pure or mixed NTS access plans with that objective.

n38 See, e.g., NARUC and Rural Telephone Coalition comments.

111. We continue to adhere to this view. Development [\*\*83] of bypass technology provides a competitive spur to ensure that the telephone system offers the type of service that is in demand and is technologically feasible. In many cases it may be appropriate to use some service other than the traditional wireline carrier. We are simply not in a position to determine what constitutes an uneconomic "bypass" service and what is a wholly new service that will attract a new set of users and enhance the ability of all users to make full use of telecommunications service-potential. For example, some comments assert that cellular services constitute a bypass technology. We have concluded, however, that cellular radio is a distinct service that serves distinct needs and that cellular service could be complementary to existing wireline service. Indeed, a given technology may be the efficient means of providing service to certain groups yet constitute uneconomic bypass for other services or groups.

222. In addition to the bypass problem, long run reliance upon usage-based prices for the recovery of fixed-costs will distort economy-wide investment decisions, artificially restrict calling patterns, and may jeopardize the competitive position the U.S. now [\*\*84] holds in the world marketplace. In comments filed in response to the *Fourth Supplemental Notice*, NTIA has estimated that non-cost based pricing results in a \$1.7 billion annual consumer loss due to repression of calls that would have been made at rates equal to cost. While we have some questions concerning the methodology used in this study, we find the prospect of losses of such a magnitude to be deeply disturbing. n39

n39 In an independent study, James Griffin estimates this loss (including the loss due to intrastate MTS pricing) as \$1.5 billion annually. See James M. Griffin, "The Welfare Implication of Externalities and Price Elasticities for Telecommunication Pricing," *Review of Economics and Statistics*, February 1982, pp. 59-66. Certain assumptions underlying the results of this study are questionable or unclear. Nevertheless, while this Commission has been unable fully to corroborate estimates of damage, the evidence that significant harm results from current pricing structures seems strong.

113. Cost-based rates provide correct signals to the marketplace. Both investors and consumers are certain to respond to such cost-based rates by redirecting their behavior [\*\*85] in ways that redound to the benefit of the U.S. economy. In the short run, substantial growth in toll calling could be expected as consumers make better use of the network. In the long run, technologies that make more intensive use of the telecommunications system will create even larger benefits. In [\*276] an economy increasingly dependent upon information and communications, the dynamic losses caused by investment misdirection can no longer be afforded.

114. Arguments against the Mixed 1 option were similar to those leveled against Pure 1. As with the Pure 1 approach, rates for private line users would be substantially increased. As with Pure 1, it was argued that such substantial

rate increases would result in bypass and in economic inefficiency. Several of these participants also argued that the means by which the contribution would have been allocated between private line and message services under Mixed 1 was arbitrary. n40

n40 *See, e.g.*, Comments of Ad Hoc Telecommunications Users; Aeronautical Radio, Inc.; AT&T/BOCs; First Data Resources; GTE; IBM; Kansas Public Service Commission; NTIA; Pennsylvania PUC.

115. We are persuaded that either the Pure 1 or Mixed [\*\*86] 1 approaches would result in rates that are unrelated to costs for an important class of users and that any subsidy that could be collected from these rates would be shortlived. As users who are best served by the telephone network found lower priced (though higher cost) alternatives, society as a whole would be the loser and the public interest would be disserved.

116. The Mixed 2 plan would eliminate much of the discrimination between private line and message services through use of a ceiling rate. Telephone subscribers who make no use of the interstate network, however, would continue to pay nothing. Supporters of the Mixed 2 approach argued that this approach would resolve the bypass threat by greatly reducing the total bill paid by any large user, while continuing to allow small users and non-users to pay very little or nothing, maintaining universal service.

n41 *See, e.g.* Comments of Rural Electrification Administration, Virginia Corporation Commission.

117. We are convinced, however, that the Mixed 2 proposal, as described in the *Fourth Supplemental Notice*, is unworkable. The distribution of interstate calls by subscribers is highly skewed. A substantial portion [\*\*87] of total callers make no calls in any given month. Under the Mixed 2 approach, such users would pay nothing. Heavy users are currently a small fraction of total users, but make a large majority of total calls. Such users would be protected by the maximum charge. The Mixed 2 approach, however, does not alter total revenue requirements. The costs allocated to the interstate jurisdiction are unlikely to fall as a result of the Mixed 2 approach. To recover revenue requirements, access tariffs would have to levy heavy usage charges on moderate users. These charges could be far in excess of the current payments. This approach could result in an inefficient and undesirable increase in the number of subscribers who make no interstate calls. As a result, telephone companies could [\*277] find themselves unable to devise charges to meet their authorized revenue requirements. For these reasons, we conclude that the Mixed 2 approach is inappropriate.

118. Proponents of the Pure 2 approach n42 argue that Pure 2 corresponds with economic cost causation and that only the Pure 2 approach can eliminate bypass, encourage efficient use of the national telecommunications network, and be sustained in [\*\*88] a competitive environment. Pure 2 would also resolve the discrimination between private line and message service, a fundamental objective of this proceeding. It would do so by charging all users in the same way. Only costs that vary on a usage basis would be recovered on a usage basis. Costs imposed on a non-usage basis would be recovered on a non-usage basis.

n42 Proponents of the Pure 2 approach include ABC/CBS/NBC; Ad Hoc Telecommunications Users Committee; Aeronautical Radio; Association of Long Distance Telephone Companies; AT&T/BOCs; Business Telecommunications Corporation; Department of Justice (in reply comments); First Data Resources; GTE; IBM; MCI; Rochester Tel; SNET; SPC; Tel. Systems Management Corp., *et al.*; US Tel; USTS; Western Union.

119. The majority of those commenting supported the Pure 2 option for the same reasons they found both the Pure 1 and Mixed 1 schemes objectionable. n43 They assert that the Pure 2 approach would enhance network efficiency in at least two ways. First, since under this plan charges would reflect costs, they claim that Pure 2 would eliminate uneconomic bypass. Only these alternative technologies that have real advantages over [\*\*89] the telephone network would survive. Second, usage based rates could fall substantially since such rates would no longer recover NTS costs. As a result, telephone users would no longer artificially restrain their calling. Users could weigh the price of a call against the benefit that they would receive from a call, and would make that call whenever the value of the call is at least equal to its cost.

n43 AT&T and many other telephone companies that had supported the tentative plan in their comments filed in response to the *Second Supplemental Notice*, reversed their earlier position and agreed with heavy users that Pure 1 is an invitation to bypass.

120. Opponents of the Pure 2 approach<sup>n44</sup> make two arguments. First, some contended that we could not lawfully impose charges on end users. Access charges, they argue, must be paid from interstate carriers to exchange carriers. In the alternative, some argued that we could not impose charges on subscribers who make no interstate calls. Second, many argued that even if we could impose such a charge we should not. It was argued that Pure 2 would constitute a [\*278] substantial step away from universal service since many users [\*\*90] would be unable or unwilling to pay the flat fee for interstate access. Further, it was argued that the Pure 2 approach could lead to the loss of nationwide rate averaging. These drawbacks, it was felt, would be particularly severe in high cost rural areas. Some of these considerations have led us to reject the Pure 2 approach.

<sup>n44</sup> Those arguing against the Pure 2 approach include the California PUC; Consumers Union, *et al.*; Florida PSC; Haviland Telephone *et al.*; Michigan PSC staff; NARUC; National Association of State Utility Consumer Advocates; North Dakota PSC; Rural Electrification Administration; Washington UTC; Wisconsin PSC.

121. We reject the notion that we cannot impose a flat fee on subscribers, or that a subscriber must make interstate calls before a subscriber can be assessed such a charge. A subscriber who obtains a line to a local dial switch or a manual switchboard necessarily obtains access to interstate as well as local services. The cost of that access has traditionally been described as non-traffic sensitive because such costs do not vary with usage. A subscriber who does not use the subscriber line to place or receive calls imposes the same NTS costs [\*\*91] as a subscriber who does use the line. A subscriber who does not make local calls would normally pay a flat fee for the exchange portion of such costs. Imposing a flat charge for the interstate portion of those costs is equally reasonable. Any other procedure violates the general principle that costs should be recovered from the cost-causative ratepayer whenever it is possible to do so. <sup>n45</sup>

<sup>n45</sup> See *Phase II Final Decision and Order in Docket 19129*, 64 FCC 2d 1 (1977); see also *First Report and Order in CC Docket 79-105*, (uniform system of accounts), 85 FCC 2d 818 (1981).

122. We find more merit, however, in the second point raised by the opponents of Pure 2. We cannot ignore the problems which the implementation of Pure 2, especially its implementation on an immediate basis, would have upon universal service and rural subscribers. It has become quite clear to us that the major goals in this proceeding -- the continued assurance of universal service; the elimination of unjust discrimination or unlawful preferential rates; the encouragement of network efficiency; and the prevention of uneconomic bypass -- are to some [\*\*92] extent conflicting and that there is no possibility of devising a "perfect" plan that would fully and immediately effectuate all of our goals. Rather, it has become clear that any acceptable plan must balance these goals in a satisfactory manner. For example, it would be unacceptable for the Commission to put a plan into effect that ameliorates existing efficiency, bypass and discrimination problems, but which, at the same time, had serious consequences for universal service.

123. Moreover, we recognize that the balance to be drawn is a very delicate one and that some adjustments may be necessary. For this reason, we have felt it necessary to move cautiously and have incorporated a transition period for our plan. We have also taken the special precaution of establishing a Universal Service Fund to [\*279] protect the needs of subscribers in rural or high costs areas. We now proceed in the succeeding sections to describe our plan.

#### B. *The Long Range Plan*

124. We are adopting a transition plan that will produce steps toward a rate structure that promotes optimal utilization of telecommunications facilities and a long range plan that will recover significant portions of NTS costs [\*\*93] through flat charges that are collected from end users by exchange carriers. We believe it will be possible to achieve that result at the end of a transition period without jeopardizing universal service. We will, however, keep CC Docket 78-72 open in order to conduct a proceeding in the fifth year of the transition and to receive periodic or special reports during the course of the transition period that will enable this Commission to make any adjustments that might be necessary.

125. Although the long range NTS plan will not be fully effective until the 1990s, the total plan will probably be more understandable if we begin with a description of that plan. Under the long range plan, different charges will be assessed for the interstate use of lines that are also used for local exchange service and the use of lines that are dedicated to interstate service. The latter category includes interstate WATS access lines. It also includes all private lines, including closed end FX or CCSA lines, that terminate in a PBX, key system, or other customer premises equipment that is not used exclusively for a particular interstate service.

126. The charges for the line that is commonly used for [\*\*94] multiple services will reflect the interstate portion of investment in that line, associated NTS plant, and other investment and expenses that are attributed to that element.

We will call these the "Common Line" charges. The charge for the other category, which we will call "Dedicated Access Line", will inevitably be higher because it will reflect the total or unseparated cost of these facilities. n46

n46 Although we are describing this element as the "Dedicated Access Line" element, it does not include all lines that are dedicated to interstate services. Some of those lines or portions of such lines are included in the Special Access and Dedicated Transport elements.

127. We have made some revisions in the existing cost allocations to reflect private line usage of certain station equipment that is in fact jointly used by common line users and users of any private line that terminates in a PBX or similar equipment. Such jointly used equipment is apportioned to MTS and WATS under the current cost apportionment procedures. We are also apportioning a pro rata share of investment in unused or reserve lines to the Dedicated Access Line element. These changes will correct anomalies [\*\*95] in the existing cost apportionment methods that impose an unfair burden upon MTS customers. We have decided to refrain from apportioning costs to a private line category as a surrogate for a leaky PBX charge [\*280] as proposed in the *Second Supplemental Notice*. 77 FCC 2d at 241. This problem is likely to become much less significant in the future because the access charge plan will remove much of the incentive for substituting private line service for MTS. Moreover, any remaining inequity will be at least roughly balanced by the assignment of investment in unused lines to the Dedicated Access Line element on the basis of relative use. An apportionment that was based upon projected use would probably apportion a smaller portion of that investment to the Dedicated Access Line element because common line use is likely to grow at a faster rate than private line use in the future.

128. We are also establishing a third NTS category for pay telephones. Although the NTS costs associated with pay telephone calls do represent fixed costs, it would be impossible to recover such costs through flat rates. We are accordingly prescribing usage charges that will [\*\*96] be collected from end users when an interstate or international call is made from a pay telephone. We will call this element the Pay Telephone element.

129. We have also decided that a portion of the common line revenue requirement should be recovered through a carrier's carrier charge. At the present time most interstate common line costs are reflected in nationally averaged MTS and WATS rates, but the compensation that exchange carriers receive through the settlements and divisions of revenues process reflects the actual costs of each carrier that participates in the pool arrangement. n47 When we adopted the *Second Supplemental Notice* we assumed that we could eliminate discrimination and preferences in end user rates for interstate services without drastically altering the telephone industry's voluntary pooling arrangement. We accordingly proposed to establish carrier's carrier access charges that would be uniform in all exchanges of all carriers and proposed that access charge revenues be pooled in essentially the same manner that MTS and WATS revenues are pooled now. n48

n47 That arrangement is described in the *Second Supplemental Notice*. See 77 FCC 2d at 226-228.

n48 The pool we proposed at that time would have differed from the settlements/divisions pool in some respects. *Id.* at 238-239. [\*\*97]

130. Although some comments that were filed in response to the *Second Supplemental Notice* questioned the desirability of uniform access charges with pooling, comments from both large and small telephone companies generally supported that proposal. None of the telephone companies indicated that it would not wish to be included in any such arrangement.

131. After the settlement of the AT&T antitrust case was announced, we recognized that it would probably be necessary to create different arrangements for the preparation of any common [\*281] tariffs and the administration of any revenue pools. The *Fourth Supplemental Notice* invited comment upon a proposal to create an association to perform administrative functions that AT&T would have performed under the tentative plan in the *Second Supplemental Notice*. The *Fourth Supplemental Notice* also invited further comments upon some possible alternatives to nationwide averaging of access charges.

132. The most recent comments demonstrate that the telephone industry consensus no longer exists. The AT&T comments indicate that the BOCs do not wish to participate in common access tariffs or access revenue pools. Rochester, Continental [\*\*98] and Centel have also indicated that they do not wish to participate in such arrangements. Many telephone companies and others have argued that nationwide averaging of access charges should be maintained. Some

contend that nationwide averaging with pooling is essential to avoid severe hardships for some subscribers. n49 Such national averaging would allow below cost rates in high cost rural areas with attendant gains in universal service. Opponents of nationwide averaging argue that averaging results in a deviation of costs from rates and the prospect of inefficient use of the network. n50 Some contend that averaging might also have an undesirable effect on incentives to contain costs. n51 Uniform rates also limit a carrier's flexibility to meet unique circumstances, such as an unusual threat of uneconomic bypass or a reduction in universal service in the area served by a particular carrier. If we adopt rules that require every carrier to follow the same path, we will be hardpressed to satisfy legitimate needs of companies that require more rapid movement toward cost-based pricing and those companies that require a more gradual transition.

n49 *See especially*, Haviland Telephone Company, p. 7; Ketchikan Public Utilities, p. 2; Michigan Action Groups, p. 6; Rural Telephone Coalition, p. 14; REA, p. 6; Curtis M. Bushnell, p. 2; First Data Resources Reply, p. 16; NARUC Reply, p. 2.

n50 *See, e.g.*, comments of AT[T] Centel; Continental Telecom; GTE (in the future); NTIA; Rochester Telephone; SNET; Cincinnati Bell; USTS; Vermont PSB; Western Union.

n51 *See especially*, Rochester Telephone, p. 34.

[\*\*99]

133. For reasons that are explained more fully in Part VI, we have decided that we should not require every exchange carrier to participate in common tariffs for all access elements. We have also concluded that some adjustment in flat end user common line access charges must be made in order to balance the critical need to move towards a rational cost-based pricing system for access plant with the maintenance of universal service. We do not anticipate that end user rates will ever reflect the full common line NTS costs of the highest cost carriers.

134. Costs of different local exchange carriers do vary. Many of these cost variations are attributable to factors that carrier management cannot control. The Docket 80-286 Joint Board has tentatively [\*282] endorsed an industry proposal to include a high cost factor in any new separations formula for the apportionment of NTS plant. *Joint Board Order, supra*, 47 Fed. Reg. at 54485. Such a factor would represent a percentage of the NTS costs of high cost companies that would be added to a base factor percentage to determine the portion of such a company's NTS costs that would be allocated to the interstate jurisdiction. Such a percentage [\*\*100] factor would necessarily take into account any increasing cost pressures caused by inflation or other factors. The high cost factor would promote or preserve universal service by enabling high cost companies to establish local exchange rates that do not substantially exceed rates charged by other companies. In view of the purpose such a factor would serve, we will describe it as a universal service factor in this *Report and Order*. Revenues attributable to the universal service factor will be described as the Universal Service Fund.

135. The purpose that the Universal Service Fund would be designed to serve would obviously be frustrated if all NTS costs were recovered through end user charges that reflect the interstate NTS costs of a particular exchange carrier. Any reduction in the local exchange rates of such a carrier would be offset by increased end user access charges. We have accordingly decided that common line costs that are assigned to the interstate jurisdiction as a result of the application of a universal service factor should be recovered through an access charge that is assessed upon interexchange carriers.

136. Many parties have called for the creation of a "life [\*\*101] line" exception to any mandatory flat customer access charge. Life line services have been introduced in a considerable number of state jurisdictions. Such rates have not always provided benefits to the class of users who are the intended beneficiaries.

137. We are, nevertheless, prepared to entertain waiver requests from carriers who wish to provide "life line" options under the following circumstances. First, any such waiver request should state with specificity the terms and conditions which apply to life line service. Second, such waiver requests must specify the revenues which would be lost were such a life line option to be instituted. Third, such waiver requests must specify the specific adjustment to the customer access charge tariff which has been made to secure the revenues lost through the life line option. During the transition period these measures may be either an increase in the minimum flat rates or an increase in the usage charge imposed upon customers for access service. An increase in the transitional maximum charge will not be permitted. Of course, states continue to have full authority to modify existing life line rates for local exchange telephone service or [\*\*102] to institute such rates should they believe it is necessary to ameliorate the effects of interstate access charges.

[\*283] C. *The Transitional Plan for Carrier Common Line Charges*

138. Although we expect that revenues from the Carrier Common Line element will eventually be limited to the Universal Service Fund portion of the Common Line revenue requirement, substantial additional amounts must be included in that carrier's carrier charge during an interim period to avoid anomalous results that would occur if deaveraged end user rates for all other Common Line costs were implemented in 1984.

139. We have recently adopted a change in jurisdictional separations rules that will accomplish the phased removal of CPE from the interstate rate base. We decided to implement that aspect of our decision in *Second Computer Inquiry, supra*, in that manner in order to avoid an abrupt increase in local exchange rates that would result if the interstate CPE allocation were removed on a flash cut basis. The Joint Board has recently invited comment upon an alternative formula that will achieve the same results even if the divested BOCs do not have any CPE to allocate [\*\*103] after the divestiture occurs. n52

n52 The alternative formula is described in Part IV. D. of the *Joint Board Order*.

140. The purposes of the phased removal of CPE or the allocation of surrogate CPE costs would be frustrated if costs assigned to the interstate jurisdiction to limit increases in local exchange service rates were added to end user access charges. Such a cost assignment could have the same effect upon end users as a local rate increase. In these circumstances, we have concluded that it would be more appropriate to recover such costs through a carrier's carrier charge. Since such costs will disappear four years after the access charges become effective, the exclusion of such costs from End User Common Line charges will avoid churning effects upon End User Common Line charges that could make the transition to a new rate structure unnecessarily difficult.

141. Similar considerations warrant the exclusion of inside wiring costs from End User Common Line charges. Inside wiring that was capitalized as investment before this Commission required the expensing of inside wiring is being amortized and will disappear from the rate base in the early 1990's. We are also [\*\*104] considering proposals to remove expenses associated with the installation of new inside wiring from interstate rate computations. n53 It would be inappropriate to add such costs to new flat charges imposed upon end users in view of the uncertainties with respect to the future status of inside wiring. It would also be inappropriate to recover inside wiring or CPE costs through a per line charge because there is little or no [\*284] relationship between CPE or inside wiring costs of a particular subscriber and the number of loops used by that subscriber.

n53 See *Deregulation of Customer Premise Inside Wiring, 86 FCC 2d 885 (1981); Notice of Proposed Rulemaking*, (CC Docket No. 82-681), 47 Fed Reg. 44770 (October 12, 1982).

142. The present *Separations Manual* apportions NTS plant on the basis of a factor, which is called the Subscriber Plant Factor or SPF, that has been computed separately for each "study area." A study area normally means the area served by a particular telephone company within a particular state. The current factors differ widely from one study area to another and many companies that probably [\*\*105] will not be classified as high cost companies have interstate NTS costs that are substantially higher than the national average because they happen to have a high interstate SPF. If deaveraged end user rates were implemented under the present circumstances, their customers would be subjected to excessive rate increases.

143. The Joint Board is presently considering a number of alternatives to the current factors that would not be likely to produce such results. Any new factor that differs significantly from an existing factor is, however, likely to be phased in over a transition period. In these circumstances common line costs other than Universal Service Fund (USF), CPE and inside wiring costs that exceed an appropriate cut-off will be assigned to the Carrier Common Line element for an interim period. n54

n54 See Subpart F of the rules.

144. An additional assignment to the Carrier Common Line element is also desirable to place some limit upon the flat end user charges that carriers would be permitted to adopt during the transition period for End User Common Line charges. In view of all of these considerations, we have decided that, in 1984, Common Line revenue requirements [\*\*106] that exceed \$4 per line per month should be allocated to the Carrier Common Line charges.

145. The rules we are adopting establish a five-year transition period for the elimination of Common Line costs other than USF, CPE and inside wiring costs from the pooled Carrier Common Line charges. Common Line costs other

than USF, CPE and inside wiring could be described as the third component of a Common Line revenue requirement. This third component contains all the residual costs. For each local telephone company, this total residual amount is calculated as follows: Total interstate per line residual amount = total Common Line per line revenue requirement -- \$4. -- (CPE + USF + Inside Wiring)

146. Over a five year period, the total residual amount is to be allocated annually between the End User Common Line charges and the Carrier Common Line charge under the following formula:

[\*285]

Year	Carrier Contribution to total Residual amount	End User Contribution to total residual amount
1984	100%	0%
1985	80%	20%
1986	60%	40%
1987	40%	60%
1988	20%	80%
1989	0%	100%
1990	0%	100%

147. Thus, in the first year of the transition period these residual costs will [\*\*107] be recovered fully through the Carrier Common Line charges imposed on all providers of interstate switched services. In the second year, only 80 percent of the residual costs for that year will be recovered from carriers, with 20 percent recovered from end users.

148. We recognize that end user charges constitute a substantial departure from the historic means of cost recovery. Exchange carriers are unfamiliar with this new system. Such carriers, especially small carriers that are unable to devote substantial resources to this task, might be subjected to unnecessary risks if forced to move immediately to full recovery of subscriber plant through subscriber charges. The Carrier Common Line charges, administered through the exchange carrier association, offer a limited degree of risk sharing and increased certainty to these exchange carriers in the early years of the new environment. The fairly rapid reduction of such charges through the transition appears likely to limit uneconomic bypass substantially during the transition to cost-based pricing.

149. The Carrier Common Line charge will also provide the mechanism to adjust the prices charged interexchange carriers for access to reflect [\*\*108] differences in access quality. To achieve this result, we have required that the Carrier Common Line element be subdivided into two charges. The first charge, a usage charge, will be imposed upon all interexchange carriers. The second, a premium access charge, will be imposed upon only certain carriers described below.

#### 1. *The Usage Charge*

150. This charge shall be calculated on a straightforward minutes of use basis for services using common lines (e.g., MTS, WATS, FX, and OCC-ENFIA). This charge shall be levied on a nationwide equal per minute basis regardless of the costs of particular originating or terminating exchange carriers, the length of haul, or the rate charged by the interexchange carrier. An exchange carrier association, described in Part VI, shall be responsible [\*286] for tariffing and collecting both the premium charge and this usage charge and distributing revenues to all participating carriers.

#### 2. *The Premium Access Charge*

151. There is little disagreement that the quality of interconnection now received by the OCCs n55 through their ENFIA A arrangements is distinctly inferior to that received by the traditional interexchange partnership (predominantly [\*\*109] AT&T). Indeed, it appears that the level of interconnection received by the OCCs even under ENFIA B and ENFIA C arrangements (if available) is inferior to that received by the partnership. n56 Such quality differences would give a substantial advantage to the carriers that offer MTS and WATS unless access pricing is adjusted to account for quality differences until equal interconnection is available to all interexchange carriers. It is not clear, however, that this inferior level of interconnection is any cheaper to provide. Cost-based pricing would appear to require that all carriers pay their full costs regardless of any quality differences.

n55 The term "Other Common Carriers" or "OCCs" is often used to describe carriers other than telephone companies. The term "OCC" is used in the context of this *Report and Order* to describe an interexchange carrier that offers an MTS/WATS equivalent service such as Execunet or SPRINT.

n56 ENFIA A provides interconnection to the line side of a Class 5 switch, ENFIA B provides interconnection to the trunk side of a Class 5 switch, and ENFIA C provides interconnection through a tandem switch.

152. Over the past several years, BOCs have [\*\*110] been compensated for use of their facilities for OCC interconnection through the ENFIA tariff. That tariff provides a 45 percent discount from the "SEP" amount, *i.e.*, the amount that AT&T calculates that BOCs receive for exchange access through the division of revenue process. This arrangement is the result of compromise, and was adopted only as an interim measure, until the issues involved in this proceeding are solved and an access charge devised.

153. While the OCCs have generally sought a continued rate differential, few participants in this proceeding now assert that any differential should take the form of a "discount". Southern Pacific argues, however, that the existing OCC rate should not be described as a discount since the concept of discount implies that the same good is being provided. While we shall not dispute that definition of discount, cost-based pricing does not appear to allow non-cost based rates, including reductions below the cost of service, regardless of whether the service being provided is inferior to an equally costly service provided others. Instead of justifying an OCC discount, MCI claims, in reply comments, that an AT&T surcharge is appropriate. [\*\*111]

154. If the type of access received by AT&T can be provided only to one carrier (at least in the short run), then even if it does not cost much to provide this access to that one carrier, this access has an "[\*287] opportunity cost" that is equal to the amount that other carriers would be willing to pay for this preferred access. The cost of providing the favored carrier with this unique level of access includes the denial of this access to other carriers. Those carriers who receive the level of service that could be provided to any number of carriers would pay the full costs of this service. Carriers who receive the premium access service would pay the observable costs and an additional amount reflecting these opportunity costs. A surcharge for such premium access could theoretically be computed to reflect such opportunity costs, but it would probably be necessary to conduct an auction to determine the amount a carrier would pay for such premium access. We have decided that an auction would not be feasible. We will, however, assess a charge upon AT&T and its interexchange partners that will reflect an estimate of premium value. We will describe that charge as the premium access [\*\*112] charge. We will not, however, permit exchange carriers to recover premium value in addition to a total revenue requirement that is computed in the usual manner. The premium access payments will be deducted from the Carrier Common Line revenue requirement in order to compute usage charges.

155. Revenues collected from the premium carrier need not flow to the exchange carrier having the greatest value of premium access. Indeed, if exchange carriers were able to levy premium access charges, such exchange carriers would have strong incentives to continue to offer preferential service for a longer period than would be necessary. We have concluded, therefore, that the premium charge should be levied by the exchange carrier association on a nationwide basis.

156. By September of 1986, the quality of interconnection generally available to OCCs will have to be far closer to the quality of access offered the premium carrier because of MFJ requirements. Even then, however, there will still be differences having potential advantages to a premium carrier, including the premium carrier's position as fallback carrier for current subscribers not specifying some other default carrier, and the continued [\*\*113] unique premium access to nonelectronic and small switches. This residual premium access will have some value, but will have a value far smaller than is given by its present position. A decreasing surcharge is, therefore, appropriate. n57

n52 Nothing in the record causes us to expect any carrier other than the AT&T partnership will receive premium access. Improved access received by other carriers appears to reduce the value of AT&T's premium, but not to constitute a replacement of AT&T as the premium carrier. Our prescribing the gradual elimination of the premium access charge reflects our belief that exchange carriers will quickly move toward equal access.

157. A premium charge might be levied as either a lump sum or a per minute charge. We have determined that a lump sum approach [\*\*288] serves the public interest. The value of premium access does not depend on the actual rate structure selected by the premium carrier or the usage generated through that rate structure. Rather, it depends on the value of premium access in its best alternative use. This value is constant without respect to the behavior of the particular carrier receiving premium access.

158. Thus, for example, [\*\*114] the premium carrier may make investments to expand its network or reduce blockage in hopes of stimulating increased call volumes. If the premium charge were assessed on a usage basis, these investments might not be made even if they would redound to the benefit of the calling public. By levying a lump sum charge on the carrier receiving premium access, this distortion is avoided. The economic justification for a premium charge is, therefore, consistent with a lump sum charge rather than with a usage based premium charge.

159. We have invited proponents of a large or a small differential in the access compensation paid by OCCs and the telephone company partnership to submit a case for a particular differential both in this docket and in proceedings relating to the ENFIA agreement. Those participants have apparently been unable to produce submissions that have much evidentiary value. In these circumstances, we necessarily must exercise our best judgment to establish an appropriate premium amount.

160. The Element 3 discount in the ENFIA agreement was designed in part to reflect an estimate of the value of differences in access arrangements by the parties to that agreement, but that [\*\*115] discount would not establish an appropriate 1984 premium even if that discount could be readily translated into a premium. We noted in *Extension of ENFIA Agreement, supra, 90 FCC 2d at 16*, that the formula for the computation of ENFIA charges was probably designed to produce a charge that would be higher than the FX Open End charge and lower than a charge that would replicate the compensation BOCs receive from the division of MTS revenues. This was apparently perceived to be necessary to achieve equity in view of access compensation disparities between MTS and FX.

161. The existence of those disparities was an important factor in our decision to extend the ENFIA agreement without altering the Element 3 discount factor. We said (*id. at 16-17*):

We believe it is still reasonable to allow OCCs to pay charges that are lower than MTS/WATS access charges and higher than other access costs during the interim period. That interim period will, of course, end when access charges are established pursuant to the rules we are prescribing in CC Docket No. 78-72.

162. The access charge rules we are adopting do eliminate those disparities. [\*\*116] We would have adopted a smaller discount factor when we extended the ENFIA agreement if that factor had been designed for the sole purpose of reflecting the value of qualitative differences [\*289] between ENFIA and MTS/WATS access. We would have made a further reduction in the ENFIA Element 3 discount if ENFIA element 2 had been computed to reflect differences in switching costs that will be reflected in our rules for the computation of charges for the Local Switching element. See Part IV.A, *infra*. A smaller premium is also necessary because OCCs will be receiving some access before and during 1984 that is better than the ENFIA A arrangements that existed at the time the ENFIA agreement was negotiated. Nothing has occurred during the years since the ENFIA agreement was signed that would indicate that the parties to the ENFIA agreement overestimated the value of the qualitative differences in OCC and partnership access arrangements. Therefore, the 1984 premium should be smaller than an amount that would replicate the present ENFIA discount.

163. Nevertheless, a substantial premium access assessment is required in 1984 because significant disparities in the quality of access [\*\*117] will exist during that year. Those disparities will continue to provide AT&T with a significant competitive advantage.

164. Although we have not approved a differential in access compensation to provide artificial advantages for new competitors, we are, of course, mindful of the adverse effect than an abrupt elimination of access compensation disparities could have upon competition under existing conditions of unequal interconnection. In view of the uncertainties with respect to the magnitude of premium access value and the future progress to equal access, we have decided that a phased elimination of the access compensation differential is justified in order to encourage full and fair competition. That course is consistent with our determination in this proceeding that a competitive interexchange market will produce significant public benefits.

165. We have decided to implement that decision by using the dollar amount of the interstate CPE costs or surrogate CPE costs of all local exchange carriers to determine the premium access assessment.

166. Those costs have been fixed through our decision to remove a base amount from the interstate rate base during a five year transition period [\*\*118] that begins in 1983. Thus, the interstate CPE costs will be declining at the rate of 25% per year during the first years that access charges are in effect. Disparities in the quality of access arrangements for OCCs and premium carriers will be phased out during approximately the same time frame.

167. We also believe that 1984 interstate CPE costs, which we estimate to be about \$1.4 billion, will correspond with our present estimate of 1984 premium access value. Such an assessment will be substantial and is likely to be sig-

nificantly smaller than an assessment that would replicate the ENFIA A Element 3 discount. The use of CPE costs also serves administrative convenience.

[\*290] 168. We cannot, however, be certain that the decline in the premium value will correspond to the decline in CPE costs. We have accordingly described the CPE costs as a default formula for the computation of the premium in the access charge rules. Section 69.207 of the Rules says that premium access shall be equal to a CPE or CPE surrogate revenue requirement "[i]n the absence of a Commission order designating the premium access portion..." We do not intend to designate a different amount for the 1984 premium [\*\*119] assessment, but we may designate a different amount in subsequent years if we have reason to believe that premium value is declining at a much faster or slower rate than the interstate CPE costs.

#### D. Transitional End User Common Line Charges

169. Although the allocation of Common Line costs to Carrier Common Line charges should be sufficient to offset anomalies that could result from the application of transitional separations factors, this would not be sufficient to avoid the disruptive effects of immediate implementation of flat charges for the entire end user portion. The introduction of a \$4 per month per line charge for residential end users on a Mash cut basis could create an undue risk that a number of residential users would choose to cancel local exchange service. n58

n58 Possible effects of access charges upon the universality of service are discussed in Appendix G.

170. As we noted in the *Fourth Supplemental Notice*, we are quite concerned about the impact of flat charges for NTS costs, and especially a sudden shift to flat charges, on small users and on subscribers in high cost areas. Despite the attractiveness of such flat charges from the standpoint of economic [\*\*120] efficiency, we are unwilling to require immediate implementation of flat charges for the entire end user portion. The guidelines that we adopt, however, constitute a gradual transition to a new approach to compensation for interstate access that balances the goals of the Communications Act in a manner that best serves the public interest.

171. Many participants who found at least some flat charges acceptable or desirable argue that a transition period is appropriate. n59 Such a transition would allow subscribers and telephone companies the opportunity to adjust to the new environment. Other participants take the opposite view that a flash-cut approach would be most appropriate. n60 Such a flash cut would allow cost-based pricing immediately to go into effect and confer the economic advantages of flat charges that much earlier.

n59 See e.g. Comments of Ad Hoc Telecommunications User's Committee; AT[T] MCI; NTIA; Pennsylvania PUC; SNET; SPCC; United Telephone System, Inc.; USITA; U.S. Tel.; Vermont PSB.

n60 See, e.g., Comments of Aeronautical Radio, Inc.; GTE; Rochester Tel; Tel. Systems Management Corp., et. al.

[\*291] 172. We have concluded that a transition [\*\*121] to the flat End User Common Line charge we require is appropriate. A gradual transition allows a more comfortable adjustment to the new economic realities. If the timing of the transition is known, the dynamic efficiency losses that result from failing immediately to move will be small. The extremely long transition advocated by MCI appears unnecessary.

173. The gradual transition we are adopting has several advantages that, we believe, will outweigh any drawbacks. First, it establishes a schedule for movement to a cost-based access arrangement over a medium length period. Companies that have invested heavily in technologies made economic only by the continuance of uneconomic and non-cost based prices will have several years in which to amortize these investments. A pre-set transition will encourage investors to target new investments on technologies that are consistent with the underlying costs of the network and hence on the most efficient possible use of the nationwide telecommunications system.

174. A pre-set transition plan like the one we are adopting has the advantage of providing some certainty to those who must make investments in communications technologies. A fairly rapid [\*\*122] movement toward cost-based pricing can allow time for corrections in past investment, yet new investments would be made with the forthcoming prices in mind. It appears unlikely that any company would spend the thousands or even millions of dollars necessary to take advantage of the variance between price and cost during the transition if it understands that the gap is to be reduced

year by year, until it is completely eliminated at the end of a mid-length transition period. Thus, while the transition plan incorporates some features in the Mixed 2 plan in the *Fourth Supplemental Notice*, it will not have the fundamental flaw that the maximum rate must remain many times higher than cost.

175. We believe that a more lengthy transition would unnecessarily delay the advantages of cost based rates and might encourage unnecessary bypass and inefficient development of the economy. While the seven-year transition plan we have adopted might appear unnecessarily slow to some users and exchange carriers, the flexibility it provides will allow those carriers who feel compelled to move rapidly the opportunity to do so, while not forcing all carriers to adjust at this same pace. The details of [\*\*123] the transition plan are explained in the next subpart and in Subpart C of the access charge rules.

#### E. End User Common Line Rate Structure

##### 1. The Minimum Change.

176. As we have already indicated, the End User Common Line charges will meet an increasing share of total NTS costs assigned to [\*292] the interstate jurisdiction. This element, combined with the Carrier Common Line charges, will recover most of the costs of subscriber plant, including CPE, inside wire, outside wire (*i.e.*, the drop line and interface) and loop costs allocated to the interstate jurisdiction. All of these costs are non-traffic sensitive and, for the most part, are dedicated to particular consumers. (Only party line loops and any investment associated with coin phones are non-dedicated.)

177. During the transition period for End User Common Line charges we shall require that the access tariff include a minimum flat fee of at least two dollars per month for each residential common line. This payment shall be imposed regardless of whether the particular customer makes or receives any interstate calls. The minimum business line customer charge shall be four dollars per common line loop per month. [\*\*124] The difference in these charges should reflect the typically higher interstate revenue requirement generated by business lines as compared to residential lines. In addition, we believe that this differential should reduce the incentive a business subscriber might have to use its dedicated facilities in a way calculated to reduce the usage sensitive portion of its access charge, solely to escape usage payments.

178. We also believe that a differential in the transitional minimum charges for business and residential customers is justified because we have selected a low residential minimum in order to avoid an adverse effect upon universal service. Minimum charges for business customers are unlikely to have any meaningful effect upon universal service because demand for business local exchange service at least for a single line tends to be inelastic. We have, however, concluded that some limitations should be imposed upon carrier discretion to select a higher minimum rate. Section 69.203 of our Rules precludes any carrier from establishing a business minimum charge that is more than 200% of the residential minimum charge.

##### 2. The Usage Charge

179. The difference between the minimum [\*\*125] flat fee (which must be at least two dollars per month per line for residence and four dollars per month per line for business) and the total revenue requirement associated with the end user charge (four dollars per month per line in the first year and increasing amounts in later years) may be recovered through a usage charge, up to a maximum.

180. Traditionally usage has been measured on the basis of minutes of use. The *Fourth Supplemental Notice* had suggested that a per call (rather than per minute) usage measure might be more appropriate for any usage component in the end user access charge. Because nontraffic sensitive costs do not vary with minutes or number of calls, we find neither of these approaches to be clearly superior in all cases. The selection should be based on which will lead to the smaller distortion in usage patterns.

[\*293] 181. Charging users on a per minute basis will encourage users to make shorter calls than they would under efficient pricing. Charging users on a per call basis would encourage them to make fewer and longer calls. Once customers make a call they would have an incentive to communicate as long as efficient, but this efficiency gain must [\*\*126] be evaluated against the efficiency loss of fewer calls.

182. The selection of a measure of usage should be based on relative elasticities of demand. n61 If most short calls are made to convey pressing information, the per call charge would not discourage too many callers and this alternative would be desirable. If this is not the case and customers would be willing to make fewer calls or take advantage of pat-

terned calling (*e.g.*, making collect or person-to-person calls that are designed to be refused but to convey information in the request), the per minute option would be preferable. Either a per call or a per minute charge could be used as a valuable component in our transitional plan. Such a charge could be set in order to recover revenue directly from end users (rather than carriers) while prolonging the period before all rates are set on a flat basis. In the *Fourth Supplemental Notice*, we expressed our belief that the elasticity and measurement cost conditions might warrant a per call charge. Several of the comments suggest that under a Mixed 2 option the per call fee would be so high that it would discourage large numbers of calls, and that a per minute charge would [\*\*127] be more appropriate. Under the rate structure we have prescribed the per minute or per call charge would be substantially lower than would be necessary under a zero-based Mixed 2 option. We have concluded, however, that the selection of a measure of usage should be left to the exchange carriers. It is certainly possible that different carriers may face customer demands of varying elasticities. The choice that is appropriate for some may be inappropriate for others.

n61 For a discussion of how relative elasticities of demand are related to cost recovery, *see* W.J. Baumol and D. Bradford, "Optimal Departures from Marginal Cost Pricing," *American Economic Review*, vol. 60, pp. 265-283, June, 1970.

### 3. *The Maximum Charge*

183. Because common lines are similar to dedicated interstate lines, we shall require that the maximum collected on any such line through end user charges (the sum of the minimum and any usage payment) be less than or equal to the rate established for dedicated access lines. Throughout the transition period we shall require that no one customer be charged in excess of a pre-set maximum. To eliminate unlawful discrimination among services, the maximum should [\*\*128] be no more than the rate that a customer would pay as an end user Dedicated Access Line charge. n62 In special cases, however, we [\*294] may allow local companies facing hardship in meeting our requirements to raise the maximum and the rate charged for the Dedicated Access Line element above the Dedicated Access Line per line cost. Such an exception would be allowed only as a temporary expedient in the early years of the transition.

n62 *See* Section 69.205 of the rules for a description of the computation of maximum rates in each transition year.

184. In each of the five years subsequent to the introduction of the access charge, the maximum allowed each carrier shall be reduced by 10 percent, but shall never fall below total interstate costs. The exchange carrier or the exchange carrier association may adjust either the minimum, usage component, or both to recover revenue. At the end of the five year transition period, the highest maximum allowed would be reduced to 50 percent of its initial level and all Common Line costs, other than the Universal Service Fund and inside wiring costs would be recovered directly from end users.

185. For the last two years of the seven [\*\*129] year transition period, we shall allow exchange carriers to continue to recover their End User Common Line revenue requirement through such a combination of flat fee minimum charges and usage charges with the pre-set maximum. Exchange carriers facing substantial bypass threat may wish to introduce flat rate pricing for recovery of all End User Common Line costs early in the transition period. In areas where bypass is a smaller threat, the more gradual transition permitted by continuing to allow usage recovery (to a maximum) appears to have benefits that outweigh the costs.

186. A maximum End User Common Line charge that is no greater than the price paid for a dedicated interstate loop (such as that associated with a closed end WATS line) or an interstate closed end FX line will allow heavy users to make a more rational choice among private line, MTS, WATS or FX service. It would resolve fundamental problems facing this Commission in this and other proceedings. The maximum is also desirable in its own right to reduce the threat of bypass. Since a substantial share of non-traffic sensitive costs is to be assigned to the End User Common Line element and recovered through minimum and maximum [\*\*130] charges, the portion of NTS costs recovered in usage sensitive interstate rates will be substantially reduced. Heavy users, therefore, will find message rates that are dramatically reduced toward costs and would find bypass a less desirable option. The expectation of further reductions in both the maximum and the usage charge will further reduce the dangers of uneconomic bypass.

187. Generally, the usage charges will be imposed upon originating callers. We find, however, that it would be inappropriate to assess a usage charge upon the originating caller for certain calls that have traditionally been charged to the recipient. These include collect MTS calls, IN-WATS calls, and calls to an FX or CCSA subscriber that originate at

the open end. The purposes that these [\*295] services were designed to serve would be frustrated if usage charges were assessed to the originating caller.

188. It would be difficult to assess such usage charges directly to the party who receives the call because that end user will normally be served by a different local exchange carrier. We have, therefore, decided to impose a charge upon the interexchange carriers that provide such services as a surrogate [\*\*131] for a usage charge upon the recipient of the call. Such surrogate charges will, of course, be reflected in the interexchange carrier's charges to recipients in a manner that indirectly recovers appropriate costs from such recipients.

189. We have described this surrogate charge as a "transitional surcharge" in our Rules. Section 69.206 of the Rules describes the formula for computing the transitional surcharges. Although the transitional surcharge will be a carrier's carrier charge, it is an integral part of the transition plan for End User Common Line charges. Transitional surcharge revenues will be deducted from the End User Common Line revenue requirement in order to compute the usage charges that are assessed directly to end users.

190. As ENFIA A access is currently provided, it is difficult for some exchange companies to attribute usage to originating customers. It might appear difficult, therefore, to apply the usage sensitive charges and the maximum charge to these services. One solution is to develop a surrogate charge for these services. We believe, however, that coordination of billing between the exchange carrier and the interexchange carrier offering ENFIA A service is [\*\*132] more desirable, efficient, and non-discriminatory.

191. In this *Report and Order* we require local exchange carriers to offer billing services to all interexchange carriers if they offer billing services to any. *See* Part IV. C, *infra*. We anticipate that the OCCs will take advantage of exchange carrier billing services and will submit their calling records to the exchange carriers doing the billing. The exchange carriers can, and are expected to, compare the identities of ENFIA A or C callers with their own subscriber rolls, coordinate calls and callers made over ENFIA A or C lines with calls made over other types of interconnection, and bill the end user with a usage charge appropriate for the totality of interstate calls made. If OCCs take advantage of exchange carrier billing services, or if ENFIA A or C minutes can be attributed to end users without this service no surrogate charge is necessary. n63

n63 We are not including such a surrogate charge in the rules we are adopting, but will consider waiver petitions to permit such surrogate ENFIA A charges if a carrier demonstrates that it would not be feasible to collect the charges from end users. We would expect a strong showing that alternative methods are not feasible. [\*\*133]

192. So long as the maximum End User Common Line charge differs from the minimum, we must deal with the incentives that [\*296] might encourage heavy use of one line for interstate and other lines for local or intrastate toll calling. We have considered two options. First, all users, business or residential, could be required to pay the maximum for all lines in addition to their first line. Alternatively, total usage could be aggregated and divided over total lines regardless of use.

193. Transitional issues become important in making that choice. While such users should not expect to be subsidized in the long run, it might be unjust and inefficient to require them to pay high rates if they made their original investments in good faith and with the expectation that the current pricing structure would continue. Furthermore, the number of lines is likely to be a very poor proxy for ability to pay. Such users appear entitled to the benefits of a transition.

194. We, therefore, shall require customers having multiple lines to pay as if their calling had been spread evenly over all of their lines. Because the total usage of all of these phones is aggregated, customers would have no incentive [\*\*134] to load all interstate calling inefficiently on any one line. Moreover, the transition plan will tend to limit the willingness of any user to distort investment strategies in response to differences in single line and multiline rates.

#### F. Monitoring of the Effects of End User Charges

195. We are well aware that the plan we adopt today constitutes a significant departure from interstate pricing approaches developed in a monopoly environment. We are totally committed to insure that this approach does not lead to a disruption of our nation's telecommunications system or to the elimination of universal service. That commitment is reflected in our decision to exclude Universal Service Fund costs from end user charges before and after the transition

periods that are described in this *Report and Order*. That commitment is also reflected in our decision to conduct another notice-and-comment phase of this docket before taking the final steps in the transition to flat rate end user charges.

196. In view of the importance that we attach to the universal service objective, we have decided that this Commission should also monitor the effects of the implementation of end user access charges [\*\*135] during the transition period. We are accordingly directing the Common Carrier Bureau to develop and present to us a monitoring system designed to insure that any developments based upon our access charge plan which threaten the "universal" character of service are brought to our attention in sufficient time for us to be able to take ameliorative action. We further direct that such a plan be in place on or before January 1, 1984, the date of institution of access charges. This monitoring plan should be designed to place as little a burden as possible upon the small businesses which constitute the overwhelming majority of our nation's telephone systems. [\*297] The Common Carrier Bureau is directed to present to us within 90 days of the release of this *Report and Order* its proposal for such a monitoring program.

#### IV. GUIDELINES FOR RECOVERY OF TRAFFIC SENSITIVE COSTS

197. In the *Second Supplemental Notice* we presented a plan to prescribe access charges for four categories of interstate service: MTS/WATS; FX/CCSA open-end access; private line; and OCC-ENFIA. Because it would have included toll connecting trunks which did not carry exchange traffic, we rejected the definition [\*\*136] of "exchange circuit plant" appearing in the *Separations Manual* as a basis for defining the investment to be included in the access revenue requirement. Instead, in order to determine the investment that would be allocated to exchange access services, we defined "exchange plant" as plant used to furnish both toll and local service. Investment in other plant, called interexchange plant, would be excluded from the access revenue requirement. 77 FCC 2d at 239-240.

198. We had proposed that investment in exchange trunk outside plant (OSP) used jointly for exchange and toll message service (exchange trunk OSP in Category 1.22) and related exchange trunk circuit equipment (central office equipment in Category 8.12) be distributed among the three message service categories on the basis of minutes of use. Investment in exchange plant used for private line services and related equipment was to be directly assigned to the private line category. (OSP linking end offices and toll offices, however, was to be excluded and considered interexchange plant.)

199. Investment in traffic sensitive Category 6 central office equipment (local dial switching equipment) was [\*\*137] to be distributed among the message access service categories (MTS/WATS; OCC-ENFIA, and FX/CCSA) on the basis of relative dial equipment minutes (DEMs), except for that portion directly assigned to private line services like CCSA. We proposed to rely on the factors specified in the *Separations Manual* for allocating investment in other traffic sensitive plant among the four access service categories. Direct investment in traffic sensitive equipment unrelated to OCC exchange access, however, was to be excluded from exchange plant. If *Manual* factors could not be used, we proposed at least to rely upon *Manual* principles or, alternatively, relative minutes of use to distribute the cost of the remaining traffic sensitive plant among the service categories.

200. Because the costs and revenues associated with interstate FX and CCSA open-end access services have been treated as intrastate, we found it necessary to adjust the revenue requirement for each access service category to reflect a credit to the FX/CCSA [\*298] category. Only in this way could we prevent a double charge to users of this interstate service. By the time our access charge plan is implemented, however, we [\*\*138] expect that the *Separations Manual* will be revised. We note that the Joint Board has unanimously proposed that the investment, expenses and revenue attributable to interstate FX and CCSA open-end access services be treated as interstate costs and revenues. n64 Thus, when the access charge tariff replaces the intrastate tariff for these services, there should be no need to make the proposed credit adjustment.

n64 See *Joint Board Order, supra*, 47 Fed. Reg. at 54495.

201. To compute the access charge for each message service, we proposed that its revenue requirement be divided by total holding time minutes of use for that category to obtain a charge per holding time minute of use. An interstate carrier using that message access service would then pay the local carrier an amount equal to the product of that unit charge and that carrier's holding time minutes of use.

202. The MFJ is, of course, a supervening event that occurred since we released the *Second Supplemental Notice*. The MFJ not only requires AT&T's divestiture of the BOCs, but also imposes upon the BOCs the obligation to provide exchange access to all interexchange carriers equal in price and quality to that [\*\*139] provided to AT&T. Recognizing that facilities to provide such access do not presently exist, the MFJ sets a timetable for phasing in the required

equal access. Each BOC must begin to offer such access to all interexchange carriers no later than September 1, 1984. n65 BOCs must file tariffs (to be effective on the date of divestiture) which will govern BOC provision of exchange access to all interexchange carriers.

n65 By September 1, 1985, equal access must be available through end offices serving at least one-third of the BOC's exchange access lines. Unless a BOC obtains a waiver of the schedule requirements, equal access through each of its end offices must be available by September 1, 1986. Such a waiver is available only for end offices using electromechanical switches or serving fewer than 10,000 access lines. To receive the waiver, the BOC must show the Court that for particular categories of service the cost of equal access through such end offices outweighs the potential benefits to users of telecommunications services. Any denial of access based on this exception must be minimized both to its extent and duration. *See MFJ*, App. B, Section A, para. 3.

203. Tariffs [\*\*140] described in the MFJ must meet the following general criteria:

(1) that they provide unbundled schedules of charges for all exchange access services, including those provided to AT&T (MFJ, App. B, Section B, para. 1);

(2) that they discriminate against no carrier or other customer (MFJ, App. B, Section B, para. 1);

(3) that they require interexchange carriers to pay only for the [\*299] type of access they use (i.e., no "take it or leave it" bundling of services) (MFJ, App. B, Section B, para. 2); n66

n66 Nothing in the decree precludes a BOC from also offering exchange access superior or inferior in type or quality to that provided AT&T at charges reflecting the increased or reduced cost of access.

(4) that their charge for each type of exchange access must be cost justified (MFJ, App. B, Section B, para. 2). n67

n67 This means that differences in charges must be justified on the basis of differences in services.

204. The MFJ defines "exchange access" to include any activity or function that a BOC performs in connection with the origination or termination of interexchange telecommunications. The judgment envisions a tariffed "menu" of such services from which an interexchange [\*\*141] carrier may select the options it wants. It expects that each BOC will unbundle the rates for as many of these services or functions as technology will permit. The goal of this requirement is to give an interexchange carrier maximum flexibility in requesting and paying for the precise type of exchange access it requires.

205. As the Competitive Impact Statement prepared by the Department of Justice makes clear, n68 the MFJ does not purport to prevent the Commission from prescribing access charges to recover BOC costs allocated to exchange access by jurisdictional separations that do not satisfy all the conditions imposed by the MFJ upon carrier initiated tariffs. Its intent is only to require that, given the Commission's ground rules, the BOCs use a cost-based tariff structure, non-discriminatory in effect, to differentiate among the access charges they levy for each element of service. n69

n68 *See* Competitive Impact Statement filed by United States Department of Justice at 35-36, *United States v. American Telephone and Telegraph Co.*, D.D.C. Civil Action No. 74-169.

n69 An antitrust decree could not, of course, limit this Commission's power to prescribe a system of charges that is designed to satisfy Communications Act requirements. The MFJ does not purport to do so. [\*\*142]

206. In the *Second Supplemental Notice*, we had concluded that the only way to eliminate the discrimination among interstate and foreign services was to develop "new allocation procedures in which formulae would be applied uniformly for all services to those plant elements which are used in basically the same way by all services and applied selectively to specific services for those plant elements which are used differently for different services." 77 *FCC 2d at 231*. Thus, the general criteria that the MFJ imposes upon BOC initiated access charges are fundamentally consistent with the goals of this proceeding. The MFJ, however, would include in access charges compensation for the use of facilities and services that our tentative plan had excluded from its definition of access services. In the *Fourth Supplemental Notice* we noted that while the BOCs could comply with MFJ requirements by filing supplemental charges for ele-

ments excluded from our rules for computing access charges, it [\*300] might be desirable to adapt our plan to include charges for such facilities and services. n70 *90 FCC 2d at 153*. We sought suggestions [\*\*143] to adapt that plan to include these additional services and facilities.

n70 Examples of such facilities and services include the lines or trunks between a telephone company end office and an interexchange switch and billing and collection services.

207. We have concluded that, for reasons we have already discussed, the better choice is to adapt our tentative plan to account for the additional access elements contemplated by the MFJ. In particular, we have added to the plan an element we call the "Dedicated Transport element" through which local telephone companies will recover the interstate revenue requirement associated with the costs of the facilities linking the switches of interexchange carriers to the distribution facilities of local carriers. While we recognize that this element reflects costs that are fundamentally non-traffic sensitive in nature, we have chosen to include the Dedicated Transport element in our discussion of traffic sensitive costs because we perceive it to be an intrinsic part of the costs associated with providing interexchange carriers with access to the local network. Moreover, while the costs associated with the Dedicated Transport element are [\*\*144] not traffic sensitive and will not be recovered through usage sensitive rates, these facilities will continue to have such an impact upon the local carrier's configuration of the traffic sensitive components of its network that we believe it is logical to discuss recovery of the cost associated with this component of local network facilities in this Part of this *Report and Order*.

208. The *Separations Manual* classifies certain central office equipment as non-traffic sensitive and allocates the related investment between the jurisdictions as if it were subscriber plant equipment. As previously noted, we have decided that we should not include this non-traffic sensitive central office equipment in our NTS plan because the separations classifications may change in the future. We are, nevertheless, including separate elements for traffic sensitive and non-traffic sensitive portions of Category 6 central office equipment in this part of our plan for the initial access charges because it appears unlikely that any changes in the separations classifications for Category 6 central office equipment could be implemented in 1984.

209. In the *Fourth Supplemental Notice*, we stated that [\*\*145] we still found it "reasonable to expect interexchange carriers to compensate exchange carriers for traffic sensitive costs on a traffic sensitive basis." *90 FCC 2d at 152*. The tentative plan in the *Second Supplemental Notice* called for interexchange carriers to compensate exchange carriers for traffic sensitive costs on a traffic sensitive basis. In their responses to the *Fourth Supplemental Notice*, some participants stated that end users should be charged directly for all [\*301] costs associated with access services, including traffic sensitive costs. n71 This, they asserted, would reduce administrative expenses and eliminate the inaccuracies of separations and settlements. We believe it would accomplish neither. With the adoption of our access rules, the settlements process for access service compensation will end. While billing end users for all access costs might indeed reduce administrative expenses for the interexchange carriers, such an approach would impose a tremendous burden on the exchange carriers and end users. If the customer originating the call had to pay directly for the costs of the facilities used to terminate his interstate [\*\*146] call, this would require the terminating exchange carrier, apparently through recourse to the interexchange carrier involved, to identify the end user originating the call and then to bill that user directly for the costs associated with the type of interconnection provided to the interexchange carrier. This would not only impose substantially greater administrative burdens upon these exchange carriers, but also would constitute a drastic change in the relationships among end users, local telephone companies and interexchange carriers, a change that we cannot perceive to be in the public interest. If instead all end users are expected to bear the costs of all plant in their exchange area used to provide access service to interstate carriers, whether the resulting charge is flat, usage sensitive or a combination of both, almost certainly that approach will result in costs being recovered from customers who have not caused the exchange carrier to incur those costs. In particular, end users will be subsidizing the use of their local facilities by those terminating calls in their exchange area. Such an unfair result cannot be in the public interest. Moreover, this approach would not eliminate [\*\*147] any alleged inaccuracies in the separations process.

n71 *See, e.g.*, Comments of United States Transmission Services, pp. 12, 20; Comments of the Association of Long Distance Telephone Companies, p. 8 at n. 10, pp. 25-26; Joint Comments of Tel. Systems Management Corporation, Satelco, Inc. and Teltec Saving Communications Co., p. 2; Comments of Curtis M. Bushnell, Public Utility Consultant, pp. 15, 19.

210. In general, those participants addressing the appropriate structure for charges to recover traffic sensitive costs agreed that the rates should be usage sensitive. n72 In its comments to the *Fourth Supplemental Notice*, Southern Pacific adds that these charges should be sufficiently unbundled to assure that each interexchange carrier pays only for the local access facilities it receives. We believe that the rules we have adopted to recover the costs of access facilities are sufficiently refined to achieve this result. Southern Pacific also asserts that these charges should be adjusted to reflect the diminished value of inte-rexchange service resulting from unequal interconnection. We have already explained why we have chosen to rely [\*302] upon a premium access charge [\*\*148] to account for differences in the quality of interconnection offered to different interexchange carriers. *See Part III.C, supra*. Consequently, our rules for computing charges to recover traffic sensitive costs rely only upon cost causation to compute charges.

n72 *See, e.g.*, Comments of Centel, SBS and USITA.

211. In developing our access charge rules we have considered exchange access for interexchange carriers providing switched services to be composed of two categories or groups of elements. The first category consists of the transmission (and related switching) facilities which carry interexchange traffic between the interexchange carrier's facilities and the Class 5 (end) office at which this traffic originates or terminates. This plant always includes some dedicated trunks which carry only that interexchange carrier's traffic to a switch within the exchange. It also includes the interface between the dedicated transport line and the exchange carrier's switch. For the OCCs, it would correspond to Rate Element 1 in the ENFIA A tariff (BSOC-8) and in the ENFIA B and C tariff (BSOC-9). This is the element we have called "Dedicated Transport." If the local switch [\*\*149] is not the end office switch used to terminate or originate an interexchange call, additional trunks and possibly local tandem switches will be required to complete transmission between that end office switch and the interexchange carrier facilities. Most of this equipment is traffic sensitive (TS) and because it may be shared by several carriers, we call the associated access element "Common Transport."

212. The second category, called the "end office" category, corresponds to the central office equipment in the end office at which the interexchange carrier's traffic originates or terminates. This element includes all the traffic sensitive central office equipment (COE) used to provide switching and related services, including operator assistance services. In this Part, we describe the guidelines we have developed to recover the costs allocated to the different plant elements within the categories. We also discuss the rules that will govern recovery of costs for such special services as Billing and Collection.

#### A. End Office Charges

213. To complete transmission of interstate or foreign switched communications to and from the premises of an end user, an interexchange carrier must [\*\*150] rely upon facilities located at the end office to which that end user's telephone is directly linked. In particular it must use local dial switching equipment and may use operator services to assure successful transmissions. We refer to the charges associated with the use of this equipment generically as "end office charges." In this section we unbundle these charges into five elements: (1) Line Termination; (2) Local Switching; (3) Intercept services; (4) Information services; and (5) Operator Assistance [\*303] services. The first two elements reflect an interexchange carrier's use of local switching equipment, which the *Separations Manual* classifies as Category 6 central office equipment; the remaining three elements reflect an interexchange carrier's use of equipment that the *Separations Manual* classifies as Category 1 central office equipment. For this reason we are adopting these *Separations Manual* categories as the basis for defining the direct costs allocated to each of these elements. n73

n73 The procedures for computing charges for those elements are described in Section 69.106-69.110 of the rules.

#### 1. Category 6 Central Office Equipment

214. *Line [\*\*151] Termination Element.* The *Separations Manual* divides Category 6 Central Office Equipment (COE) into non-traffic sensitive (NTS) and traffic sensitive (TS) subcategories to distinguish the fixed costs of terminating lines in the switch from the usage sensitive costs of switching. n74 The Line Termination element consists of the portion of the investment in the local switch that separations considers non-traffic sensitive and the associated indirect investment and expenses. Such costs should be recovered from all interstate carriers providing switched services and allocated among these carriers based on their relative conversation minutes. n75

n74 That portion of non-traffic sensitive category 6 central office equipment used to provide trunk conditioning and signalling between the carriers' switching facilities is included in the Dedicated Transport element.

n75 The allocation of NTS Central Office Equipment on a usage basis represents an apparent inconsistency with the approach we have taken to recover almost all other non-traffic sensitive plant. We believe, however, that this apparent inconsistency is resolved by a closer examination of the facilities involved. Non-traffic sensitive facilities the costs of which are to be recovered through end user charges are all dedicated to particular subscribers or, in the case of party lines, groups of subscribers. (The only exception is pay phone service, the costs of which are apportioned on a usage basis). As compared to older electromechanical facilities, a far larger fraction of modern central office facilities has been classified as non-traffic sensitive. Such modern facilities can offer subscribers many more or improved service options than could the facilities that they replace. Not all subscribers require or even desire such additional vices. It does not seem appropriate, therefore, to treat these facilities as if they were dedicated. The Joint Board will have the opportunity more closely to investigate whether the *Separations Manual's* treatment of the costs associated with these electronic switches should be revised. It is possible that after its investigation is completed we shall perceive a need to revise the rate structure for this element so that it reflects cost causation more accurately.

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215. Separations has relied upon factors developed by Bell-USITA studies to determine the portion of investment in different types of switches that is and is not traffic sensitive. In CC Docket No. [\*304] 80-286, the Joint Board is considering whether these factors should be revised. n76 We believe, however, that to assure that our access charge plan becomes effective on January 1, 1984, we must provide carriers with specific guidelines for developing their access charges as early as possible. Consequently, we must proceed to establish these guidelines without the benefit of the Joint Board's recommendations. We have concluded that in developing the access charges to become effective in 1984 it is reasonable to rely upon existing Bell-USITA factors to distinguish NTS from TS Category 6 COE. If Joint Board recommendations result in the revision of these factors, we would expect these changes to be reflected in access charges for later years.

n76 See *Joint Board Order, supra*, 47 Fed. Reg. at 54498.

216. Our tentative plan in the *Second Supplemental Notice* had assigned Line Termination costs to private lines even though they do not terminate in a Class 5 (end office) [\*\*153] switch. We intended that apportionment to serve as a surrogate for certain costs, including those attributable to "leaky PBXs", that cannot be easily identified. n77 In the plan we adopt today, we have already allocated to private lines the costs of other NTS plant that could serve to ensure recovery as a surrogate for these less easily identifiable costs. We also believe that the leaky PBX phenomenon may become much less significant in the future as cost-based access charges produce a shift to MTS by those private line customers capable of "leaking." For these reasons we are not assigning any Line Termination costs to private line services.

n77 These costs include the costs of "hard wiring" these lines into place or otherwise providing special arrangements or treatment for private lines. They also include costs attributable to the "leaky PBX" phenomenon that we described in the *Second Supplemental Notice*. See 77 FCC 2d at 241. This phenomenon arises whenever an interstate call is "patched" through a PBX from a private line to a common subscriber line. That common line, the local exchange switch, another subscriber's common line and another subscriber's station equipment are all used to complete the call, but such private line usage of those facilities is not presently reflected in the computation of private line access service compensation.

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217. *Local Switching Element*. Through charges associated with this element, local carriers will recover the costs associated with interexchange carriers' use of traffic sensitive (TS) Category 6 central office equipment (COE) to complete interstate switched services. n78

n78 Some services classified as private line are, in fact, switched (*e.g.*, CCSA). If costs of some traffic sensitive switching equipment are now directly assigned to such services, we intend such direct assignments to continue.

218. In the *Second Supplemental Notice* we had concluded that no traffic sensitive costs should be assigned to services not using the local exchange's switching facilities. Consequently, we proposed that these costs be allocated on a usage basis among three switched service categories: MTS/WATS; FX/CCSA open end access; and [\*305] OCC-ENFIA. Weighted dial equipment minutes (DEMs) were used as the unit of measurement.

219. The *Separations Manual* uses DEMs as the unit of measurement for purposes of allocating the traffic sensitive portion of Category 6 COE between the interstate and intrastate jurisdictions. However, Section 24.83 of the *Manual* applies a weighting [\*\*155] factor known as TWF (Toll Weighting Factor) to the "toll" DEMs to reflect the difference in average cost per toll minute of use as compared to the average cost per exchange minute of use. The present *Manual* does not specify the TWF factors. n79 Different factors were developed for different types of switches in the Bell-USITA studies that developed NTS-TS ratios for the same categories of switches. The TWF factor differs from the subscriber plant factor (SPF) in that TWF is related to cost causalational principles. Long distance calls require switching capabilities that local exchange calls do not. the TWF factor was designed to segregate costs that are peculiar to long distance calls. n80

n79 The Joint Board has tentatively recommended that this continue. *See Joint Board Order, supra*, 47 Fed. Reg. at 54505.

n80 Although the TWF factor was designed to reflect cost causalational principles, it is not based on a historical cost causalational principle. The *Manual* was designed to allocate costs between two "old" services that will continue to exist. Allocations are based upon actual relative use during a prior period rather than projected use during some future period.

220. [\*\*156] In comments filed in response to the *Second Supplemental Notice*, Southern Pacific suggested that costs that are assigned to the interstate jurisdiction as a result of the application of the TWF factor should be excluded from the computation of ENFIA A access charges because ENFIA A services use the local exchange in the same manner as local exchange service. n81 (Comments, pp. 47-50). In Reply Comments to the same *Notice*, AT&T agreed that some adjustment would be reasonable. It noted that at the open-end FX also uses local exchange switching in the same manner as local exchange service. (Reply, p. 63).

n81 At the time these comments were filed, the ENFIA B and ENFIA C service offerings did not exist. ENFIA B and ENFIA C provide access through trunk side connections to end offices and through trunk side connections to tandem offices respectively. ENFIA B provides more signaling information to the interexchange carrier than does ENFIA A, as well as automatic number identification and answer supervision. ENFIA B also permits subscriber use of rotary dial telephones to reach OCC switches, it permits an OCC switch to serve subscribers in more than one exchange directly.

221. [\*\*157] In the recent *Joint Board Order*, n82 the Joint Board proposed that both interstate FX/CCSA open-end access services and interstate ENFIA services be explicitly recognized in the *Separations Manual* as interstate services. It also recommended that for apportioning costs of traffic sensitive switching equipment, all FX/CCSA, [\*306] ENFIA A and ENFIA C dial equipment minutes be treated like exchange service DEMs with no toll weighting factor applied to them. Recognizing that ENFIA B appeared to use the local switch more like MTS than like exchange service, the Joint Board is seeking to determine whether the similarity between ENFIA B and MTS warrants treating DEMs generated by ENFIA B use of local switches like DEMs generated by MTS use.

n82 *See Joint Board Order, supra*, 47 Fed. Reg. at 54495, 54498.

222. If the average costs associated with different interstate switched services' use of local dial switching equipment vary, these differences should be reflected in the rate structure of this element in order to assure that there will be no unlawful discrimination in rates for functionally equivalent services. As a first approximation to achieving this goal we are requiring [\*\*158] that exchange carriers establish separate charges for two categories of service. The first category corresponds to local dial switching provided through line side termination at a Class 5 (or end) office or, for interstate services other than MTS and WATS, through termination in a local tandem switch. The second corresponds to local dial switching provided through trunk side termination at a Class 5 office for MTS/WATS equivalent services and switching provided for MTS and WATS. Based on available information we believe these service categories result in a grouping together of those interstate service offerings for which the average cost per minute of using the local switch is approxi-

mately the same. In particular, use of switching equipment by FX/CCSA open-end access, ENFIA A and ENFIA C services should fall within the first category of service while end office switching for MTS, WATS and ENFIA B should fall within the second category.

223. For computing 1984 access charges, the costs associated with local dial switching equipment shall be allocated between the two service categories based on relative DEMs, after the toll weighting factors developed in the separations process have [\*\*159] been applied to DEMs generated by services in the second service category. n83 To convert these allocations to monthly per minute [\*307] charges, the revenue requirement for each service category shall be divided by that category's projected average conversation minutes. n84 For a given month, the local switching equipment charge levied upon a carrier providing a service (or services) included in that service category will be the product of that category's unit charge and the conversation minutes generated by the carrier's service(s).

n83 We recognize that the Joint Board deliberations may result in development of new TWFs to be applied exclusively to ENFIA B services. We anticipate that the scheme for allocating investment in TS local dial switching equipment we prescribe here would be altered so that these new TWFs would be applied to ENFIA B DEMs. We believe, however, that it is unrealistic to expect that development of such new TWFs could be completed before the end of the third quarter of 1983. The carriers require a reasonable time to develop and file their 1984 access charges and we shall require time to review these filings. For this reason, we conclude that 1984 access charges should not reflect the development of any new TWFs for ENFIA B services.

n84 These averages shall be developed through traffic studies, with necessary information being supplied by the interexchange carriers if the exchange carrier is unable to obtain such information directly.

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224. In responses to our *Second Supplemental Notice*, some participants had suggested that the tentative plan be modified in order to incorporate peak and off-peak pricing in the prescribed access charges. (Consumers Union Reply, pp. 9-10; NTIA Reply, pp. 32-33) Such a modification would presumably be limited to the traffic sensitive components like the Local Switching element inasmuch as non-traffic sensitive costs do not vary with usage. That suggestion warrants consideration as a long-run solution. However, we could not devise adequate rules for computing cost-based peak or off-peak access charges for this traffic sensitive plant from the information in this record. Therefore the rate structure, at least for 1984 access charges, will reflect no discount for off-peak usage of traffic sensitive exchange facilities. n85

n85 We intend shortly to establish a Joint Board that will consider the need for changes to the *Separations Manual* that will allocate investment and expenses between the jurisdictions based on peak and off-peak use of exchange facilities. When that Board has completed its work on this subject, we shall reconsider our decision concerning a peak/off-peak rate structure for traffic sensitive access charge elements.

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225. It should be noted that the efficiency benefits of peak pricing flow from the use of peak pricing in end user rates. The use of peak pricing in a carrier's carrier charge need not have any direct effect upon usage. Consistency between carrier's carrier charges and end user rates would be desirable, but time of day pricing of access service compensation is not a condition precedent for time of day pricing of end user services. MTS tariffs have established different rates for different times for a number of years even though the settlements formula for computing MTS access service compensation has never assigned different weights to different MTS minutes.

## 2. Manual Switchboard Services

226. Category 1 central office equipment consists of investment in manual switchboards. Manual switchboards are used primarily in connection with MTS and WATS service. In reply comments to the *Second Supplemental Notice*, however, AT&T asserted that the OCC-ENFIA and FX-CCSA services should share in costs relating to manual switchboards providing information and intercept services because both FX-CCSA open end access and OCC-ENFIA services [\*308] also rely upon those operator services. [\*\*162] AT&T indicated that directory and intercept switchboards can be identified without undue difficulty. Therefore, we propose to associate Category 1 investment allocated to the interstate access with one of three access elements: (a) the Intercept element; (b) the Information element; and (c) the Operator Assistance element.

227. *Intercept Element.* A local carrier provides Intercept services when it causes a telephone call directed to an improper telephone number to be redirected to an operator or a recording that tells the caller why the call, as dialed,

could not be completed and if possible, provides the correct number. By its nature, this service must be provided either to all interexchange carriers or to none. We believe that because all rely upon this service to assure successful completion of their customers' interexchange calls, all should share in the costs associated with its provision. There do not appear to be any cost or value differences with respect to the use of Intercept services that would warrant the application of any weighting factors to distinguish one interexchange carrier's use from another's. Therefore, we have decided to subject all interexchange carriers [\*\*163] to a per minute Intercept charge that is computed by dividing costs allocable to this element by total conversation minutes for all switched or partially switched interstate services.

228. *Information Element.* As its name suggests, Information service is provided when, by dialing the proper service code or number, a customer is connected to an operator who will tell him the telephone number of another customer, provided that the latter's number is or will be listed in the telephone directory. Based upon AT&T's *Second Supplemental Notice Reply Comments* we conclude that the costs associated with this service can be unbundled from those associated with the use of other Category 1 COE. We believe that these costs should be unbundled from other manual switchboard costs. At the present time directory information that is provided for long distance services is provided through transmission facilities of AT&T and its interexchange partners. These costs will accordingly be assessed upon those carriers unless other interexchange carriers establish connections with such directory assistance facilities. n86

n86 If that contingency arises, exchange carriers that provide the information service will be required to devise an appropriate method to apportion such costs among all interexchange carriers that are connected with such directory assistance switchboards.

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229. *Operator Assistance Element.* This element describes the remaining interstate operator services, primarily direct assistance in the completion of toll calls. To this element we allocate that investment in Category 1 COE not already allocated to either the Intercept or Information elements, as well as the indirect investment and expenses associated with this Category 1 investment under our [\*309] allocation rules. The costs associated with this element should be recovered through a non-discriminatory, usage-sensitive rate structure imposed only upon those interexchange carriers who in fact use these interstate Operator Assistance services.

#### B. *Transport Charges*

230. As part of its access service, each local exchange carrier will provide transmission (and possibly) switching facilities to carry interstate switched traffic between an interexchange carrier's facilities and the end office through which this traffic originates or terminates. This plant always includes some dedicated trunks or lines, which carry only that interexchange carrier's traffic to a switch within the area served by the local carrier. 87 We refer to the element corresponding to this plant as the "Dedicated [\*\*165] Transport" element. If this exchange carrier switch is not the end office switch used to originate or terminate the interstate call, additional trunks, local office and local tandem switches will be required to complete the communications path between the originating (or terminating) end office and the interexchange carrier's facilities. We refer to the element corresponding to this plant as the "Common Transport" element. n88 The costs associated with both Dedicated Transport and Common Transport will be recovered as part of the carrier's carrier charge for access to the local company's facilities needed to complete interstate communications. n89

n87 In some cases two exchange companies jointly might provide such a trunking service.

n88 The procedures for computing charges for the Transport elements are described in Sections 69.111 and 69.112 of the Rules.

n88 We are not, however, including any use of switching in a local dial (Category 6) switch in the Common Transport element.

#### 1. *Dedicated Transport Element*

231. This element consists of the dedicated voice grade transmission facilities and the interface at which those facilities and the exchange carrier's switch are [\*\*166] joined. n90 For non-premium carriers, *i.e.* [\*310] the OCCs, this element would correspond to what is now designated as rate element 1 in the ENFIA A tariff. To this element we allocate investment in the outside plant linking the carriers' switching facilities as well as any Category 8 and non-traffic sensitive Category 6 central office equipment used to provide trunk conditioning and signaling between the carriers switching facilities.

n90 The facilities included in this element and other elements are the subject of the Settlement Agreement between the Bell System companies and the OCCs that we accepted as a disposition of Docket 20099. *See 52 FCC 2d 727 (1975)*. That agreement established interim rates for the OCCs' use of certain Bell System facilities. It also established procedures for revising such rates that are still in effect. In particular, it permitted a carrier-initiated increase in the rates only on six months' notice to the OCCs. *Id. at 734-35*. We predicated our acceptance of that agreement on our finding that "the responsibilities undertaken by the parties are in the public interest because they expedite and further the implementation of established Commission policy." *Id. at 732*. If applied to the access tariffs which will replace the existing tariffs under which the BOCs provide dedicated transport facilities to the OCCs, such a notice requirement could prevent the timely implementation of these access tariffs. We have not determined whether the agreement purports to establish a notice requirement under these circumstances. Because we find such delay contrary to the public interest, we are abrogating any contractual notice requirement of the Settlement Agreement that might be applicable. Any other provision of that agreement or the subsequent ENFIA agreement that may be inconsistent with the Rules we are adopting will, of course, cease to be effective when access charges become effective. The decision in *MCI Telecommunications Corp. v. FCC, 665 F.2d 1300 (D.C. Cir. 1981)* does not preclude us from abrogating provisions that are inconsistent with our prescription of an access charge plan. That decision related to carrier-initiated tariff charges.

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232. USITA has suggested that the costs associated with this element be recovered through rate structures reflecting "capacity ordered." A rate structure based on "capacity ordered" may bear little relationship to what is, in fact, provided. We believe that an interexchange carrier should pay only for facilities it in fact receives. We can appreciate that in order to plan its network to assure the highest quality of service to all its customers a local carrier requires advance information of an interexchange carrier's anticipated needs and demands upon the local system. We do not believe that this information bears any intrinsic relationship to the costs incurred in currently providing services to these carriers. n91

n91 *See Reply Comments of United States Independent Telephone Association.*

233. We are requiring that the revenue requirement associated with the Dedicated Transport element be split into three parts on the basis of relative net investment in: (1) interface arrangements; (2) voice grade transmission facilities; and (3) equipment used to provide conditioning for such transmission facilities. As a result, the charge associated with the Dedicated Transport element [\*\*168] will be the sum of a charge reflecting the costs of voice grade transmission facilities dedicated to an interexchange carrier's use, a charge reflecting the costs of conditioning those facilities and a charge reflecting the costs of any additional central office equipment located at the boundary between those facilities and the local carrier's switch to which they are joined. In requiring this unbundling of charges our aim is to assure that the charges imposed upon an interexchange carrier for its use of dedicated transport facilities reflect the costs associated with the facilities provided to that carrier. n92

n92 We believe that this is very similar to the refinements within this rate element advocated by the Ad Hoc Committee and Southern Pacific in their comments submitted in response to the *Fourth Supplemental Notice*. *See Report on Access Charges attached to Comments on the Fourth Supplemental Notice filed by the Committee and Comments of Southern Pacific Communications Company, Appendix B.*

234. *Interface Arrangements.* To this supplement we have allocated all investment in central office equipment used to provide [\*311] interface arrangements. We have taken this [\*\*169] step because we recognize that exchange carriers will be offering to interexchange carriers access arrangements that rely upon central office equipment to provide different signaling and other capabilities. We shall require that each exchange carrier establish in its access tariff a separate charge for each additional kind of interface arrangement it proposes to offer. n93

n93 Such arrangement might include, for example, an E & M lead interface, which is: A specific form of interface between a switching system and a trunk in which the signaling information is transferred across the interface via 2-state voltage conditions on two leads, each with ground return, separate from the leads used for message information. The message and signaling information are combined (and separated) by a signaling system appropriate for application to the transmission facility. Engineering and Operations in the Bell System (1977) at 652. For a general discussion of common interface arrangements, *see id.* 181-86, 384-403.

235. We shall require that each exchange carrier present a listing of subelements corresponding to all the interface arrangements it intends to offer. It is through these subelements [\*\*170] that the carrier will recover the share of its projected revenue requirement for Dedicated Transport that our allocation rules have apportioned to interface arrangements. To provide carriers with sufficient flexibility to develop access charges reflecting the many kinds of interface arrangements they may choose to offer, we have refrained from prescribing rules specifying precisely how the charges associated with these subelements must be calculated. We do require, however, that differences in the charges for these interface arrangements reflect cost differences.

236. *Conditioning arrangements.* The quality of voice communications over transmission facilities may be impaired by such factors as trunk loss, noise or echo. Alone or in combination, these factors may partially or sometimes completely obscure the information content of voice transmissions. Transmission facilities, however, may be conditioned to control these parameters n94 in order to improve the quality of such transmissions.

n94 *See, e.g.,* the family of "W types" of conditioning offered in the Bell System's Facilities for Other Common Carrier Tariffs.

237. We shall require that each exchange carrier present [\*\*171] a system of subelements corresponding to all the conditioning arrangements it intends to offer. Subelement charges will also be designed to recover the aggregate conditioning revenue requirement and charges for particular subelements will be designed to reflect cost differences among conditioning arrangements. n95

n95 Association tariffs may contain exceptions for participating carriers that offer interface and conditioning arrangements that differ from any standard subelements in the association tariff. Similar exceptions will be permitted for Special Access subelements.

[\*312] 238. *Transmission facilities.* To this subelement we allocate investment in all dedicated voice grade transmission facilities to be provided to interexchange carriers to complete their interstate or international communications services. These dedicated facilities are analogous to the non-traffic sensitive subscriber line plant dedicated to an end user's use. Consequently, we shall require local telephone companies to recover the costs associated under our allocation rules with this subelement through a flat monthly charge imposed upon each interexchange carrier receiving access through such facilities. [\*\*172] The costs associated with Dedicated Transport facilities are a function of two parameters. The first is the distance between the interexchange carrier's facilities and the "entry switch" through which that carrier's traffic enters the exchange area. The second is the number of voice grade channels provided to the interexchange carrier. The latter we shall call "conversation capacity." We shall require that the monthly charge levied upon an interexchange carrier for voice grade facilities dedicated to its use shall be based upon the conversation capacity provided by these facilities and a distance factor.

239. At this time all AT&T toll offices are linked to local offices through 4-wire or 4-wire equivalent voice grade facilities. At least some AT&T offices are collocated with end office switches. Other interexchange carriers, however, have never been allowed to collocate their switches with local telephone company switches. A strictly distance-sensitive rate structure for dedicated transmission facilities would thus give AT&T an unfair competitive advantage. Consequently, we shall require that for purposes of computing a monthly charge associated with this subelement, for an interexchange [\*\*173] carrier other than AT&T the distance between the interexchange carrier's facility and the "entry switch" to which it is linked shall be deemed to be the minimum of the following: the airline distance between the entry switch and this interexchange carrier facility; and the airline distance between the entry switch and any AT&T toll switch within 5 miles of the interexchange carrier's facility. n96

n96 This "five-mile" requirement is similar to one imposed in the MFJ upon any BOC-initiated tariff to reduce the competitive advantage AT&T enjoys over other interexchange carriers because of the location of some of its switches. The MFJ has required that under such tariffs until September 1, 1991, the charge for delivery or receipt of traffic of the same type between an end office and each interexchange carrier's facilities located within the exchange area (or any reasonable subzones) be equal per unit of traffic delivered or received for all such carriers. If the facilities of another interexchange carrier are located within 5 miles of an AT&T Class 4 switch, with respect to any end office served by that switch, the OCC facility is to be considered within the same subzone as the AT&T switch. This requirement applies even if a BOC uses different transmission and switching facilities to serve AT&T and the other interexchange carriers; it exists to assure that the OCCs are not charged

more for transmission merely because AT&T's switches are more advantageously located with respect to or linked to an end office.

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[\*313] 240. We recognize that the costs of providing Dedicated Transport to a particular interexchange carrier also depend upon the transmission media selected to carry its traffic between its facilities and the "entry switch." A purely cost-based rate structure would tie the charges imposed on an interexchange carrier to this factor also. With all the permutations and combinations of transmission media possible, however, such a rate structure could easily become unworkably complicated. The rate structure we have adopted today, while not purely cost-based, avoids the administrative problems associated with such a rate structure and provides local exchange carriers with the incentive to use the most efficient means of transmitting traffic and the flexibility they need in planning their network. We believe that these advantages warrant this limited departure from cost-based pricing, at least during the first year in which access charges are in effect.

## 2. Common Transport Element

241. To this element we allocate the investment in all outside plant used in whole or in part to transmit an interexchange carrier's switched traffic between the end office at which it originates or [\*\*175] terminates and the transport facilities dedicated to that carrier's use. We also allocate some investment in intermediate switching facilities such as local tandem offices. n97

n97 We note that the plan we adopt today for developing a carrier's carrier charge will accommodate access arrangements provided by the independent telephone companies and by the divested BOC, regardless of the shape of the local access and transport areas (LATAs) ultimately approved by the court in *United States v. Western Electric Company*, D.D.C. Civil Action No. 82-0192.

242. The costs associated with this access element are both usage and distance sensitive. Consequently, we are prescribing a rate structure that is both usage and distance sensitive. The measure of usage shall be conversation minutes of use, while the measure of distance shall be the airline distance from "entry switch" to the end office at which a call originates or terminates.

## C. Other Charges

### 1. Billing and Collection Services

243. To this element we are allocating all the costs associated with a local carrier's providing billing and collection services to an interexchange carrier. In particular this would include investment [\*\*176] in Category 4 central office equipment, automatic message recording equipment, and most of the revenue accounting expenses allocated to the interstate jurisdiction. n98

n98 Computation of charges for this element is described in Section 69.114 of the Rules.

244. The MFJ would permit a BOC to restrict its offer of billing [\*314] and collection services to only some interexchange carriers unless the BOC threatened to withhold service from a customer failing to pay charges levied by such interexchange carriers. n99 The MFJ does require, however, that if a BOC offers billing and collection services to even one interexchange carrier, that the charge for this service must be in the BOC's access tariff. Only common carrier services can be tariffed. The hallmark of a common carrier service is that it is offered to all indifferently. *See CCIA v. FCC, supra*, slip op. at 25. Consequently, to assure a result consistent with our powers under Title II of the Communications Act of 1934, as amended, *47 U.S.C. 201 et seq.*, and the intent of the MFJ, we shall require that an exchange carrier offering billing or collection [\*\*177] or billing information services to one interexchange carrier must offer them to all.

n99 In the latter case the MFJ does require the BOC to offer billing and collection services to all.

245. In contrast with our treatment of rates related to other access elements, the only restrictions we shall place upon a local carrier offering Billing and Collection services is that it not discriminate among carriers selecting these services. Any differences in charges levied for these services must be cost justified.

## 2. Special Access

246. Special Access includes a variety of services and facilities that we have decided to include in our system of access charges in order to ensure that tariffed access charges of all exchange carriers encompass services and facilities that the divested BOCs will be offering pursuant to tariffed access charges. n100 If the MFJ did not exist, we would probably exclude these facilities from the access charge scheme and classify them as "interexchange" for this purpose. Most services that use these facilities -- such as program transmission, telex, etc. -- are not close substitutes for MTS and changes in existing rate structures would not be required in [\*\*178] order to eliminate discrimination or preferences among MTS and services that are close substitutes for MTS.

n100 Computation of charges for this element is described in Section 69.113 of the Rules.

247. The Special Access category also includes a portion of interstate or international private lines that terminate in a PBX or similar equipment and interstate WATS lines. We limit the Dedicated Access Line element to the portion of those lines on the customer side of an end office in order to create a Dedicated Access Line element that is analogous to the Common Line element. We use that demarcation in order to establish parity for comparable elements. A portion of such private lines and a portion of some WATS access lines that are not included in the Dedicated Access Line element are included in access service for purposes of the MFJ. We are assigning [\*315] those portions of those lines to Special Access in order to make access charges for all carriers correspond with the BOC access charges.

248. Although we have described Special Access as an element for cost allocation purposes, the Special Access category in fact encompasses a number of elements that must be priced separately. [\*\*179] The same charges could not be applied to video "lines", telex lines and pieces of WATS access lines without creating unlawful preferences. Such facilities have very different cost characteristics and are used for very different purposes.

249. We have not attempted to provide guidelines for apportioning the Special Access revenue requirement among the rate elements or subelements within that category and we have not described the subelements that should be used. This proceeding was not designed to develop criteria for designating such subelements or for apportioning costs among appropriate subelements and the record in this docket does not contain much information that would be useful for those purposes. Such questions have been or will be addressed in other Commission proceedings. n101 We are accordingly directing exchange carriers to establish subelements and methods for computing subelement charges that are consistent with applicable Commission rules and decisions.

n101 See *AT&T Private Line Rate Structure and Volume Discount Practices*, 74 FCC 2d 226 (1979).

## V. COMPUTATION OF ACCESS CHARGES

250. In order to compute a charge for an access [\*\*180] element it will generally be necessary to compute a revenue requirement for that element. Under the rate base -- rate of return method of ratemaking costs or revenue requirements consist of two components. The return component is computed by multiplying the rate base or investment by an allowed rate of return. The expense component covers the carrier's allowable operating expenses.

251. We have decided that the usual rate base - rate of return method should be used to compute access charges for each element except Billing and Collection. We are not imposing any constraint upon the return carriers may earn for that service because local exchange carriers do not possess sufficient market power with respect to that service to warrant a rate of return prescription. If the local exchange carriers establish excessive Billing and Collection charges, the interexchange carriers can, and undoubtedly will, do their own billing and collection.

### A. Rate of Return

252. We will require the exchange carriers to compute charges for all the other access elements that are targeted to earn the same return. We are not, however, specifying a prescribed return in the [\*316] text of the access charge [\*\*181] rules. Such prescriptions necessarily must be revised from time to time in *ad hoc* proceedings that are designed for that purpose. It would not be appropriate to effect changes in a prescribed rate of return through amendments to the rules. We are, however, requiring exchange carriers to use the currently authorized rate of return to compute access charges until that prescription is superseded by further order of this Commission.

253. We have already prescribed a rate of return of 12.75% for AT&T interstate operations. This targeted rate was established after consideration of all AT&T interstate capital costs, including capital costs associated with the provision

of access service. Although that prescription has not been imposed directly upon other telephone companies, the existing partnership interstate settlements arrangement has been designed to enable every telephone company to realize the same achieved rate of return that AT&T realizes on interstate operations. Thus, the use of any rate of return other than 12.75% for the purpose of targeting access charges for BOCs or independent telephone companies would be a departure from the *status quo*.

254. Although the *Second* [\*\*182] *Supplemental Notice* did propose to use the AT&T authorized rate of return for purposes of targeting access charges, the *Fourth Supplemental Notice* invited comment on the desirability of prescribing a different return inasmuch as BOC costs of capital may diverge from AT&T costs of capital after divestiture. n102 Most participants who have discussed this subject have suggested that the 12.75% return be used for the initial access charges. No evidence has been developed in this record that would enable us to predict any future divergence in AT&T and BOC costs of capital. Therefore, we will require that a 12.75% return be used to target access charges of any exchange carrier and interexchange services of AT&T until a different authorized rate of return is established in subsequent proceedings. We may or may not conduct separate proceedings to consider any future revisions in the prescribed rate of return for access and interexchange services.

n102 The *Fourth Supplemental Notice* also suggested that returns allowed by state commissions might be used if access charges are disaggregated on a state-by-state basis. The Executive Agencies of the United States recommended that procedure (Comments, p. 18), but Southern New England Telephone Company said (Comments, p. 12) that it would probably be "inappropriate" to use a state rate of return for any interstate service. Inasmuch as we have decided that such disaggregation would not be appropriate, there is no reason to give further consideration to that approach. Any nationwide charges necessarily must be based upon a nationwide rate of return.

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#### B. Identification of Access Costs

255. Several steps are necessary to identify the investment and expense that is attributable to a particular access element. Investment [\*\*317] and expenses relating to telephone operations must be segregated from other investment and expense. Interstate telephone operations investment and expense must be segregated from intrastate investment and expense. The access charge or exchange plant portion of interstate investment and expense must be segregated from other interstate investment and expense. The access portion must be allocated among the access elements.

256. Carriers are already obliged to perform the first two steps in order to compute revenue requirements for interstate services. This Commission has provided guidance for the identification of regulated service costs through accounting rules and decisions in tariff proceedings. We have also prescribed rules for the separation of investment and expense between the interstate and intrastate jurisdictions. Those rules are contained in the *Separations Manual* that has been incorporated as Part 67 of our Rules, 47 C.F.R. Part 67. The telephone companies have developed detailed and elaborate [\*\*184] procedures to implement the separations rules.

257. The tentative plan described in the *Second Supplemental Notice* would have used the division of revenue or "DR" procedure that AT&T developed to implement the *Separations Manual* in order to determine interstate investment and expense for the computation of access charges. Several comments that were filed in response to that *Notice* questioned the wisdom or propriety of using the DR procedures for that purpose. MCI noted that there is no single fixed document describing Bell System DR procedures that could be incorporated by reference in access charge computation rules. MCI observed that the 11-volume DR Manual is revised monthly and does not contain a complete description of the procedures used to separate interstate and intrastate costs. In its *Second Supplemental Notice* comments, MCI said (p. 55):

The operative steps are actually taken by a computer located in Atlanta referred to as ISIS. AT&T has informally advised MCI that the programming for ISIS was developed sequentially over a period of many years and that there is no complete set of program inputs in existence.

258. Inasmuch as there is no fixed set of DR procedures [\*\*185] we could not incorporate the DR procedures in access charge rules even if we could warrant that the DR procedures have produced accurate results in the past. Moreover, we are not in a position to give such a warranty. The SBS *Second Supplemental Notice* comments observed (p. 48) that the 11-volume DR Manual implements a 96-page *Separations Manual*. SBS implied that some errors of interpretation must have been introduced into the separations implementation process in the course of amplifying the prescribed

rules. Although our staff does monitor these processes, this Commission has not formally addressed the myriad of interpretation questions that are lurking within the separations implementation process.

[\*318] 259. USTS filed a petition for evidentiary hearing that was based in large part upon its contention that an evidentiary hearing would be required to compile a record that would enable us to prescribe any separations implementation procedures. We agree that an evidentiary hearing may be necessary to prescribe separations implementation procedures. We have, however, concluded that it will not be necessary to prescribe such procedures in order to prescribe rules for the [\*\*186] computation of access charges. We are adopting rules for the computation of access charge revenue requirements that are based upon the premise that investment and expense attributable to regulated interstate operations has already been identified. We can proceed on that assumption without sanctioning separations implementation procedures that may be questionable or foreclosing interested persons from raising questions with respect to the accuracy of the underlying data when access service tariffs are filed.

260. We recognize that the information filed pursuant to Rule 61.38 may not at present be sufficient to enable this Commission or affected persons to identify all questions with respect to the accuracy of interstate costs that might be raised in a tariff proceeding. We have, however, decided that we should not delay the adoption of access charge rules to resolve data problems that are not unique to access charges. Any errors in the separations implementation process affect all state and federal tariffs for services offered by telephone companies. Proceedings other than this docket can and will be used to make separations implementation more visible to regulators and all affected [\*\*187] persons. n103

n103 The exchange plant Joint Board has invited comments upon a proposal that may serve that purpose. *See Joint Board Order, supra*, 47 Fed. Reg. at 54490.

261. The allocation rules we are adopting do establish procedures for segregating access investment and expense from other interstate investment and expense and procedures for apportioning the access investment and expense among access elements. We have generally used the term "interexchange category" to describe investment, etc., that is not apportioned to any access element. For convenience, we have combined apportionments between interexchange and access and apportionments among access elements in a single set of rules. We have included the Billing and Collection element in that apportionment scheme even though our rules do not require the computation of a revenue requirement for that element because it is necessary to apportion costs to that element in order to identify the costs that are attributable to the other elements.

262. The plan we have adopted for the allocation of certain nontraffic sensitive costs between end user and carrier's carrier charges requires a further step in order to compute charges [\*\*188] for the End User Common Line and Carrier Common Line elements. The combined charges for those elements will be designed to recover a revenue [\*319] requirement for the provision of common lines. Subpart F describes the procedure for segregating that revenue requirement among those elements. We have described the combined revenue requirement for those elements as the Common Line element in the investment and expense allocation rules. n104

n104 Total revenue requirements for some other elements such as Local Switching, Dedicated Transport and Special Access will also have to be segregated to compute subelement charges.

### C. Apportionment of Investment

263. Investment can be described as direct investment or indirect investment. The direct investment includes the facilities and equipment such as terminals, lines and switches that are actually used in the telephone operations. Indirect investment includes land, buildings, vehicles, office furniture, etc.

264. The allocation of direct investment is generally determined by the nature of the access elements we have described in Parts III and IV of this *Report and Order*. The elements encompass functions that usually correspond [\*\*189] to particular categories of facilities and equipment. n105 For example, the Intercept element encompasses the switching facilities and operator services that perform the intercept function and the portion of manual switchboard facilities that are used for that purpose are assigned to the Intercept element.

n105 In view of the functional nature of the access charge elements, the rules for apportionment of direct investment in subpart D essentially define each access element except the End User Common Line and Carrier Common Line elements.

265. The direct investment allocation rules (Sections 69.303-69.306) relate the description of access elements in Parts III and IV to the plant categories that have traditionally been used for separations purposes. The *Separations Manual* describes three major categories of direct investment -- station equipment, outside plant or OSP and central office equipment or COE.

266. Station equipment consists primarily of equipment included in Accounts 231 (station apparatus), 232 (station connections) and 234 (large PBXs). All such equipment is normally described as non-traffic sensitive plant. Some station equipment is used exclusively in connection [\*\*190] with Special Access or Pay Telephone services and is assigned to those access elements. Some station equipment is used by the telephone companies in their own operations and should be viewed as indirect investment that is not directly associated with any access element. That investment will be apportioned in the same manner as furniture, office equipment, vehicles, etc.

267. Most of the station equipment is used in conjunction with common lines, but this same equipment is often used in connection with WATS access lines or private lines. Whenever a private line terminates in a PBX, the PBX, the terminals and the inside wiring [\*\*320] between the terminals and the PBX are used to originate or terminate calls that are transmitted over the private line. Therefore, this category must be apportioned between the Common Line element and the Dedicated Access Line element. We have decided to use an equivalent line concept that is similar to the Mixed 1 proposal for that purpose. The total number of common or local exchange subscriber lines will be multiplied by the applicable interstate separations factor to determine the Common Line element line count that will be used for purposes of that [\*\*191] apportionment.

268. The Joint Board in Docket 80-286 is considering a new formula in order to replicate the results that would be produced by the present transitional plan for the elimination of CPE from the interstate rate base in an environment in which some local exchange telephone companies may not own any CPE. We have generally described such an interstate apportionment as surrogate CPE in the access charge rules. Inasmuch as any surrogate CPE investment or expense is indirectly attributable to the use of CPE, surrogate CPE will be apportioned in the same manner as CPE investment or expenses if we adopt such a transitional separations factor.

269. The apportionment of Outside Plant or OSP reflects the basic scheme of the access charge plan. The rules use the term "Customer OSP" to describe lines that are included in our NTS plan and comparable portions of Special Access lines. That category does not include any line that connects an interexchange carrier or an enhanced service provider with the local exchange switch. The Customer OSP lines in use will, of course, be assigned to the Common Line, Pay Telephone, Dedicated Access Line or Special Access elements. An equivalent line [\*\*192] apportionment will be used to apportion the unused voice grade lines among those elements.

270. The present separations formula includes common lines and WATS access lines in the same category for purposes of determining interstate investment. If we elect to retain that approach in the separations proceeding, an adjustment will be necessary in the apportionment between the Dedicated Access Line and Common Line elements in order to assign an amount to the Dedicated Access Line element that reflects unseparated investment in interstate WATS access lines. The access charge rules describe such a contingent adjustment.

271. OSP that is not classified as Customer OSP must be apportioned between access elements and the interexchange category. The MFJ demarcation points will be used for that purpose in order to produce traffic sensitive access elements for the independent telephone companies and the undivested BOCs that will be comparable to the access elements of the divested BOCs.

272. The remaining OSP will be apportioned between Special Access and the Transport elements. Special Access not only includes the portion of lines or trunks used for special services such as telex [\*\*321] and [\*\*193] video that are not located on the customer side of the end office, but also includes comparable portions of lines or trunks that are used for the "Dedicated Access Line" services. We have used this demarcation in order to produce charges for a Dedicated Access Line element that are comparable to the NTS common line charges.

273. The Transport elements encompass the trunks between the end office and the interexchange facility. These may include exchange trunks between Class 5 offices or Class 5 offices and tandem offices. The assignment to Dedicated Transport or Common Transport is, of course, determined by the definition of those elements that is described in Part IV. If the line or trunk is used exclusively for interexchange services of a particular interexchange carrier it is assigned to Dedicated Transport. Other lines or trunks that are classified as Transport facilities are assigned to the Common Transport element.

274. The description of traffic sensitive elements in Part IV of this *Report and Order* necessarily determines the apportionment of Central Office Equipment that is included in COE Categories 1 and 6 in the present *Separations Manual*. COE 1 equipment will be [\*\*194] apportioned among the Intercept, Information and Operator Assistance elements. COE 6 equipment will be apportioned between the Line Termination and Local Switching elements.

275. Inasmuch as the Transport elements encompass facilities between the end office switch and the interexchange switch, tandem switch investment (COE Category 2) and any portion of COE Category 3 investment that is classified as exchange investment for purposes of the MFJ will be included in the Common Transport element. We are not, however, assigning any COE 6 investment to Common Transport when an interexchange transmission is routed through more than one local dial switch at the originating or terminating end. The apportionment formula for COE 6 investment has been designed to take such usage into account.

276. The *Separations Manual* classifies Automatic Message Recording Equipment as COE Category 4. Inasmuch as information recorded by such equipment is used primarily for billing purposes that investment will be assigned to the Billing and Collection element.

277. Although COE Category 5 is described as Other Toll Dial Switching Equipment, it includes equipment "used primarily for operator dialed toll... [\*\*195] traffic." Any Category 5 equipment that may be classified as exchange for MFJ purposes will accordingly be assigned to the Operator Assistance element. Category 5 equipment that is not exchange equipment for MFJ purposes will, of course, be assigned to the interexchange category.

278. COE Category 7 includes the type of switching equipment that is used for services we have described as Special Access. Such [\*322] investment will accordingly be assigned to Special Access unless it would be classified as interexchange for MFJ purposes.

279. The circuit equipment that is included in the COE 8 category will be assigned or allocated in the same manner as the associated OSP.

280. The *Second Supplemental Notice* proposed to use factors in the 1978 AT&T FDC 7 Central Submission for purposes of apportioning indirect investment and expenses. 77 FCC 2d at 243. Upon further reflection we have concluded that we should not use those factors for this purpose. Those factors were developed for an analogous but somewhat different allocation purpose and would accordingly have to be modified to fit our access charge plan. n106 Even if each factor could be adapted, it [\*\*196] would not be desirable to use a cost allocation methodology that employs such a large number of different factors. Both BOC and independent telephone company data must be used to compute access charges. Some limitation must be placed upon the number of different categories that are used in order to enable independents to develop or provide data for the computation of access charges and the computation of distributions from any access charge revenue pools. We have accordingly used indirect investment and expense categories that are more aggregated than either the 1978 Central Submission categories or the categories described in the appendix to the AT&T *Second Supplemental Notice* comments.

n106 Categories and factors that were subsequently adopted in the *ICAM* would also have to be adapted because they were designed for four service categories that are quite different from the functional access categories described in this *Report and Order*.

281. Land and building investment represents the bulk of the indirect investment. We have accordingly concluded that we can strike an appropriate balance between excessive disaggregation and excessive aggregation by apportioning [\*\*197] subcategories of Land and Building investment in a particularized manner and apportioning all other indirect investment on the basis of the apportionment of combined direct investment and land and building investment.

282. We have decided to use the space categories in the *Separations Manual* for purposes of apportioning building investment. This should not impose an undue burden on the carriers because such investment has already been assigned to those categories in order to identify the interstate investment. Many of the space categories are closely related to equipment categories that we are using for purposes of apportioning the direct investment.

283. The *Separations Manual* divides Space Category 1 (Operating Room and Central Office Equipment Space) into three subcategories -- Manual Switchboard, Circuit equipment, and Dial switching -- that do correspond with identifiable equipment categories. Each of those categories will be apportioned in the same proportions as the [\*323] associated COE. Space Categories 2 and 3 also consist primarily of operator space and will be apportioned in the same proportions as manual switchboard investment.

284. Space Categories 4, 6 and [\*\*198] 9 (Commercial Office, Revenue Accounting and General Office) are associated with major expense categories and will be apportioned in the same manner as combined expense in each such category.

285. Space Categories 5, 8 and 11 describe investment that is not related to any access service. Such investment will accordingly be assigned to the interexchange category.

286. Space Category 7 includes garage and storeroom space. Inasmuch as equipment that would be contained in such space is likely to be used primarily for OSP installation and repair that investment will be apportioned in the same proportions as combined OSP investment.

287. Space Category 10 investment (Antenna Support) will necessarily be apportioned in the same proportions as the antenna supported.

288. Most land investment can and will be apportioned in the same manner as the buildings that occupy the land. Storage space is likely to be used in the same manner as garage and storage space in buildings and will accordingly be apportioned in accordance with the same formula. Land other than storage space that is not occupied by a building obviously cannot be related to any particular category. Such investment will be apportioned [\*\*199] in the same proportions as combined land investment in the other land categories.

#### *D. Apportionment of Expenses*

289. Expenses can also be classified as direct or indirect expenses. Certain expenses such as depreciation and maintenance can be directly associated with particular tangible investments in buildings, facilities and equipment. Such expense will be apportioned in the same manner as the associated investment. Property taxes can also be associated with a particular investment and will be apportioned in the same manner.

290. We have concluded that rental payments for the use of a switch or a building, etc., should be apportioned in the same manner that investment would have been apportioned if the carrier owned the equipment or the facility. Therefore, we are also describing such rental payments as direct expense.

291. Indirect expense includes taxes and certain hypothetical taxes that are treated as expenses for ratemaking purposes as well as the expenses in the 600 series of accounts. We have departed somewhat from the separations methodology for apportioning income taxes because that methodology includes some steps that [\*324] appear to be unnecessary when charges [\*\*200] for almost all the relevant categories are to be targeted to earn the same rate of return. n107 Inasmuch as the income taxes are taxes upon profits and the profits will be directly related to net investment, such tax expense will be apportioned upon the basis of relative net investment.

n107 The separations methodology computes taxable income separately for interstate and intrastate services and uses that ratio to apportion tax expense. That step appears to be necessary for separations purposes because state and federal regulators authorize different returns.

292. Hypothetical tax expenses, such as expense related to investment tax credits that are claimed for tax purposes, are associated with particular investments. Such expenses and related credits will accordingly be attributed to the associated investment and apportioned in the same manner as such associated investment.

293. Traffic expenses consist primarily of operator activities and will accordingly be apportioned among the three operator elements in the same proportions as the COE 1 investment.

294. A substantial portion of Commercial Expenses are generated by sales and advertising activities that should be excluded [\*\*201] from access charges because there is no reason to anticipate that the local exchange carriers will have any reason to advertise exchange access services. We have accordingly assigned expenses in Accounts 642 and 643 to the interexchange category.

295. Commercial expense also includes Connecting Company Relations, Local Commercial expense, Public Telephone Commissions, Directory expenses and other commercial expenses. The public telephone commissions are obviously attributable to the Pay Telephone element and the directory expenses are obviously attributable to the Information element. Local Commercial expense consists primarily of billing and collection activities and will accordingly be assigned to the Billing and Collection element.

296. At the present time a substantial portion of Connecting Company Relations expense is attributable to the administration of the settlements process. That process will be replaced in large part by access charges. Companies will still incur expenses in connection with the computation of access charges and the computation of distributions from access charge revenue pools. We have, however, decided to classify the access charge expenses as revenue accounting [\*\*202] expenses for purposes of this expense apportionment. Inasmuch as most of the expenses that will remain in the Connecting Company Relations category will be attributable to interexchange settlements, the Connecting Company Relations expense will be assigned to the interexchange category.

297. The remaining commercial expenses cannot readily be attributed to any category or element. Those expenses will be apportioned in the same proportions as the combined commercial [\*325] expenses that have been directly assigned to an access element or the interexchange category.

298. Revenue accounting expenses that are not attributable to access charges will be assigned to the Billing and Collection element because such expenses are generated primarily by such activities. We have also established a formula for the allocation of access charge revenue accounting expenses among access charge elements. Most of those expenses will be allocated to end user access elements because the billing and collection of end user charges is likely to generate greater expense.

299. The Big 4 Wage Factor from the *Separations Manual* will be used to apportion certain expenses such as social security taxes and [\*\*203] pensions that are closely related to wage expenses. The Big 4 Wage Factor is based upon the wage portion of maintenance, traffic, commercial and revenue accounting expenses.

300. The *Separations Manual* also uses the Big 4 Wage Factor to apportion general office expenses other than engineering expenses. We have concluded that it would be appropriate to use the same factor or this purpose. Inasmuch as engineering expense is related to the equipment and facilities that are used in telephone operations, we have decided to apportion that expense on the basis of the apportionment of the combined direct investment.

301. Although the existing license contracts between AT&T and the BOCs will be terminated before access charges become effective, it will still be necessary to apportion this type of expense because some independents have similar arrangements and the BOC central organization will probably perform some services that AT&T General Departments have performed in the past. We believe expenses for services that are performed by an affiliated company should be apportioned in the same manner as expenses for services that a company performs for itself. We are accordingly requiring that [\*\*204] license contract expense be apportioned in that manner.

302. Expenses and income charges and credits that are not included in one of the specific categories described in the rules will be apportioned on an aggregate basis. The Other Investment factor for indirect investment that is not land and building investment will be used for that purpose.

### **Legal Topics:**

For related research and practice materials, see the following legal topics:  
Communications LawTelephone ServicesLocal Exchange CarriersRatesCommunications LawTelephone ServicesLocal Exchange CarriersTariffsCommunications LawTelephone ServicesPayphone Services