D.T.C. 10-2

Comcast Phone of Massachusetts, Inc.

Response to DTC-Comcast 1-1

EXHIBIT B (Part II)

LEXSEE 93 FCC 2D 241

In the Matter of MTS and WATS Market Structure; (Part 2 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 597

February 28, 1983 Released; Adopted December 22, 1982

ACTION:
[**1]

THIRD REPORT AND ORDER

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

OPINION:

[*325] VI. *LEVELS OF AGGREGATION*

A. *Prior Proposals*

303. The tentative plan described in the *Second Supplemental Notice* proposed nationally averaged carrier's carrier access charges and the creation of an access charge revenue pool. Uniform charges necessarily require revenue pooling because different exchange carriers have different costs. Some carriers would be overcompensated and others would be deprived of a compensatory return if each [*326] carrier kept the proceeds from access charges that are computed to reflect the average costs of all carriers.

304. The *Second Supplemental Notice* said that distributions from an access charge revenue pool would reallocate total access charge revenues "among the exchange carriers in order to enable each exchange carrier to receive its interstate exchange plant costs and a share of the residue that reflects its pro rata share of the interstate exchange plant investment." *77 FCC 2d at 233.*

305. [**2] Some comments that were filed in response to the *Second Supplemental Notice* observed that we did not specify whether distributions taken from a pool would be based upon the authorized or the achieved rate of return. We always contemplated that any pool distributions would be based upon an achieved return although the charges would, of course, be designed to produce revenues that are equal to the authorized revenue requirement.

306. The *Fourth Supplemental Notice* invited comments upon the desirability and feasibility of some alternatives to nationwide uniform charges. One of those alternatives -- separate access charges on a state-by-state basis -- would have required revenue pooling. The other two alternatives -- a separate schedule for a limited number of classes of exchange carriers or a separate schedule for a limited number of classes of exchanges -- would not require revenue pooling.

307. All four alternatives were based upon the assumption that all exchange carriers would be participating in common tariff arrangements. We assumed that this would be the case because none of the telephone company comments that were filed in response to the *Second Supplemental Notice* [**3] expressed a desire to opt out of such ar-

rangements. Inasmuch as some telephone company comments that were filed in response to the *Fourth Supplemental Notice* do express such a desire, the advantages or disadvantages of the alternatives described in that *Notice* may be academic unless we conclude that we can and should compel unwilling carriers to participate in common tariff arrangements.

B. *Compulsory Common Tariffs*

308. Most comments that discuss the advantages and disadvantages of common tariff arrangements apparently assume that this Commission does have discretion to require averaging or deaveraging, but a few participants have raised questions with respect to the scope of our discretion. Some carriers who do not desire to join in common tariff arrangements apparently believe that any carrier has an absolute right to establish its own rates based on its own costs. n108 Other participants who state that averaging is essential to achieve Communications Act goals contend, or at least imply, that it would [*327] be unlawful for us to permit any carrier to withdraw from averaged common tariff arrangements.

n108 *See* especially Rochester Telephone Corporation Reply, p. 14.

[**4]

309. No provision of the Communications Act explicitly supports either position. That Act does not expressly require averaged rates and it does not confer any express right to deaverage. Neither this Commission nor the courts have been required to determine whether a carrier has a right to establish separate charges because no carrier has ever attempted to withdraw completely from the uniform MTS rate structure. n109

n109 Rochester Telephone cites *American Telephone and Telegraph Company v. FCC, 487 F.2d 864 (2d Cir. 1973)* and *MCI Telecommunications Corp. v. FCC, 561 F.2d 365, 375* (D.C. Cir.), *cert. denied, 434 U.S. 1040 (1977),* to support its claim that it has an absolute right to file its own tariffs. Neither case involved any question with respect to separate or common tariffs. Moreover, the general language with respect to carrier's rights related to revisions of carrier-initiated tariffs that had never been found to be unlawful. Those courts were not describing the scope of the remedial powers we may exercise after we have found that the entire telephone industry has been maintaining an unlawful rate structure.

[**5]

310. We believe that our general powers under Section 4(i) of the Act, *47 U.S.C. § 154*(i.), are sufficient to enable this Commission to compel carriers to participate in common tariff arrangements if we find that such arrangements are necessary to accomplish Communications Act goals. Section 4(i) provides:

The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions. n110

n110 Those powers have been construed very broadly in the past. *See, e.g., U.S. v. Southwest Cable Co., 392 U.S. 197 (1968); National Broadcasting Co. v. U.S., 319 U.S. 190 (1943).*

311. A rule that requires a common tariff arrangement would not conflict with any express provision of the Act. A rule that makes participation in such arrangements voluntary also would not conflict with any express provision of the Act. Therefore, we do have discretion to compel, or to refrain from compelling, participation in a common tariff arrangement.

312. We believe that our power to compel participation [**6] in such arrangements should be used sparingly. A carrier should not be prohibited from pursuing a course that its management believes to be in its best interests unless the public interest requires such a prohibition. A carrier obviously should not be precluded from filing separate access charge tariffs that reflect the costs of that carrier if such a prohibition would produce results that are less consistent with Communications Act goals than results that the filing of a separate tariff would produce.

313. In view of these conclusions we have decided that the advantages and disadvantages of mandatory common tariff arrangements should be examined separately for different groups of access [*328] elements. We have reached different conclusions for different groups.

314. The Carrier Common Line element was designed in part to mitigate the effects that unlimited deaveraging would produce. Therefore, we believe it is essential to recover those charges through interexchange carrier assessments

that are computed on a uniform nationwide basis and to create a pool arrangement for the distribution of such revenues. Our purpose would be frustrated if some exchange carriers recovered the carrier's [**7] carrier portion of the Common Line revenue requirement directly from the interexchange carrier. Such a practice could lead to a deaveraging of MTS and other switched service rates that would reflect cost differences among carriers. This would impose burdens upon the customer of high cost or high SPF carriers that the Carrier Common Line charge was designed to avoid.

315. A common tariff arrangement is also necessary at this time because a large portion of the Carrier Common Line revenue requirement will be recovered through the premium access assessment during the early years of the transition. Differences in the quality of interconnection will vary from place to place and from month to month during the transition period. Any effort to measure premium value in a particular exchange in a particular month would create significant administrative burdens for all carriers and for this Commission. We have decided that it would be preferable to compute an annual premium on a national basis that reflects our best estimate of the premium access that will exist during a particular year. It may be impossible to compute a premium access charge in any other manner.

316. The considerations that [**8] require a uniform nationwide charge for the carrier's carrier portion do not apply to the end user portion of the Common Line revenue requirement. Premium access is not a factor and separate tariffs for the end user portion need not impose hardships in high cost or high SPF areas. n111 There is accordingly no reason to preclude a carrier from devising its own charges if it wishes to do so.

n111 Universal Service Factor costs will, of course, be assigned to the carrier's carrier portion. *See* Subparts III.B and III.C, *supra.*

317. Moreover, a compulsory common tariff arrangement for that element would not only be unnecessary, but would also be undesirable. We have designed transitional rules for End User Common Line charges that give carriers considerable discretion in designing a transition to flat rates for all end users. Flexibility is desirable because different approaches are likely to be appropriate for different carriers in different areas.

318. Our effort to achieve parity among services would be frustrated if a carrier filed a tariff for one or two end user elements [*329] that reflected its own costs and joined a common tariff for other end user elements that [**9] reflected average costs of a group of carriers. Some restriction upon the filing of separate end user tariffs is accordingly necessary in order to achieve the primary objective of this phase of this proceeding. Section 69.3 of our Rules permits a carrier to file a separate tariff for an end user access element if, but only if, that carrier files a separate tariff for all end user access elements. n112

n112 All of the restrictions upon separate tariffs and deaveraging are described in Section 69.3.

319. We do not perceive any significant advantage from requiring a common tariff for the other carrier's carrier elements that we have described as traffic sensitive. Any deaveraging of the access charges will not, of course, automatically lead to a deaveraging of the interexchange carrier's end user rates. Even if that result did occur, it appears doubtful that the differentials would be large enough to impose a significant hardship upon end users in particular areas. Present and proposed separations methods for the apportionment of traffic sensitive plant do not create the same kind of discrepancies that are or may be reflected in interstate NTS costs. Therefore, we will not preclude [**10] separate tariffs for the traffic sensitive elements.

320. We will, however, preclude a carrier from filing a separate tariff for any traffic sensitive element if the carrier does not file a separate tariff for all traffic sensitive elements. Many of these elements are closely interrelated and a combination of separate and common tariffs for the same carrier could produce anomalous results that are inconsistent with the goals and requirements of the Communications Act.

321. The existence of multi-carrier extended area arrangements also requires a further restriction upon the filing of separate tariffs for traffic sensitive elements. If an extended area arrangement exists an interexchange carrier that interconnects with any local exchange carrier in the extended area necessarily obtains access to the entire extended area. The local exchange carriers are essentially providing a joint access service. Therefore, we will not permit any local exchange carrier to file separate traffic sensitive tariffs for a portion of an extended area. We will permit carriers in an extended area to file a joint tariff for traffic sensitive elements that differs from any national common tariff if all of the [**11] participating carriers concur in the rate and agree upon an apportionment of the revenues. Such a joint tariff must, of course, reflect the combined costs of all participating carriers.

322. If carriers in an extended area cannot agree upon a rate for a particular area, common tariff arrangements that have been established nationally will have to be used for that purpose. Such a requirement is necessary to assure that some access charge will be [*330] effective in all areas even if the participating exchange carriers annot agree upon rates or the division of revenues.

C. *Deaveraging By A Carrier*

323. A separate tariff for end user or traffic sensitive elements might be computed to reflect the average costs of a particular carrier or group of carriers. A tariff could also be devised to reflect greater disaggregation. The comments indicate that a few carriers may wish to file separate tariffs that are highly disaggregated.

324. Our discussion of deaveraging in the *Third Supplemental Notice* noted that past efforts to devise deaveraged rates for a particular carrier or group of carriers have not produced lawful rates. We also concluded that our past decisions have established [**12] a policy that precludes selective deaveraging by a carrier in the absence of a showing that such deaveraged rates reasonably approximate actual cost differences. *81 FCC 2d at 194.* We said that we would continue to enforce that policy and we noted that Central Submission data submitted by AT&T indicates that AT&T did not have the data that would be necessary to justify a deaveraged rate schedule. *81 FCC 2d at 195.*

325. We have not received any information in or out of this record during the intervening two years that would indicate that any carrier is presently in a position to devise highly disaggregated access tariffs that will not create new forms of discrimination. We have, therefore, concluded that unlimited deaveraging within tariffs of a particular carrier or group of carriers should not be permitted at this time.

326. Data that are collected on a study area basis may, however, be sufficient to enable a carrier to justify rate differentials among different study areas. We will, therefore, permit a carrier to file access tariffs with different rates in different study areas if it chooses to do so. Our decision to permit such [**13] filings does not, of course, relieve such a carrier of its duty to submit cost support data that will justify any such differentials.

D. *Voluntary Common Tariffs*

327. Most participants in this proceeding agree that exchange carriers who wish to enter into a voluntary common tariff arrangements and a voluntary revenue pool should be permitted to do so. Some participants have, however, observed that any averaging and pooling arrangement has some disadvantages. Some have said that such arrangements do not create incentives for users or carriers that promote economic efficiency.

328. AT&T observed (Comments, p. 71): "Because rate averaging separates prices from local costs, averaging encourages the overuse of the more costly but underpriced facilities and the underuse of the less costly but overpriced facilities."

[*331] 329. Voluntary common tariff arrangements for access elements other than the Carrier Common Line element would not be likely to produce significant distortions because the lowest cost carriers are likely to withdraw from such pooling arrangements in due course. An access plan that includes such arrangements will probably ultimately produce common tariffs and revenue [**14] pools for a large number of relatively small companies that do in fact have comparable costs.

330. Some comments have observed that pooling does not create efficiency incentives for carriers that participate in a pool. For example, Rochester Telephone said (Comments, p. 34):

If the pooled revenues are distributed according to each carrier's costs, as presumably they would have to be, there is little or no economic incentive to reduce the cost of access under this system. Indeed, an exchange carrier that reduces its costs becomes relatively more disadvantaged, for it receives from the pool a smaller proportion of the interstate revenues contributed by its subscribers to the pool.

331. The present partnership settlements arrangement for BOCs and independent telephone companies that are described as "cost study" companies essentially provides cost plus compensation for each carrier. This method of compensation does appear to create little or no incentive to improve efficiency. Many participants do believe, however, that any access charge revenue pool should be designed to provide a uniform return for all pool participants. n113

n113 *See* GTE, p. 23; United Telephone System, Inc., p. 2; Ketchikan Public Utilities, p. 7; Curtis M. Bushnell, p. 21.

[**15]

332. Although a uniform common tariff arrangement necessarily requires a revenue pool, it does not inevitably require pool distributions that are based upon the settlements partnership model. It may be possible to create greater efficiency incentives by devising a pool distribution formula that does not guarantee a uniform return for all participants. Since such questions apply to involuntary as well as voluntary pools, we believe this possibility warrants further study. We do not, however, have sufficient information at this time to devise pool distribution rules that differ from the settlements model. The public interest would not be served by delaying initial access charges to devise such an alternative. We have accordingly decided to adopt distribution rules that do follow the settlements model. n114

n114 The distribution of revenues to carriers that are not average schedule companies is described in Sections 69.607-69.610 of the Rules.

333. Rochester Telephone also asserts (Comments, p. 39) that companies that participate voluntarily in a common tariff and pooling arrangement "would run the risk of antitrust liability under the Sherman Act." It appears doubtful that common [**16] tariff and [*332] revenue pooling arrangements that are limited to access services could provide a basis for a colorable antitrust claim. The Sherman Act does not prohibit concerted activities, it merely prohibits concerted activities that are likely to produce an unreasonable restraint of trade.

334. We observed in the *Second Supplemental Notice* that such arrangements are unlikely to produce anticompetitive effects. That *Notice* said *(77 FCC 2d 235):*

Local exchange facilities are presently provided exclusively on a monopoly basis and carriers providing such service do not compete with each other in the provision of that service. We recognize that this situation may change with time as improving technology *(e.g.,* direct satellite, cellular radio) makes exchange competition more economically feasible. However, these changes will not occur in the short run. (footnote omitted).

335. Access service competition between the carriers that are likely to participate in a pool is not likely to occur even in the more distant future. Alternative access that bypasses wireline facilities of a local exchange carrier is likely to be offered in conjunction [**17] with an interexchange service. Therefore, a local exchange carrier is not likely to be providing bypass in the franchise area of another local exchange carrier if that carrier is not providing interexchange services. The MFJ bars the divested BOCs from the interexchange market and most smaller independents do not have the means to enter that market. One can imagine large independents offering bypass services in BOC exchanges, but the BOCs are not likely to remain in any pools by the time that becomes a realistic possibility. Therefore, any common tariff and pooling arrangements that we are mandating or permitting cannot be viewed as price-fixing or profit-pooling by actual or potential competitors in an access service market.

336. The Justice Department apparently shares our perception of the competitive implications of voluntary access pools. The Justice Department comments do not oppose voluntary common tariffs or voluntary pools as such.

337. Such voluntary arrangements not only do not have disadvantages that would warrant a prohibition, but also have important advantages. The telephone industry is composed of a limited number of large companies that serve over 90% of the local [**18] exchange subscribers and a very large number of small companies that serve the remaining subscribers. Most of these smaller companies have never filed any tariff of any kind with this Commission. It would be totally unrealistic to expect such companies to prepare and justify separate tariffs in accordance with the rules we are adopting in this *Report and Order.* It would also be unrealistic to suppose that this Commission could review 1500 access tariffs in a meaningful manner if they did choose to do so. A common tariff arrangement that most [*333] of the exchange carriers can use is clearly necessary to make any access charge rules work. Such arrangements would, therefore, presumably be immune from antitrust sanctions because they are necessary to make the regulatory scheme work even if this Commission did not mandate or sponsor such arrangements. *See Silver v. New York Stock Exchange, 373 U.S. 341 (1963).*

338. The involuntary arrangements for universal service charges should not, of course, present any antitrust question because participation in those arrangements would be the product of regulatory coercion. n115

n115 The decision in *Cantor v. Detroit Edison Co., 428 U.S. 579 (1976),* would not be analgous because the regulatory coercion in the rules we are adopting does not have the same *pro forma* character as the actions of the Michigan Commission.

[**19]

E. *Creation of the Association*

339. A voluntary or involuntary common tariff arrangement necessarily requires that some entity compute the charges and prepare and justify the tariffs on behalf of all the participating carriers. A revenue pool requires that some entity compute the distributions that each participant is entitled to receive from the pool.

340. In the past AT&T has acted as a tariff filing agent for the entire industry and has also performed most of the administrative functions in connection with the settlements pooling arrangement. The AT&T role as a tariff filing agent is implicitly recognized in Section 203(a) of the Act. Section 203 requires every common carrier "except connecting carriers" to file tariffs with this Commission for interstate and international services. It also requires that the tariffs describe charges between points on the carrier's system and between points on the carrier's system and "points on the system of its connecting carriers." This essentially relieved a "connecting carrier" of the burden of filing its own tariffs with this Commission and imposed that burden upon the carrier that is not described as a "connecting carrier." The term [**20] "connecting carrier" encompasses most independent telephone companies and probably encompassed almost all non-Bell companies when the Act was adopted. Thus, Congress effectively made AT&T a tariff filing agent for the entire industry.

341. The *Fourth Supplemental Notice* invited comment on a proposal to create a new intra-industry entity to perform the tariff filing and pool distribution functions because such an AT&T role in the post-divestiture environment would appear to conflict with the spirit, and possibly the letter, of the then proposed consent decree. Most comments from participants who do not oppose any common tariff or pooling arrangement have endorsed the industry association concept.

[*334] 342. A few comments have questioned the desirability or legality of Commission action to mandate the creation of such an association. Such participants apparently believe that we should allow institutional arrangements for common tariffs and pools to emerge spontaneously. We do not believe that would be a feasible option if an access charge system is to be in place by the beginning of 1984. Such an association must have a functioning organization by the time the divestiture occurs. [**21] We necessarily must mandate the creation of an exchange carrier association and adopt some rules with respect to its organization and functions in order to ensure that an access charge system will work. n116

n116 Those rules are set forth in Subpart G.

343. Rochester Telephone has questioned our authority to mandate the creation of such an association and has described such an action as a delegation of powers to a private organization. Comments, p. 39; Reply, p. 13. We do not believe it would be appropriate to describe our action as a "delegation" because the preparation of tariffs and the administration of revenue pools is not a governmental function. It would probably be more accurate to describe our action as an exercise of our Section 203(b)(2) power to modify the requirements of Section 203 by creating a new entity to perform functions that Section 203(a) assigned to AT&T. If we failed to exercise our power to transfer such functions from AT&T to a new entity we would be creating an unnecessary conflict between the regulatory scheme and the MFJ. Moreover, as previously noted, the creation of such an association is essential to the success of an access charge system and [**22] is accordingly within our Section 4(i) power to issue orders that are necessary to the performance of our statutory functions.

344. Although the Justice Department did not oppose common tariffs or voluntary pooling of access charge revenues, the Department has expressed the view that this Commission should not sponsor a carrier association. That view may reflect a concern that a Commission-sponsored association could become a vehicle for other concerted activities that might have anti-competitive implications. We feel that such activities are unlikely. Nevertheless, we have decided that we should impose some restrictions upon the scope of the association's activities. We will preclude the association from engaging in activities that are not directly related to the preparation of access charge tariffs or the distribution of access charge revenues unless such additional activities are expressly authorized by this Commission. We will, of course, expect the association to seek prior approval for any additional association activities.

F. *Organization of the Association*

345. We have concluded that membership in the association [*335] should be limited to exchange carriers that participate [**23] in access charge revenue pools that are administered by the association and that the governing board

should be composed exclusively of exchange carrier representatives. Although the *Fourth Supplemental Notice* invited comment upon the advisability of including a Commission representative on the association board, further reflection leads us to conclude that it would be unwise to do so. This Commission will be obliged to review the tariffs that the association files and to determine the merits of any petitions to investigate, suspend or reject such tariffs. An appearance of a conflict of interest might be created if a Commission representative participated in the association decisions that might be challenged in such proceedings. We have also decided not to accept suggestions that state commissions, interexchange carriers or consumers be represented on the governing board of the association. As we stated in the *Fourth Supplemental Notice,* "the Communications Act already provides safeguards adequate to protect the interests of these groups in the fair, evenhanded implementation of any access charge plan we might adopt." *90 FCC 2d at 150.*

346. We have [**24] concluded that we should adopt a rule describing the membership of the governing board in order to establish appropriate representation for different classes of carriers. We are not, however, adopting that rule at this time. We will issue a supplemental order in this docket adopting such a rule and prescribing some organizational steps after the notice period expires for carriers that may choose not to participate in common tariffs for 1984. n117

n117 We do not plan to invite further supplemental comments before we issue that supplemental order.

347. We do not plan to adopt rules that would restrict the association's discretion in acquiring staff or borrowing staff from its members or contracting with accounting firms, banks or others to perform some of the association's tasks. The observation in the *Fourth Supplemental Notice* that the BOC central organization might continue to perform many tariff preparation and pool distribution functions that have traditionally been performed by AT&T personnel was presented as a possible solution to staffing problems the association may encounter. We do not believe, and have never believed, that it would be necessary or desirable for [**25] this Commission to prescribe the staffing arrangements the association would be required to adopt.

348. The association will be responsible for filing the Carrier [*336] Common Line tariffs and common tariffs for every other access element for those carriers that choose to join in association tariff n118 In general, carriers may choose to participate in common tariffs for the end user elements or the traffic sensitive carrier's carrier elements or both. In order to enable the association to adjust its tariffs to reflect the costs of carriers that do choose to participate in common tariffs, we shall require that any exchange carrier that does not desire to participate in a common tariff provide ample advance notice that it has chosen to file a separate tariff.

n118 This will, of course, take the form of a single tariff with multiple elements. We will permit carriers who do not join some elements to cross-reference the association tariff for elements such carriers join.

349. The costs of managing the pooling and distribution, along with the costs of actually filing tariffs, are to be included among costs recovered through association charges.

G. *AT&T Role in Preparation of* [**26] *Initial Tariffs*

350. It appears doubtful that the association could have an organization in place in sufficient time to prepare the initial access service tariffs that must be filed by October 3, 1983. We have accordingly decided that AT&T should continue to perform its traditional role in the preparation of tariffs for the telephone industry until the initial access charge tariff is ready for filing. n119 AT&T should, of course, respond to policy directives from the association directors when a governing board has been selected.

n119 Inasmuch as the association will be relieving AT&T of burdens imposed by Section 203, we expect that AT&T will lend funds to the association to permit it to function until it receives a disbursement from access charge revenues.

351. AT&T participation in the preparation of the initial access charge tariffs would probably be necessary even if the association could create a functioning organization immediately. AT&T will necessarily be required to file new end user tariffs for interstate and international services in order to reflect the effect of the access charges. In view of the magnitude of the changes that the implementation of initial access [**27] charges will produce, access charges and new end user charges for interexchange services should become effective simultaneously. We could not responsibly permit massive changes in end user rates to become effective upon less than 90 days notice and it appears doubtful that we

could require more than 90 days notice for access tariff filings. In these circumstances, coordination in the development of access charge tariffs and new end user tariffs for AT&T services is essential to ensure a smooth transition.

n120 End user rates of other interexchange carriers will undoubtedly also be changed to reflect access charges. We do not, however, expect to require 90 days notice from those carriers.

352. Such coordination problems should not be as significant in subsequent years because the changes in access charges probably [*337] will not be significant enough to require simultaneous changes in end user rates. It should be possible to achieve a smooth transition by mandating an AT&T role in the preparation of common tariffs for access charges that ends when the initial access charges are filed. We do not envision, mandate or sanction any AT&T role in the preparation of access charge [**28] tariffs or the distribution of access charge revenues after divestiture of the BOCs occurs.

353. The Justice Department comments indicate that the Department does not object to a pre-divestiture AT&T role in the preparation of access charge tariffs. We accordingly assume that the procedure we envision will not conflict with the letter or the spirit of the MFJ.

354. The preparation of the initial access charge tariffs will undoubtedly be a difficult task. In order to enable AT&T to begin collecting the necessary data, we are making this *Order* effective on the day after the date of publication in the *Federal Register.* We have decided to require exchange carriers that choose to file any separate tariffs for 1984 to notify AT&T of their decision within 40 days after the release of this *Report and Order.* We are also requiring that AT&T notify all the affected carriers that this notice requirement exists within 10 days of the release of this *Report and Order.*

355. It is vitally important that acceptable access tariffs become effective by the day on which divestiture of the BOCs occurs. We therefore feel compelled to monitor the progress of access charge preparation. To this [**29] end, we require AT&T to file progress reports until the initial access charges have been filed. The first report will be filed 8 weeks after the release of this *Report and Order* and subsequent reports will be filed at 6-week intervals.

356. We also expect that AT&T and any carrier that may choose to file a separate tariff will file petitions for waiver if shortcuts must be used to adapt readily available data to the methods we are prescribing for the computation and assessment of access charges. We recognize that some carriers will not be able to provide all of the data that would be required and that some kind of sample procedure will be necessary to develop data for average schedule companies. The filing of such waiver petitions will provide an additional opportunity to monitor the progress of access charge preparation. n121

n121 The Chief of the Common Carrier Bureau will, of course, act upon any waiver petitions that do not present fundamental policy questions that require a Commission decision.

357. We believe the procedures we are adopting will achieve the purposes of this proceeding without imposing undue burdens upon any carrier or creating administrative burdens [**30] that exceed the capabilities of our staff. n122

n122 We have necessarily been obliged to impose some restrictions upon the options of carriers that do not choose to join in common tariffs in order to prevent the filing of tariffs that could not be adequately reviewed. For example, the rules we are adopting preclude tariffs that are disaggregated within a study area. We may relax such restrictions in the future after we have acquired more experience with access service tariffs.

[*338] H. *Regulatory Flexibility Certification*

358. For the following reasons, we certify that the Regulatory Flexibility Act is not applicable to the rules we are adopting in this proceeding.

359. A few of the comments have questioned the adequacy of the initial regulatory flexibility analysis in the *Fourth Supplemental Notice. n123* The Regulatory Flexibility Act is not literally applicable to this proceeding. That Act was apparently designed for the protection of small businesses that are directly subject to administrative rules rather than businesses that are indirectly affected by the results that any rules will produce. The access charge rules are, of course, imposed upon the local exchange [**31] carriers that will be required to compute and collect access charges in accor-

dance with those rules. Those carriers are accordingly the only businesses that might be entitled to claim some protection under that Act.

n123 *See* especially Small Business Administration comments.

360. Although some local exchange carriers are very small, no telephone company appears to fall within the Regulatory Flexibility Act's very special definition of a "small entity." That Act incorporates the definition of a "small business" in Section 3 of the Small Business Act as a definition of a "small entity." The latter definition excludes any business that is dominant in its field of operation. Exchange carriers, even small ones, enjoy a dominant monopoly position in their local service area. This Commission has found all exchange carriers to be dominant in the *Competitive Carrier Rulemaking, 85 FCC 1, 23-24 (1980).* Indeed the smallest exchange carriers are probably even more dominant than the large ones because bypass competition is very unlikely to develop in the areas they serve.

361. Although the Regulatory Flexibility Act is not applicable to this proceeding, [**32] Congress did express essentially the same policy objective in the Communications Act. Sections 2(b) and 203(a) of the 1934 Act were designed to relieve most small telephone companies from many reporting and other burdens that the Act imposed upon AT&T.

362. We recognize that we cannot and should not expect a telephone company with eight employees to do everything that Pacific Telephone is expected to do. We have designed the access charge rules to minimize the administrative burdens that are imposed upon smaller companies. We have mandated the creation of an association that will perform tariff preparation and pool distribution functions and we have designed requirements for those functions [*339] that will adapt the existing average schedule settlements procedures to an access charge system. We believe that we have complied fully with the requirements of the Communications Act and the spirit of the Regulatory Flexibility Act.

VII. *CONCLUSION*

363. We emphasize how difficult and how important has been the task of devising an access charge plan. In this proceeding, we have focused on the present and the future rather than the past. The monopoly telecommunications environment [**33] of the past has ended. The approaches taken in the past to balance the four goals of universal service, non-discriminatory, cost-based prices and a viable, efficient telecommunications network -- goals which we believe have been the aim of the Communications Act since its passage -- are no longer appropriate. These past approaches have essentially been nothing more than the development of special, discriminatory rates for different customers making identical use of access plant in interstate service. It is readily apparent that in an era of facilities-based competition and resale such approaches are not viable. Any attempt to insure continued support for local telephone service through the prohibition of bypass systems would lead to a stifling of innovation and, quite probably, to the transformation of the nation's telephone system -- currently the best in the world -- into an outmoded and technically inefficient system. Such a system would almost certainly be unable to attract sufficient capital to maintain, much less upgrade, the system.

364. In our *Fourth Supplemental Notice* we put forth for comment four differing approaches to the resolution of the principal question in the [**34] access charge docket. These were not presented as specific plans subject to a vote of the parties. Rather they were propounded as examples of the types of plans which could be developed. In issuing that *Notice* we hoped that participants would propose methods to combine or improve upon the simplistic approaches we described. Our hope was well justified. The comments filed by participants in this proceeding have, in overwhelming measure, been constructive and of tremendous value to us in fulfilling our task. Our task, we state once again, is to devise that access charge plan which best balances the many objectives of the Communications Act.

365. The plan we adopt today is largely based upon those comments. It recognizes both the need for some national averaging and the clear advantages of disaggregation when such disaggregation is desired by the carriers and is in the public interest. It clearly recognizes the need for a smooth transition from the existing system of discriminatory but largely usage based carrier charges to a new system relying chiefly upon flat customer charges. Such a movement is, in our opinion, necessary to serve the public interest and to insure [*340] the [**35] maintenance of our nationwide network of telephone service. Despite this we have, through our plan, insured that universal service will not be eliminated. The inclusion of a permanent, nationally averaged, carrier's pool to direct revenues to high cost areas is a central feature of this plan. We have not been limited by the traditional division between "traffic sensitive" and "non-traffic sensitive" costs in determining which costs should ultimately be placed upon individual customers. Rather, we have attempted to differentiate network functions, which may appropriately be recovered through carrier's carrier charges, from end user service, which can only be ordered by end users, which is dedicated to individual end users, and which must, in our opinion, be recovered from those end users.

366. We have directed the Common Carrier Bureau to develop a monitoring function to insure that the changes that will result from this *Report and Order* do not impair universal service. Such a monitoring function must and will be in place before the institution of access charges. Along with our transition plan, this will insure that, should unforeseen circumstances arise, we have an ample opportunity [**36] to act before irreparable harm to the universal character of telephone service takes place. We now commit ourselves to taking such action should, contrary to our expectations, it be necessary. Such actions might include adjusting end user flat charges, adjusting the Universal Service Fund, adjusting the degree of nationwide pooling, or requiring that certain transitional benchmarks be met.

367. Finally, we have provided a two-year period after individual phone companies are responsible for collecting most dedicated NTS costs from their subscribers before equal flat customer access charges will be required. We recognize that during the transition period some telephone companies may develop mechanisms for recovering those costs from their customers which will better balance the four goals of the Communications Act than can a single national plan. We will conduct a further notice and comment phase of this proceeding in the fifth year and will evaluate nationwide and local effects of the transition before proceeding with the final steps in the transition plan. We recognize that a plan that may be ideal for most of the country may not be ideal for all of the country. This *Report and* [**37] *Order* recognizes that individual carrier flexibility is fully consistent with the Communications Act. We expect to work with State regulatory commissions, and State legislatures, during the transition period to continue to seek better ways to reconcile the need for an efficient, cost-based recovery scheme with the need for a universal telephone system and to harmonize our efforts so as not to frustrate the achievement of our policies and objectives.

368. The task we have faced in designing our access charge plan has been, perhaps, the most difficult ever to come before the [*341] Commission. It is also, quite probably, the most important to have come before us. The correct resolution of this phase of this docket is an essential prerequisite for the development of meaningful competition in interstate telecommunications, for the assurance that common carrier telecommunications can play the central role in our nation's economy and, indeed, in the world economy that is warranted by its value to citizens and by its unique characteristic of being substitutable for a wide variety of goods and services. No one, and no commission, can predict the future of telecommunications with any degree [**38] of certainty. Our access charge plan is, in our opinion, the best plan for the present and immediate future that can be devised based upon our present level of knowledge. We remain committed to careful monitoring of developments in the field of common carrier telecommunications and to making any adjustments that may be warranted, based upon these future developments, to serve the public interest.

VIII. *ORDERING CLAUSES*

369. Accordingly, IT IS HEREBY ORDERED, That pursuant to *47 U.S.C. §§ 154*(i) and (j), 201, 202, 203, 205, 218 and 403 and *5 U.S.C. § 553,* Part 69 IS ADDED to the Rules of this Commission as set forth in the attached Appendix A, effective on the date following publication in the *Federal Register.*

370. IT IS FURTHER ORDERED, That each revenue requirement that is computed in accordance with such rules shall be based upon a 12.75% return until further order of this Commission.

371. IT IS FURTHER ORDERED, That in accordance with the rules in Appendix A and the directives of this *Report and Order,* AT&T shall prepare the initial tariffs for interstate access services provided by members of telephone [**39] company association and shall file these tariffs no later than October 3, 1983.

372. IT IS FURTHER ORDERED, That AT&T file reports describing its progress in preparing these initial access tariffs with the Chief, Common Carrier Bureau. These reports shall continue until AT&T has filed the initial access tariffs. The first report shall be filed eight (8) weeks after the release of this *Report and Order.* Subsequent reports shall be filed thereafter at six (6) week intervals.

373. IT IS FURTHER ORDERED, That within ten (10) days of the release of this *Report and Order* AT&T shall notify each telephone company that has participated in the division of revenues or settlements process that the company is required to decide whether to file any tariffs separate from those filed by the association and to notify AT&T of its decision.

374. IT IS FURTHER ORDERED, That each telephone company that has participated in the division of revenues or settlements process shall notify AT& T of its decision to file any separate tariffs within forty (40) days of the release of this *Report and Order.*

[*342] 375. IT IS FURTHER ORDERED, That the Petition for Evidentiary Hearing of the United States [**40] Transmission Systems, Inc. filed on June 26, 1980, IS DENIED.

376. IT IS FURTHER ORDERED, That the Motions for Leave to File Late Comments filed by the Federal Executive Agencies and the Council on Wage and Price Stability ARE GRANTED.

FEDERAL COMMUNICATIONS COMMISSION * WILLIAM J. TRICARICO *Secretary*

NOTE: Appendices B, C, D, E, F, G and attachments are available for public inspection in FCC Dockets Branch, Room 239 and FCC Library, Room 639, 1919 M Street, N.W., Washington, D.C. 20554.

CONCUR BY:

JONES (IN PART)

DISSENT BY:

JONES (IN PART)

DISSENT:

SEPARATE STATEMENT OF COMMISSIONER ANNE P. JONES CONCURRING AND DISSENTING IN PART

In Re: MTS and WATS Market Structure, CC Docket 78-72, Phase I

The FCC's decision in this proceeding is undoubtedly the most significant one that the agency will make during my tenure as a Commissioner. I believe it is vitally important that the FCC's access charge plan (ACP) be clear, practical and carefully crafted to support the pro-competitive policies this agency has adopted for the telecommunications industry. From a public policy perspective, competition in the telecommunications industry is simply a means to an end, namely, a form of economic discipline that encourages [**41] telecommunications suppliers to provide consumers a broad choice of products and services at the least possible cost. The Commission's encouragement of telecommunications competition is intended, therefore, to improve the welfare of consumers of telecommunications products and services. While I believe that the basic thrust of the Commission's access charge plan is a step in the right direction, I fear that the specific plan adopted is improperly focused, needlessly complex, and not fully committed to the goal of promoting vigorous competition in the telecommunications industry. As I explain herein, I would prefer a simpler, more comprehensive approach that would encourage the rapid development of telecommunications competition and the early realization of its benefits for consumers.

[*368] This proceeding was initiated as a market structure inquiry. Following the court's directions in *Execunet I,* n1 the Commission set out to determine whether MTS and WATS services should be offered on a sole source or competitive basis. *Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978).* As part of that inquiry, the Commission specified that it would [**42] reexamine the separations process. *Id. at 759.* Finding it "necessary to formulate policy in this area," the Commission proposed to determine what reimbursement interstate services should make to local operating companies for the use of local plant, on a cost causational basis; what additional charges, if any, should be levied [*400] on interstate services to support local exchange services; and whether and how these charges can be equitably imposed on all interstate services.

n1 *MCI Telecommunications Corp. v. FCC, 651 F.2d 365 (D.C. Cir. 1977), cert. denied, 434 U.S. 1040 (1978).*

Id.

Following the ENFIA negotiations, n2 the Commission seemed to lose sight of this resolve. Instead of addressing the broader concern of reforming the separations process and moving toward cost causational pricing of network access, the Commission narrowed its focus merely to adjusting prices so that it could eliminate discriminations in current access arrangements for MTS, WATS, and certain private line services and in the interstate rates for these services. Thus, rather than beginning its analysis [**43] of access charges from the perspective of establishing economically-efficient network access prices, the Commission framed the issue as a "discrimination problem" when it proposed an access charge plan in the *Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980).* This orientation is still evident in the current access charge plan. *(See e.g.,* p. 30 description of various plans as "Alternative Strategies for Reducing Discrimination.") I now believe this change in perspective was unwise.

n2 *See Exchange Network Facilities, 71 FCC 2d 440 (1979).*

By reorienting the focus of the access charge issue as a rate discrimination problem, the Commission diverted its attention from causes to symptoms of anomalous pricing of both local exchange access and interstate switched network services. The fundamental problem is *not* that interstate MTS and WATS rates are discriminatory compared with interstate private line rates. Rather, the basic problem is that neither the current compensation mechanism for local exchange access for interstate telecommunications services nor rates for MTS and WATS are [**44] priced on a cost causational basis. n3 By neglecting the goal of cost causation in favor of treating the symptoms of non-cost-based rates, the Commission's access charge [*369] plan has introduced new distortions in the pricing of private line services and, paradoxically, has created new rate discriminations in the pricing of local exchange access lines.

n3 *MTS and WATS Market Structure, 67 FCC 2d 759 (1978).*

The shift in emphasis from close adherence to the principle of cost causation to "alternative strategies for reducing discrimination" is more than a semantic difference or a subtlety with no substantive impact. Encouraging nondiscriminatory access to local exchange facilities at cost-based rates is essential to the realization of the Commission's goal of fostering a competitive MTS and WATS market. By assigning a higher priority to achieving "equitable access" to local exchange facilities than to encouraging efficient, cost-based pricing of the usage of local telephone plant, the Commission may have adopted an access charge plan that will discourage new entry into the MTS and WATS market, slow considerably the growth rate of the other [**45] common carriers (OCCs), and provide the basis for continuing dominance of AT&T in the MTS and WATS market.

The following discussion will outline the specific reasons why I feel that the access charge plan adopted by the Commission may severely frustrate the realization of the open entry policy for the MTS and WATS market adopted by the Commission in this proceeding. I also propose a more comprehensive alternative plan that is fully consistent with the goal of an open entry, competitive MTS and WATS market.

The Access Charge Plan and Its Impact on Economic Efficiency and Competition in the MTS and WATS Market

Much of my concern over the ACP centers on the treatment of non-traffic sensitive (NTS) costs during the transition period. The ACP correctly recognizes the need to shift the recovery of interstate NTS local exchange costs from interexchange carriers to local exchange end users as a flat charge rather than on a usage-sensitive basis. n4

n4 This principle of cost causation is fundamental to any access charge plan, a point that I have emphasized in earlier phases of this docket. See "Statement of Commissioner Anne P. Jones in which Commissioners Mimi W. Dawson, Henry M. Rivera and Abbott Washburn Join *In Re:* MTS and WATS Market Structure, CC Jones," Session on *Separation Changes and the Joint Board in Light of the AT&T Divestiture,* Twenty-First Annual Iowa State Regulatory Conference, Ames, Iowa, May 20, 1982.

[**46]

Given this recognition of where we need to go I find it both unfortunate and ironic that usage-sensitive recovery of NTS costs remains such a major component of the Commission's transition plan. To a limited extent, usage-sensitive charges may be sensible expedients for the recovery of NTS costs that the Commission has ordered phased out, or may decide to phase out of the interstate jurisdiction, such as customer premises equipment (CPE) or inside [*370] wiring. There is little point in building transitional costs into flat charges that will be reduced following the transition period. Rather, it is important that users clearly perceive the direction and magnitude of the significant change in the pricing and cost recovery policy that the Commission's ACP represents. Consequently, usage-sensitive recovery of CPE and inside wiring costs through a carrier's-carrier charge is a reasonable mechanism for recovering transitional costs. By adopting this transitional mechanism, the flat-rate recovery of NTS costs provides an accurate signal concerning the direction and magnitude of NTS cost recovery on a going-forward basis.

By contrast, the combination of an end-user flat fee and interstate [**47] usage fee ("mover") permitted by the ACP during the transition period appears discriminatory, needlessly complex, confusing, and highly accelerated in its first year revenue impact. The transition plan establishes different minimum end-user flat charges for residence and business customers (two and four dollars, respectively) with no empirical evidence that cost-justifies the differential. n5 It also requires that an exchange carrier that attempts to design an enduser usage charge for recovering the difference between the maximum and minimum interstate revenue requirement per line estimate, somehow, the price elasticity of demand for end-user access to an intercity carrier. It is not clear that the "pricing flexibility" provided by the transitional, usage-based mechanism for recovering NTS costs will provide a local exchange carrier much certainty concerning recovery of its interstate NTS revenue requirements, given the maximum charge and the unknown price elasticity of demand for interstate access. Thus, the risk of a revenue requirements short-fall appears substantial.

n5 Paragraph 117 alludes to the ". . . higher interstate revenue requirements generated by business lines as compared to residential lines" but does not indicate whether the prescribed differences in the transitional flat rate charges closely tracks actual differences in cost between these two user classifications.

[**48]

In addition, the combination of flat fee and mover charge introduces a billing complexity that many consumers may find difficult to understand. Also, large users that quickly reach the maximum monthly charge or "cap" may appear to receive a discriminatory "volume discount" unrelated to any economies of bulk usage. Low and moderate volume users will find their relative proportion of NTS costs sharply increased as compared with high-volume users. Since the ACP moves nearly one-half the interstate NTS revenue requirement onto end users in just the first year, local exchange carriers may have a reduced incentive to move steadily toward full flat rate recovery of end user NTS costs. In effect, the Commission has delegated to the local exchange carrier the responsibility for timing the implementation of its policy for assigning interstate NTS costs to end users.

The complexities and peculiar incentives induced by the "mover" [*371] and "cap" transitional cost recovery mechanism could be completely avoided by simply phasing in the end-user flat charge on a straightline basis over the transition period with no usage charges. In other words, the flat-rate end-user charge would simply increase [**49] in equal dollar increments per year until the end of the transition period where the flat rate would just equal the average interstate NTS revenue requirement per line. All end-user lines would be subject to the same flat rate with no discrimination in pricing between business and residential users. Over the transition period, all end-user NTS costs not recovered in the Mat-rate line charge would be recovered by a carrier's-carrier charge. This approach narrowly circumscribes the use of a traffic-sensitive mechanism for recovering NTS costs and places both carriers and customers on a predictable path toward eventual full flat-rate recovery of end-user interstate NTS local exchange costs.

It is also unfortunate that the "Universal Service Fund" (USF) established by the ACP will be funded through a usage-sensitive carrier's-carrier charge. Unlike the end-user mover charge, a usage-sensitive mechanism is employed on a permanent rather than transitional basis to help recover the NTS costs in "high cost" exchanges. A more efficient alternative would be the imposition of a uniform surcharge or "tax" on every local exchange access line. n6 As Appendix G of the *Third Report and Order* [**50] suggests, the demand for access tends to be inelastic. A tax imposed on a good or service having an inelastic demand will minimize the loss in consumer welfare compared with a tax on a good or service with more elastic demand. n7

n6 For example, if the annual subsidy necessary to fund the USF were $410,000,000 annually, then the estimated uniform surcharge per line per month would be 36! See "Separate Statement of Commissioner Mimi Weyforth Dawson re: MTS and WATS Market Structure," Figure II.

n7 See Agnar Sandmo, "Optimal Taxation: An Introduction to the Literature," *Journal of Public Economics* 6 (1976): 37-54.

Given the growing availability of alternative local distribution technologies, the demand for local exchange access by intercity carriers will probably become more elastic over time. Imposing such a surcharge will decrease the quantity demanded for access at the margin and impose a loss in economic welfare depending on the price elasticity of demand. This potential loss in economic efficiency induced by usage-sensitive recovery of NTS costs could be completely avoided through imposition of a line surcharge. Ironically, by funding the USF through a carrier's-carrier [**51] charge, interstate MTS and WATS rates must then recover the carrier's-carrier USF charge. Of course, this method is equivalent to present practice, except that the amount of subsidy embedded in MTS and WATS rates would be reduced given the phase-in of end-user line charges.

[*372] Apart from the economic inefficiency induced by funding the USF through usage-sensitive carrier's-carrier charges, I have serious reservations about the concept of the USF as developed in the ACP. While nominally intended to maintain "universal service," the USF is targeted toward the subsidy of "high cost" telephone companies, *not* consumers

who might abandon telephone service at some higher but *unknown* level of telephone rates. Putting the matter plainly, the USF is first and foremost a mechanism for protecting telephone companies. This protectionist mechanism may produce "trickle down" benefits to local subscribers, although the potential subsidization of *all* users is a highly inefficient way to achieve a "universal service" goal. n8 Possibly the protection of "high cost" telephone companies is a worthy goal of public policy. If so, it should be addressed forthrightly and on its own merits [**52] and not treated as if it were equivalent to helping *targeted* consumers pay the costs of accessing the local telephone exchange.

n8 For further discussion of this point, see Bridger M. Mitchell, "Pricing Subscriber Access to the Telephone Network," *The Rand Paper Series #P-6815,* October, 1982.

Regulatory Cost Allocation. Essential to the design of nondiscriminatory rates for network access is avoiding the pitfalls of regulatory cost allocation. n9 By stressing equitable rather than cost-based access charges, the ACP ignores the history and lessons of the Commission's previous experience with regulatory cost allocation. This experience suggests that cost allocation procedures as prescribed by the Commission may result in rates filed by carriers that bear little relationship to the underlying economic costs of providing telecommunications services. As a result, regulatory cost allocation methodologies that result in "allocated costs" that depart from economic costs or regulatory cost allocation rules that grant dominant firms considerable discretion in implementing the regulatory costing methodology may encourage inefficient market entry or repel innovative competitors. [**53] In either case, regulatory cost allocation is both a controversial and a highly problematical regulatory tool for promoting competition in the telecommunications industry.

n9 The term "regulatory cost allocation" refers to various costing procedures or rules that a regulatory agency prescribes for computing the costs of individual services provided by a regulated carrier. Regulatory cost allocation is distinguished from the Uniform System of Accounts that determines the level of total revenue requirements of a carrier but not the disaggregated costs attributable to any given service.

The ACP is a regulatory cost allocation methodology, not a pricing mechanism based on marginal cost or on general principles of efficient rate structure design. Since the ACP reflects little familiarity with the hazards of a regulatory costing methodology, I feel that some review of the Commission's experience with cost allocation in markets subject to competitive entry is essential to the further [*373] discussion of my reservations with the ACP. This discussion also helps to explain why my alternative approach, which largely eschews regulatory cost allocation, offers important advantages.

Regulatory [**54] cost allocation apportions both the operating expenses and the return on net depreciated assets of a regulated carrier among various "service" categories. The perceived regulatory need for cost allocation in interstate telecommunications was a direct byproduct of the Commission's *Above 890* decision in 1959 which permitted users to build their own private microwave transmission facilities. n10 To discourage large private line customers from building their own facilities, AT&T introduced its TELPAK bulk rate private line tariff that offered substantial discounts to large users of private line circuits. For the next fifteen years, the Commission attempted to determine in multiple dockets whether such rate adjustments by AT&T were simply a lawful pricing response to competition or pricing behavior intended to eliminate competition. The development of regulatory cost allocation procedures emerged as a focal point of such deliberations.

n10 A review of the Commission's experience with regulatory cost allocation in various dockets is reviewed by Walter G. Bolter, "The FCC's Selection of a 'Proper' Costing Standard after Fifteen Years -- What Can We Learn from Docket 18128?" in *Assessing New Pricing Concepts in Public Utilities,* ed. Harry M. Trebing (East Lansing, Michigan: Michigan State University, 1978), pp. 333-372.
[**55]

The relative merits of "long run incremental cost" (LRIC) versus "fully distributed cost" (FDC) were hotly debated before the Commission during the 1970s. Finally, in 1976, the Commission decided in Docket 18128 that FDC "Method 7" based on the principle of "historical cost causation" would provide the basis for the development of lawful tariffs for AT&T's interstate services. n11 Despite the potential loss in economic efficiency that a FDC pricing standard may induce, the Commission believed that only a FDC standard would ensure that AT&T was "accountable" for its ratemaking practices. n12 n11 *Revision of Tariff FCC No. 260 Private Line Services, 61 FCC 2d 587 (1976).*

n12 A contemporary discussion of the carrier "accountability" standard is provided by William H. Melody, "Interservice Subsidy: Regulatory Standards and Applied Economics" in *Essays on Public Utility Pricing and Regulation,* ed. Harry M. Trebing (East Lansing, Michigan: Michigan State University, 1971), pp. 167-210.

Apart from the controversy over FDC versus LRIC as the appropriate regulatory cost standard, another fundamental difficulty in any regulatory costing methodology [**56] is the troublesome concept of a "service." Once the carrier has defined its service offering, the Commission has required the carrier to "cost-justify" the rates for the defined service. n13 Granting the carrier broad discretion in defining services creates incentives for the carrier to [*374] implement regulatory cost allocation rules to achieve corporate objectives that may conflict with public interest goals, including that of encouraging competitive telecommunications markets. In other words, regulatory cost allocation can be used strategically by the regulated dominant firm to achieve corporate objectives and influence its market environment. n14 As Alfred Kahn has observed, " . . . what constitutes a separate product or service depends in a sense on what it pays the businessman to price or cost separately. n15

n13 The Commission's requirements for cost justification are prescribed in Part 61.38 of the Commission's Rules.

n14 For further discussion of the incentives of a regulated dominant firm, see Jerry B. Duvall, "Emerging Rate Structures in Interstate Telecommunications," paper presented at the *Michigan State University Institute of Public Utilities Fourteenth Annual Conference* "Adjusting to Regulatory, Pricing, and Marketing Realities," Williamsburg, Virginia, December 14, 1982. A theoretical analysis of such incentives is developed in Gerald W. Brock, *The Telecommunications Industry: The Dynamics of Market Structure* (Cambridge, Massachusetts: Harvard University Press, 1981).

n15 Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions,* v. 1 (New York: John Wiley & Sons, Inc., 1970), p. 78.

[**57]

By exercising its discretion in the definition of tariffed services, the regulated dominant firm can pursue some of the profit strategies of an unregulated monopolist. For example, an unregulated monopolist can implement a profit-enhancing price discrimination strategy by segmenting its market in accordance with perceived differences in the elasticity of demand and charging different profit-maximizing prices in each market. n16 Successful implementation of this pricing strategy, however, requires some mechanism to prevent resale and arbitrage between the high and low price market. A regulated dominant firm can implement a similar strategy by designing a tariff that "creates" separate services that, for all practical purposes, simply segments users in terms of differing elasticities of demand. n17 Tariff restrictions that prohibit resale or shared use can effectively segment the market to permit successful implementation of the price discrimination strategy. n18 Not all price discrimination schemes [*375] implemented by a regulated dominant firm are necessarily harmful to consumers. For example, price discrimimation embedded in a volume-sensitive, nonlinear rate structure or a self-selecting, [**58] two-part tariff provides a mechanism for reconciling conflicting regulatory objectives such as wide subscribership to telephone service versus the pricing of usage to high-volume users at marginal cost. n19 Such rate structures, however, should be designed pursuant to regulatory rate structure guidelines to insure that the resulting price discrimination is welfare-enhancing rather than harmful to consumers and competitors. I propose this type of efficient price discrimination subject to federal regulatory guidelines as an aspect of my alternative access charge plan presented later in the statement.

n16 A clear discussion of this price discrimination strategy is provided by James M. Henderson and Richard E. Quandt, *Microeconomic Theory: A Mathematical Approach,* 3d ed. (New York: McGraw-Hill, 1980), pp. 181-184.

n17 Interstate MTS and WATS are possible examples of this market segmentation strategy. Large-volume users of switched message service are likely to have a more elastic demand for MTS than small-volume users, given the availability of both private and public alternative, high-volume transmission facilities. By constructing highly dissimilar rate structures for MTS and WATS, AT&T has been able to segment effectively the market for public switched network service to exploit the differences in the price elasticity of demand for small and large-volume users.

n18 To the extent rate of return regulation is binding, the regulated dominant firm is constrained from earning excess profits that an unregulated monopolist might obtain by implementing a market segmentation and price discrimination strategy. Of course, the regulated firm may still earn excess profits through a similar pricing strategy, although it may camouflage such earnings through "organizational slack" or operating inefficiencies. Perhaps more troublesome than the possibility that a regulated firm may evade regulation and earn excess profits through price discrimination is the possibility that a regulated dominant firm will define services and implement price discrimination schemes in order to accentuate the growth of its rate base or attempt to discourage the entry of competing suppliers. In short, price discrimination as a pricing strategy utilized by a regulated dominant firm may result in substantial economic inefficiency in the use of resources and may have a potential anticompetitive effect.

n19 For further discussion of these and other rate structure options, see Edward E. Zajac, *Fairness or Efficiency: An Introduction to Public Utility Pricing* (Cambridge, Massachusetts: Ballinger Publishing Company, 1978), Chapter 4. Also see the references cited in footnote 35.

[**59]

In general, given the distorted pricing incentives that rate-base regulation may induce, including the entry of a regulated firm into competitive markets at rates below cost, n20 regulators should be especially sensitive to inefficient, discriminatory rate structures and to the definition of services proposed by regulated carriers. As Roger Sherman and Michael Visscher have observed.

n20 See Harvey Averch and Leland Johnson, "Behavior of the Firm Under Regulatory Constraint," *American Economic Review* 52 December 1962): 1053-69.

n21 Roger Sherman and Michael L. Visscher, "Rate-of-Return Regulation and Price Structure" in *Problems in Public Utility Economics and Regulation,* ed. Michael A. Crew (Lexington, Massachusetts: Lexington Books, D.C. Heath and Co., 1979), p. 129. (Emphasis added.)

Price structures may not portray for consumers the full range of opportunities available. The consumer simply is not asked to make some choices, and by that fact alone the range of consumer choice is cut. This is so because the shape of the service can be seriously affected by the aspects of choice in which it is expressed and offered to consumers. Any failure of regulation to deal with [**60] the question of price structure is important, then, not simply because prices may be set at levels that are not optimal but also because the elements of products or services that are priced may not be the best ones. *So products and services can be defined inadequately for ideal pricing, before the pricing task itself is even undertaken.* n21

To the extent a regulated carrier defines a service in order to

segment the market and implement a price discrimination scheme, [*376] it is highly probable that a substantial proportion of the "allocated costs" of the service will appear as "common costs" shared by other "services". This outcome is not surprising if the new service uses to a considerable extent the *same* facilities as existing services. Moreover, the regulatory rule which distributes the shared or common costs among the carrier's services may become itself a strategic variable that the carrier can vary to achieve corporate objectives. For example, the regulated firm can lower or raise its service-specific costs by increasing or decreasing total shared costs of production and by varying the ratio of direct to common costs for any given service. n22 Since the definition [**61] of services and implementation of regulatory cost allocation procedures by a regulated dominant firm may be driven by incentives such as keeping costs low on services facing competitive entry, it should not be surprising that the resulting "allocated costs" may bear little relationship to the underlying facility costs used to provide tariffed "services".

n22 For a recent theoretical analysis of such incentives, see David Sappington and William G. Shepherd, "Sustainability, Entry Restriction, and Induced Technical Bias," *Quarterly Review of Economics and Business* 22 (Winter 1982): 43-52. Also see Roger G. Noll and Lewis A. Rivlin, "Regulating Prices in Competitive Markets," *Yale Law Journal* 82 (June 1973): 1426-1434, Ronald R. Braeutigam, "An Analysis of Fully Distributed Cost Pricing in Regulated Industries," *Bell Journal of Economics* (Spring 1980): 182-96, and Jerry B. Duvall and Michael D. Pelcovits, "Reforming Regulatory Policy for Private Line Telecommunications Services: Implications for Market Performance," FCC Office of Plans and Policy *Working Paper* #4, December, 1980.

In recent years, the Commission has become aware of some of the pitfalls of regulatory [**62] cost allocation as a regulatory tool. In CC Docket 79-245, the Commission revised the fully distributed cost methodology prescribed in Docket 18128. n23 In this decision, cost allocation procedures were simplified and the number of "service categories" was reduced. In CC Docket 79-246, the Commission has begun to recognize the inevitable problems which result when a carrier is given broad discretion in defining services and designing tariffs for such services. n24

n23 *Report and Order in CC. Docket No. 79-245, 84 FCC 2d 384, recon. denied,* 86 FCC 3d 667 (1981), *aff'd sub nom MCI Telecommunications Corp. v. FCC, 675 F.2d 408 (D.C. Cir. 1982).*

n24 *Private Line Rate Structure and Volume Discount Practices, 74 FCC 2d 226 (1979).*

From the Commission's experience with regulatory cost allocation in recent years, it is becoming increasingly apparent that the definition of "services" should closely track the underlying facilities used to transport and switch electronic information. Technical parameters rather than market segmentation strategies should provide the guiding principle for designing [**63] a tariff. In other words, the actual facilities used in providing a network service should drive the definition of the service. This principle implies that the pricing of the "rental services" of a telecommunications facility, either on a [*377] dedicated or demand basis, should be indifferent to both the *identity* of the user and the *purpose* of the user's traffic placed on the network, unless a clear causal relationship exists between the purpose of the communications traffic and network operating costs. Of course, certain overhead costs in addition to directly-attributable labor expense must still be assigned to a service defined in terms of actual facilities used to provide the service. However, a facilities-driven concept of a tariffed service should more closely approximate the relevant opportunity costs that a user will consider when choosing between the rental of common carrier telecommunications facilities or the building of private communications systems.

This approach to the tariffing of network services simply replicates the reality of the contemporary telecommunications industry. If a large telecommunications user decides to build its own private communications [**64] network, it does not build "switched network services" or "dedicated private line services." Rather, it buys switching and transmission *facilities* with given technical parameters. It is the capital cost of these facilities together with their operating and maintenance expenses that provide the baseline comparison between the tariffed "services" of a common carrier and the decision to deploy private bypass facilities. n25 If the tariffed service does not bear a close relationship to the underlying facility costs, then uneconomic bypass may be encouraged.

n25 It is important to emphasize that the difficult regulatory problem of allocating shared costs to various "services" is minimized if a facilities-orientation to regulatory cost allocation is adopted. After all, a large user which buys its own communications facilities will find few common costs to allocate among "services," since the notion of a "service" for its purposes becomes perfectly transparent, i.e., a regulatory fiction that may bear little relationship to the economic costs of the underlying network facilities.

Regulatory Cost Allocation and the Access Charge Plan. Despite some progress in recent years in [**65] recognizing and avoiding some of the pitfalls in the application of regulatory cost allocation, the Commission appears to have ignored this progress in its ACP. How the ACP prices the usage of access lines to the local exchange is especially troublesome in this respect. Rather than define access lines consistently in terms of the actual, physical facilities used to originate and terminate calls, the ACP defines categories of "access service" based on the kind of traffic and the identity of the user. lines," "dedicated access lines," or "special access" arrangements. Interexchange carriers, however, must access the local switch through "dedicated transport" access lines. In some instances, both end users and interexchange carriers will access local exchange plant using *identical* facilities and use such facilities the same way, e.g., line-side terminations on the local switch.

In effect, the Commission, not unlike a regulated carrier, has [*378] defined a group of "access services" in the ACP in order to implement a price discrimination scheme based *both* on the identity of the user and the intended use of the access service. For example, Part 69.303(a) of the ACP Rules requires [**66] that investment in station equipment included in Separations Category 2 (station equipment provided for private line services) be assigned to the "special access" rate element. However, if the identical voice-grade channel is provided as a "dedicated access line" or "common line," then Part 69.303(d) of the ACP Rules requires that any investment apportioned to interstate and foreign services as a surrogate for customer premises equipment (pursuant to the "Poponoe Plan") be allocated between dedicated access line and common line elements on the basis of the relative number of "equivalent lines" in use. If the same voice-grade channel is provided to an interexchange carrier as "dedicated transport," then no investment in station equipment is directly allocated to the dedicated transport rate element. Instead, transitional station equipment costs will be recovered from interexchange carriers through the usage-sensitive carrier's-carrier charge. Thus, the ACP as a regulatory cost allocation mechanism derives three different "costs" for the same voice-grade channel depending on the identity of the user and the purpose of network access.

Not only do the allocated costs of the same voice-grade [**67] channel differ by classification of access service, but also the pricing of the same facility differs from one type of access service to another. For example, after the costs of an end-user common line are jurisdictionally separated, the interstate allocation of costs will be recovered during the transition period by end-user flat rate and mover charges and the carrier's-carrier charge. If the same voice-grade channel is provided as dedicated transport to an interexchange carrier, the facility will be priced on a "per unit of capacity" basis with separate rate elements for interface and conditioning arrangements per Part 69.112 of the ACP Rules. If the same voice-grade channel is provided as special access, it is unclear how the facility will be priced, since Part 69.113 gives the exchange carrier considerable discretion in setting rates for this classification of access service.

The inefficient price discrimination embedded in the Commission's ACP is the inevitable consequence of four controversial assumptions, viz., the need to maintain the current mechanism for the jurisdictional allocation of NTS costs; the need to subsidize high cost telephone companies rather than consumers [**68] who may require subsidized access to telephone service to remain on the network at cost-based prices; the need to fund the subsidy of high cost telephone companies indirectly from end users through a carrier's-carrier charge rather than directly through a surcharge on end-user access lines; and the need to compensate for AT&T's competitive advantage as the major incumbent interexchange carrier. I question the validity of the first three assumptions, a position that I fully explain [*379] in my proposed alternative plan. I agree with the validity of the last assumption, but I believe the Commission's ACP does not adequately address this issue.

It is not surprising that the Commission's ACP prescribes discriminatory, non-cost-based rates for network access given the four underlying assumptions of the plan. Clearly, if one group of users of network access, viz., interexchange carriers, must be singled out for purposes of "regulatory taxation," then the criteria for discriminatory treatment must be unabiguous and easily enforceable. Since it will be difficult for an interexchange carrier to pass itself off as an ordinary business line customer, it should be easy to enforce the discriminatory [**69] rate classifications of end users and interexchange carriers. Moreover, so long as the Commission's ACP prices out the entire allocated cost of some facilities (e.g., interstate dedicated access lines) but only portions of others (e.g., the interstate portion of common lines), then separate but discriminatory classifications of access service must be maintained to preserve the economically-irrational jurisdictional separation of NTS local exchange costs.

This outcome is truly paradoxical. Rather than adopting a plan fully supportive of its MTS and WATS open entry policy established earlier in this proceeding, the Commission has instead adopted a plan more supportive of the status quo, including jurisdictional cross-subsidies and discriminatory, non-cost-based prices for network access. Equally paradoxically, the Commission's ACP embodies the very pitfalls of regulatory cost allocation that the Commission in other dockets has attempted to correct. I object to these inconsistencies and hope that the Commission will closely examine them on reconsideration of this decision.

The Transition to Equivalent Network Access. The FCC's open entry decision in this proceeding is necessary for [**70] competition in the MTS and WATS market but alone is not sufficient. Over the years, AT&T engineered its local exchange facilities and long haul network as an integrated whole. As a result, competing interexchange carriers have been unable to access local exchange facilities in the same way as AT&T Long Lines. The OCCs generally have accessed the local exchange via line-side terminations on the local switch rather than the trunk-side terminations provided to AT&T Long Lines. An essential aspect of the Modified Final Judgment (MFJ) is the provision that requires the divested Bell Operating Companies (BOCs) to make available "premium" access to all interexchange carriers, not just AT&T Long Lines, by the conclusion of a prescribed transition period. Once equivalent access is made available to all interexchange carriers, the sufficient condition for intercity transmission competition will be satisfied, and all interexchange carriers will be able to compete on an equivalent basis of local exchange interconnection.

[*380] Until equal interconnection is available to all interexchange carriers, AT&T Long Lines receives a competitive advantage by virtue of its incumbency as the former monopoly [**71] interexchange carrier. This advantage exists even though new digital switches may be able to provide trunk-side access features as cheaply as line-side access. From an economic perspective, however, the implicit demand for premium access has increased with the entry of the OCCs, although the short run supply of premium access as provided by the BOCs is essentially fixed. Thus, the "opportunity cost" of premium access has increased. Efficient pricing of premium access during this short run transitional pe-

riod requires that AT&T pay a "quasi-rent" per unit of premium access until the BOCs can increase the supply of premium access to accommodate more than a single intercity carrier. n26

n26 This point is more fully discussed in Jerry B. Duvall, "Telephone Rates and Rate Structures: A Regulatory Perspective," paper presented at the *Workshop on Local Access: Strategies for Public Policy,* St. Louis, Missouri, September 16, 1982.

There are two aspects of the transitional pricing of premium access, viz. the pricing of the actual trunk-side connection to the local switch and the high-capacity transport facilities (trunks) that carry AT&T Long Lines' traffic from its toll office to [**72] the local switch. In my view, the Commission's ACP deals inadequately with both aspects of the transitional pricing of premium access as received by AT&T Long Lines.

The conceptual approach in the Commission's ACP for pricing the actual trunk-side connection to the local switch is correct. The ACP realistically acknowledges the practical difficulties in estimating the opportunity cost of premium access as provided to AT&T Long Lines. Linking the amount of the premium access charge, however, to interstate CPE costs or surrogate CPE costs as specified in paragraph 165 of the order is both arbitrary and nonsensical. Given the practical impossibility of "auctioning" premium access to the highest bidder, a better approach would simply begin with the proposition that AT&T should pay a premium access charge such that an "appropriate" differential is maintained between the price of line-side and premium interconnection that reflects the short term scarcity value of the superior interconnection that the BOCs provide AT&T. How large should the "appropriate" differential be? A reasonable answer to me is that the amount of the *initial* premium access charge paid by AT&T should be sufficient [**73] to maintain the existing *percentage* differential between the ENFIA per minute charge (SEP amount) paid by the OCCs and the effective per minute charge paid by AT&T for premium interconnection through separations and settlement. This differential could then be phased down to zero as premium access becomes available to all interexchange carriers.

[*381] This approach to determining the amount of AT&T's premium access charge starts at the status quo and reflects a price differential that the Commission found to be in the public interest in its recent ENFIA decisions. Whether this differential accurately measures the quality differences between line-side and premium network interconnection is, of course, problematic. Nevertheless, I believe that the Commission, having found that competition in the MTS and WATS market is in the public interest, should err on the side of encouraging, *not* discouraging, entry. After all, new competitors enter the MTS and WATS market at their own risk and with private capital. Whether these entrants succeed or fail when the differential disappears following the transition period is a problem only for the competitors, not for a regulatory agency. [**74] The Commission's objective should be the support and maintenance of competition in the industry. As this competition develops, the Commission can begin to reduce and eventually eliminate the regulation of all participants in the MTS and WATS market and thereby reduce the social cost implied by such regulation.

By setting the initial amount of premium access at only $1.4 billion, the Commission's ACP adopts the view that the effective percentage differential paid by the OCCs and AT&T should narrow considerably effective January 1, 1984. n27 The ACP provides no rationale whatsoever for this important public policy decision, and I respectfully dissent from this part of the Commission's ACP.

n27 See "Separate Statement of Commissioner Mimi Weyforth Dawson re: MTS and WATS Market Structure," p. 12.

The transitional pricing of the high volume transport facilities used by AT&T Long Lines to terminate its traffic on the local switch raises a problem analogous to the pricing of premium interconnection. By virtue of its large share of all interexchange traffic resulting from its former status as the monopoly interexchange supplier, AT&T in most cases transports traffic from its toll offices [**75] to the local switch via direct, high-volume, dedicated trunks, rather than intervening tandem switches. Such trunks provide AT&T with substantial economies of scale in transporting traffic to end offices. Lacking AT&T's market share advantage derived solely from AT&T's former monopoly status, the OCCs cannot as yet efficiently utilize high capacity dedicated trunks and in many cases must use common trunk capacity with tandem switching for transporting traffic from the OCC's point of presence to the local switch. As a result, the unit cost of transport for an OCC is probably higher than for AT&T and consequently provides AT&T with a competitive advantage that is unrelated to any "survival test" in the MTS and WATS market.

The Modified Final Judgment explicitly recognized this transitional problem and mandated that the BOCs provide exchange access on an unbundled, tariffed basis that is "equal in type, quality, and [*382] price to that provided to

AT&T and its affiliates." The basic idea is to average the costs of transport over low and high capacity facilities to even out AT&T's cost advantage during the transition to equivalent interconnection and to give the BOCs an opportunity [**76] to reconfigure their exchange facilities to accommodate multiple interexchange carriers. The approach prescribed by the MFJ is certainly one way to deal with this transitional problem. I am not sure, however, that it is the best approach or whether the Department of Justice in fact has the authority to prescribe a pricing methodology for network access. In my opinion, this matter clearly falls within the purview of the Commission. Nevertheless, the problem is real, and the MFJ offers one possible solution.

As an alternative approach, the ACP Rules prescribing the computation of common and dedicated transport access charges could be amended to levy a "premium transport" charge on AT&T to reflect its competitive advantage during the transition to equivalent interconnection and reconfigured transport facilities. This approach would at least keep the rates for common and dedicated transport somewhat closer to cost for interexchange carriers other than AT&T in contrast to the MFJ approach where cost averaging insures that no transport rates will reflect costs for any interexchange carrier. Whatever the approach, it is not clear to me that the Commission's ACP adequately addresses this [**77] problem, especially if AT&T's current trunking capacity is defined by the ACP Rules in Part 69.112 as mostly "dedicated transport" while the OCCs' equivalent facilities are classified as mostly "common transport." The difficulty with assessing the significance of this particular problem is the lack of illustrative data in the decision that might have provided some sense of the quantitative impact of applying the Commission's ACP Rules. Lacking such data, it is impossible for me to evaluate the possible deleterious effect of this aspect of the ACP on competition in the MTS and WATS market. I believe, however, that this matter should be given a careful look by the Commission on reconsideration of the ACP decision.

The Effect of Surrogate Charges on Competition. During the phase-in period of end-user flat charges for network access, Part 69.206 of the ACP Rules prescribes that a surcharge be levied on all interexchange carriers that offer MTS, In-WATS, FX, CCSA or CCSA equivalent service as a surrogate for usage charges upon an end user that originates a collect MTS or In-WATS call or originates an FX, CCSA or CCSA-equivalent call at the open end. This rule will be costly to implement, [**78] will introduce needless temporary distortions in the pricing of private line services, and may have an anticompetitive effect.

It must be emphasized that this costly rule is needed only to compensate for a defect in the end-user mover charge mechanism. Rather than eliminate the mover charge mechanism and the [*383] inefficiencies it creates (as already discussed), the ACP prescribes yet *another* distortionary rule to "patch up" the defects of the first. Together, the end-user mover charge mechanism and the surrogate charge rule create pointless complexity and economic waste that could be completely avoided. These two aspects of the ACP alone provide a clear example of needless social cost induced solely by regulation.

As a result of the surrogate charge rule, the total user cost of using interstate private line services such as FX lines will now include *two* types of interstate usage-sensitive charges during the transition period, viz., the surrogate charge and the interexchange carrier's-carrier charge. Although the surrogate charge is only a temporary phenomenom, it is unfortunate that the only category of interstate transmission service that has been priced efficiently [**79] in terms of its rate structure will now be priced inefficiently.

Taken by itself, the temporary distortion in the pricing of private line service may appear inconsequential. The cumulative effect, however, of other distortions in the ACP on private line services may have a significant effect on their "allocated" cost. For example, an ordinary business (non-carrier) subscriber to FX service will access the local exchange via a dedicated access line. As noted previously, Part 69.303(c) of the ACP Rules allocates a pro rata share of station equipment costs to the dedicated access line rate element. These costs are in addition to the actual costs of the facility itself. Consequently, the ACP requires that this component of FX service depart from its economic cost. Part 69.206 requires that the interexchange carrier providing the interexchange portion of FX service, i.e., an interstate private line, be assessed a carrier's-carrier charge on all calls plus a surrogate charge for all calls to an FX subscriber that originate at an FX open end. Presumably, the interexchange carrier will recover the carrier's-carrier and surrogate charges from the FX subscriber, possibly on a usage basis. However [**80] the interexchange carrier chooses to recover its carrier's-carrier and surrogate charges, the FX subscriber will ultimately have to absorb not only these charges but also the costs associated with the billing of surrogate charges.

An interexchange carrier that subscribes to the *identical* FX facility just described (e.g., for use as part of its public switched service) will pay different "allocated" costs under the ACP. The carrier will access the local exchange via dedicated transport facilities as prescribed in Part 69.112 of the ACP Rules. This facility may be exactly the same facility used by the ordinary business customer. Nevertheless, the allocated costs of the facility will differ given the different regulatory cost allocation rules for the various categories of access service. Among other differences, no station equipment investment is directly assigned to the dedicated transport rate element. By virtue of its status as an interexchange carrier, the [*384] carrier will be subject to carrier's-carrier charges when using the leased FX facility in addition to any surrogate charges resulting from incoming open end FX usage. The effective cost of FX facilities to interexchange [**81] carriers is difficult to estimate, given the unknown effects of carrier's-carrier and surrogate charges. It seems clear, however, that the allocated costs of FX service will depart sharply from the economic costs of the underlying private line facilities. Thus, to achieve price "parity" or "equity" between interstate switched and private line services, the ACP has mandated substantial economic inefficiency for a transition period. Since telecommunications is both a final and intermediate good, the economic waste generated by such inefficient pricing will be incorporated into the pricing of virtually every good or service that requires telecommunications as an input to production and distribution. The conscious generation of such economic waste by a regulatory agency seems difficult to justify.

The ACP properly acknowledges in paragraphs 190 and 191 the technical problem that a local exchange carrier will have in measuring interstate usage of common lines for subscribers who use an OCC for their interstate long distance calling. n28 A local exchange carrier may find it very difficult to apply accurately the end-user mover charges for customers of interexchange carriers using ENFIA [**82] A line-side terminations to originate and terminate their long haul traffic. The ACP purports to deal with this problem by requiring all local exchange carriers to offer billing services to all interexchange carriers if they offer billing services to any. The ACP anticipates in paragraph 191 that the OCCs will in fact take advantage of this exchange carrier service that will make possible the accurate billing of end-user mover charges generated by OCC customers. As an alternative to having exchange carriers provide the OCCs with billing services, footnote 63 in the ACP allows exchange carriers to file waiver petitions to permit them to impose surrogate ENFIA A charges on the OCCs if the local exchange carrier can demonstrate that it is not otherwise feasible to collect the mover charges directly from end users who are OCC customers.

n28 The difficulties involved in assessing the end-user mover charge for local exchange subscribers that use an OCC for long distance calling are essentially the same as those difficulties involved in estimating the same charges for incoming calls on an FX open end.

Given the costs that a local exchange carrier would have to incur in order to monitor [**83] the interstate usage of common lines by OCC customers for just a transition period, two factors suggest that exercise of the waiver option by exchange carriers is highly probable. First, local exchange carriers may not want to invest in line measurement equipment that may have little value following the end of the transition period. Second, the OCCs may have a major incentive to do their own billing rather than have the local exchange [*385] carrier do it for them. It must be recognized that the BOCs will in many cases be competing with the OCCs for intraLATA toll business. It is not obvious that an OCC would eagerly turn over its traffic data to its major intraLATA competitor for billing purposes.

Moreover, the billing services provided by the local exchange carriers will be unregulated. Thus, the local exchange carriers through strategic pricing of their billing services will be able to discriminate between high and low volume interexchange carriers and consequently be able to influence the OCCs' internal tradeoff between cost-effective billing services and the value of not releasing sensitive billing data to potential or actual intraLATA competitors. n29 For example, the BOCs [**84] could price their billing services above the OCCs' stand-alone billing costs and thereby discourage the OCCs from using BOC-provided billing service. The BOCs could then seek a waiver per footnote 63 and impose a surcharge on the OCCs. The OCCs would then have to collect the surrogate charges from their customers. Once the costs of this billing complexity are passed on to OCC customers, the OCCs may be competitively disadvantaged vis a vis other interLATA carriers that have premium network access that provides less costly measurement of end-user mover charges triggered by interstate toll calling. It is possible that the combination of the initial reduction in the differential in price between line-side and premium access plus the surrogate charges on ENFIA A lines may be sufficient to eliminate almost entirely the difference in price paid by the OCCs and AT&T for network access. Whatever the net impact on competition, the ACP is completely silent concerning the potential competitive problems that collection of mover charges might imply.

n29 As local exchange carriers are increasingly subject to the threat of actual or potential entry of competitors that offer alternative local distribution services, the conduct of the incumbent exchange carriers will most likely resemble the strategic behavior of any dominant firm that desires to maintain its market position.

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Implications of Pooling and ACP Administration. As the previous discussion has shown, the Commission's ACP is not closely linked to the principle of cost causation. Consequently, the ACP introduces a new set of inefficient, discriminatory rates for network access that presumably will reduce the discriminatory rate differentials between interstate MTS/WATS and private line service. Various provisions of the ACP that establish procedures for implementing and administering the plan exacerbate the deviation from cost-based pricing and increase the possibility of collusive, anticompetitive conduct among exchange carriers.

The funding of the Universal Service Fund and the recovery of transitional "carrier common line" costs through a carrier's-carrier charge not only creates economic inefficiency in the pricing of network access but also requires mandatory pooling of certain rate [*386] elements of the carrier's-carrier charges. Of course, no pooling arrangement would be necessary for purposes of the USF if a "tax" were imposed on all access lines with the proceeds collected by the telephone company and forwarded to an existing local public body for direct distribution to qualified [**86] telephone subscribers requiring financial support. Part 69.105 of the ACP Rules prescribes a uniform, nationwide charge per conversation minute for all interexchange carriers to recover the carrier common line charges. Since the costs of local exchange service will differ from one study area to another and even from one wire center to another, some pooling arrangement is necessary. Again, if local carriers were permitted to "bill and keep" such transitional charges to fund the carrier common line revenue requirement specific to a given study area, no pooling would be required.

The ACP notes in paragraph 314 that pooling of carrier common line charges is necessary to mitigate in part the effects that unlimited rate deaveraging might produce. This concern is puzzling, since the end-user mover charge will effectively result in the deaveraging of the rates of interexchange carriers as a function of the end user's geographic location and volume of interstate calling. Since interexchange rates are effectively deaveraged anyway through operation of the transition plan, there seems little point in incurring both the direct costs of administering a pooling arrangement and the social costs [**87] of the inefficient pricing of network access through transitional and permanent carrier's-carrier charges.

Notwithstanding the needless out-of-pocket and social costs generated by pooling, the ACP prescribes additional access charge inefficiencies by placing a severe constraint on the extent of disaggregation that an exchange carrier may use in deriving the allocated costs for access rate elements that are not pooled. The ACP Rules currently prohibit access tariffs that are disaggregated within a study area. Such a restriction is arbitrary and represents yet another instance where the ACP will drive the price of network access away from cost. Administrative convenience for tariff review purposes seems the only logical rationale for such a restriction. As an alternative, the extent of cost disaggregation could be left to the discretion of the state PUCs. If access charge tariffs were filed with state PUCs rather than the FCC, the administrative burden on the FCC could be lightened and access tariffs could move closer to the actual costs of local exchange access at the discretion of the state PUCs.

Paragraphs 321 and 322 of the ACP also place further restrictions on the ability of local [**88] exchange carriers to move toward cost-based access tariffs for traffic-sensitive costs. Any carrier that is part of an extended area service (EAS) agreement with other local exchange carriers must reach agreement with all participating carriers before a separate tariff for the traffic-sensitive rate elements of the access [*387] tariff can be filed in lieu of the national common tariff. The necessity for such agreement among all EAS partners means that a high-cost EAS partner can effectively prevent a low-cost EAS partner from disaggregating its EAS costs and attempting to bring its traffic-sensitive access charge rate elements closer to cost for some portion of an extended service area. This restriction effectively nullifies any potential competition between EAS partners for providing access to interexchange carriers. Of course, the existence of EAS agreements complicates the design and administration of access tariffs. Such complexity, however, provides little justification for preventing competition among EAS partners for the access business of interexchange carriers. This restriction is both inefficient and anticompetitive in nature.

The Exchange Carrier Association (ECA) established [**89] by the Commission's ACP is necessitated by the pooling requirements of the plan. I object to the creation of the ECA and question the Commission's authority to mandate the existence of such an organization. As a matter of public policy, the ECA is unnecessary since pooling is unnecessary. Nevertheless, given the reality of the ECA, its organization and membership should not be an obstacle to the further competitive development of the telecommunications industry. I fear, however, that the ECA organization contemplated by the Commission's ACP will prove a hazard to telecommunications competition. Paragraph 345 of the ACP limits membership in the association to exchange carriers that participate in access charge revenue pools administered by the ECA. Moreover, the governing board will be composed exclusively of exchange carrier representatives.

It must be emphasized that the membership of the ECA will consist entirely of competitors in the market for network access, terminal equipment, and other communications services that will cross jurisdictional boundaries. Taking a narrow view of the extent of actual or potential competition among the membership, i.e., a view that perceives ECA [**90] members only as local monopoly suppliers of exchange access, completely overlooks the other dimensions of potential rivalry among the ECA membership. Thus, the ECA and the BOC central organization as prescribed by the MFJ will provide an opportunity for collusive behavior among local exchange carriers. This possible outcome is totally inconsistent with the Commission's general support of competition in the telecommunications industry.

Local Dial Switching Investment and the Rate of Return. Paragraphs 91 and 214 in the Commission's ACP prescribe the allocation of NTS central office equipment on a usage-sensitive basis. The explanation provided in footnote 75 to rationalize this departure from the *Separations Manual* is unpersuasive. The current Joint Board in CC Docket 80-286 may ultimately adopt this change in the classification of central office equipment. Until the Joint Board [*388] makes this determination, however, it is inappropriate for the ACP to prescribe this change. If the intent of the ACP is to minimize the amount of NTS investment to be recovered through end-user flat charges, the ACP should be candid on this point and not attempt to anticipate the findings [**91] of the Joint Board.

Paragraph 254 of the ACP prescribes the exchange carriers target their access tariffs to earn AT&T's authorized rate of return on its interstate services, presently set at 12.75%. This rate of return prescription may create an incentive for exchange carriers to bias the assignment of expenses and investment toward access services if the rate of return authorized by the ACP exceeds the allowed rate of return on intrastate plant set by individual state PUCs. This incentive may be especially acute in areas where bypass of the exchange carrier is not a significant short term threat. A rule that simply requires an exchange carrier to target its access tariffs to recover the same rate of return as its intrastate operations would have avoided this incentive to misallocate resources.

Universal Service. A further objection that I have to this order rests in its discussion of the "universal service objective" of the Communications Act. *Access Order,* paragraphs 80-84. Although I agree with my fellow Commissioners that we should consider the impact that our rate decisions may have on telephone subscribers and, if possible, avoid decisions that might result in a large [**92] number of disconnects, I fear that the discussion of "universal service" contained in this order goes too far. This order concludes that "universal service" is an objective of the Communications Act and implies that any FCC action that might cause telephone subscribership to drop below its current level would be contrary to the Act. I do not believe that this is what Congress intended.

Section I of the Communications Act directs the Commission to make service "available, so far as possible, . . . at reasonable charges." *47 U.S.C. 151.* Nothing in that language suggests that the Commission is restricted from making decisions that might cause a decrease in telephone subscribership, so long as service is "available" and the charges for that service are "reasonable." I fear that the discussion at paragraphs 80-84 of this order will encourage objectors to argue that the Commission has determined that any substantial change in rates for basic telephone service is contrary to the Communications Act. I believe that this is likely to make it more difficult for the Commission to maintain its competitive policies and enforce cost-based pricing. I therefore [**93] dissent from this portion of the order.

Conclusion. The Commission's ACP is a *reaction* to the emergence of competition in the telecommunications industry, not a forward-looking plan designed to accommodate new competitive entry into the industry consistent with the Commission's policy decision made earlier in this proceeding. Other than initiating the transition of [*389] interstate NTS local exchange costs toward end-user flat charges, the ACP seems otherwise firmly committed to supporting, even defending, the status quo. As a result, the ACP has a strong protectionist flavor. Under the guise of "universal service," the ACP seeks to protect local exchange carriers from the vagaries of rapid technological change and to preserve those regulatory practices that have successfully suppressed competition in the past and have permitted the pricing of telecommunications services that is little related to the economic costs of production. As a result, it is not suprising that the old industry "partnership" with its settlements procedures intact (paragraph 332) has resurfaced as the Exchange Carrier Association. Moreover, discriminatory rate structures, a prominent feature of telecommunications [**94] pricing since Theodore Vail, remain firmly in place. Even the shifting of interstate NTS local exchange costs from interstate switched services to local exchange carriers is largely justified in the ACP by the real and present threat of local exchange bypass, not the $1.6 billion potential improvement in consumer welfare that cost-based pricing of telecommunications services will bring to the American public. It is both curious and odd that a federal regulatory agency charged with the welfare of interstate ratepayers has adopted a plan that seems less concerned with promoting and protecting their interests than with safeguarding the economic viability of local telephone companies.

I think the Commission must begin to realize that it can no longer have it both ways, i.e., pro-competition on some policy issues while "business as usual," monopoly-world regulation on others. The recent action by the Joint Board in CC Docket 80-286 is a dramatic case in point. The four "principles" which the Joint Board majority approved, and I dissented from, ignore completely the reality of telecommunications competition by failing even to mention it and by stressing the importance of protecting telephone [**95] companies by the "permanent protection of universal service." The reality is that monopoly-type regulation is fundamentally inconsistent with competition in the telecommunications industry. Pretending otherwise by clinging to the past will benefit neither consumers nor the industry as telecommunications emerges as the foundation of the information economy. Courageous regulatory leadership that peers beyond the past and present is needed now to rationalize pricing in this vital sector of the American economy.

As I have attempted to show in some detail, many of the complexities of the Commission's ACP are wholly unnecessary and do not result from any unique complexities inherent in the pricing of network access. A far simpler but comprehensive plan keyed to the future of the industry rather than its past offers major advantages to consumers.

[*390] *The Pricing of Local Exchange Access: A Federalist Approach n30*

n30 The following discussion is based in substantial part on my paper entitled "Contemporary Issues in Telecommunications Pricing" presented at the *Ninth Annual Rate Symposium on Present and Future Pricing Issues in Electric, Gas, and Telecommunications Industries,* Kansas City, Missouri, February 7, 1983.

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My approach to the pricing of local exchange access is straightforward and administratively simple. Moreover, it reflects a modern view of the appropriate role of government intervention in monopoly markets, namely, assuring nondiscriminatory access to facilities that represent substantial "sunk cost" barriers to entry and *exit. n31* Clearly, local telephone facilities involve substantial sunk costs that make market entry by competing telephone companies exceedingly costly, even if such entry were lawful. Therefore, rules which prescribe the terms and conditions of access to local exchange facilities will promote efficient use of such facilities and will permit the further development of intercity transmission competition.

n31 See Elizabeth E. Bailey, "Contestability and the Design of Regulatory and Antitrust Policy," *American Economic Review* 71 (May 1981): 178-183. More generally, see William J. Baumol, John C. Panzar, and Robert D. Willig, *Contestable Markets and The Theory of Industry Structure* (New York: Harcourt Brace Jovanovich, Inc., 1982).

Federal Jurisdiction Over All NTS Costs. The first step in my access charge plan is the assertion of federal jurisdiction [**97] by the FCC over all non-traffic sensitive (NTS) and appropriate traffic-sensitive (TS) costs involved in accessing local exchange facilities for originating and terminating long haul traffic. It is time to accept and deal with the simple truth that an arbitrary allocation of NTS costs between the intrastate and interstate jurisdiction has no economic or technological reality. An access charge plan that maintains this legal dichotomy (and economic fiction) leads inevitably to at least three network access classifications, viz., "interstate toll access," "intrastate toll access," and "local service access." If the actual physical connection to the local exchange is a line-side termination, then the same, identical facility may be tariffed at three different rates under three different rate structures. Wholly arbitrary cost allocations are then necessary to implement "cost-based" pricing of such "service categories," since the defined services are regulatory actions -- they simply do not exist in a technological sense.

These arbitrary allocations create significant social cost since regulators have to exert a major effort to enforce the regulatory distinctions. Unless the rates and rate [**98] structures are nearly the same for each classification of access service, there is a strong incentive for interexchange carriers to arbitrage the differences in rates by configuring their networks to "look like" interstate or intrastate facilities depending on the relative price of interstate vs. intrastate access. Multipart, jurisdictional classification and pricing [*391] of local exchange access is, in reality, a scheme of price discrimination where the costs of local exchange access are apportioned and recovered in access tariffs on the basis of the *identity* of the class of users, i.e., local service end users, intrastate interexchange carriers, or interstate interexchange carriers. The cost allocations among these user classes must be arbitrary, since these access service categories are regulatory fictions and not based on cost causation.

This regulatory morass with its discriminatory rate structures, tariffing complexity, incentives for arbitrage, and regulatory enforcement costs can be completely avoided by assertion of federal jurisdiction by the FCC over all NTS and TS costs of local exchange access. I recognize that this proposal represents a significant change from [**99] current regulation and is likely to draw legal fire. I submit that the Commission can legally adopt this proposal, however, for the following reasons.

The FCC's authority to assert jurisdiction over access costs and require unified access tariffs derives from the Communications Act mandate that the Commission "make available . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges." *47 U.S.C. 151.* To fulfill this mandate, the Commission occasionally is required to reexamine and rethink existing regulatory policy to ensure that it is consistent with the statute's objectives. See generally, *Geller v. FCC, 10 F.2d 973 (D.C. Cir. 1979).* And, when it appears that changes in the industry warrant changes in the Commission's regulatory efforts, the Commission is empowered to make adjustments and thus "avoid the necessity of repetitive legislation." *National Association of Theatre Owners v. FCC, 420 F.2d 194 (D.C. Cir. 1969), cert. denied, 397 U.S. 922 (1970).* See also *General Telephone Co. of California v. FCC, 413 F.2d 390* [**100] (D.C. Cir.) *cert. denied 396 U.S. 888 (1969).* In fact, the Commission, with judicial approval, has radically altered much of its regulatory policy in recent years to accommodate the modern telecommunications environment. *E.g. Computer and Communications Industry Association v. FCC, 693 F.2d 198 (D.C. Cir. 1982), petitions for cert. filed,* U.S.L.W. -- U.S. February 9 and 10, 1983) (Nos. 82-1331 and 82-1352) *(Computer II).*

Unified treatment of access costs is both desirable and necessary in today's telecommunications environment. It will facilitate open entry into the industry and thus produce the public benefits that competition fosters. It will eliminate the need for arbitrary cost allocations and subsidy schemes that encourage uneconomic bypass of the network. And, it will conform regulation of access charges to the reality of the post-divestiture telecommunications industry structure. These goals cannot be accomplished if the current system of split regulation of access costs continues. So long as there is a pretense that there is a difference between interstate access and intrastate access and an arbitrary allocation [**101] of costs to accommodate [*392] that pretense, there will be an incentive for irrational regulation that is inimical to development of a rapid, efficient telecommunications system in which access charges are cost-based and non-discriminatory.

Challenges to the legality of my proposal are likely to center upon two main themes: first, that unification of access charges is contrary to the Supreme Court's decision in *Smith v. Illinois Bell Telephone Company, 282 U.S. 133 (1930);* and second, that unification under the federal jurisdiction works an impermissible preemption of state authority to set local rates. Neither argument is insurmountable.

With regard to *Smith,* it seems entirely reasonable to conclude that the Supreme Court's analysis in that case cannot prevent the FCC from finding that an arbitrary allocation of access costs between the interstate and intrastate jurisdictions is no longer consistent with the goals of the Communications Act. *Smith* was decided in 1930. This was before Congress created the FCC and gave it the "comprehensive mandate" with "expansive powers" that the courts have recognized for many years. See *National Broadcasting Co. v. FCC, 319 U.S. 190, 219 (1943).* [**102] See also *General Telephone of the Southwest v. FCC, 449 F.2d 846, 853 (5th Cir. 1971).* It also was before technological development eroded the foundations of the monopoly market structure that existed in 1930, making competitive entry into the interexchange market possible and viable. Finally, and perhaps most importantly, it was well before the announcement of AT&T's divestiture of the Bell Operating Companies, an event that will make the technical and economic distinction between local service and long distance service even clearer.

I submit that *Smith* need not be read as a Supreme Court order that costs associated with plant used for both interstate and intrastate service always must be divided between the two jurisdictions. Rather, I advocate a more limited reading of the case as a statement that, in an environment where monopolized end-to-end communications service and rate base regulation were the norm, a state rate prescription that failed to recognize federal jurisdiction over commonly used plant was unlawful. Viewed in this light, it is apparent that *Smith* is not a bar to the adoption of my proposal. n32

n32 The validity of this conclusion is not diminished by the fact that the FCC and the states have cited *Smith* as the basis for jurisdictional separations of access costs for many years. In situations such as this, where recently changed circumstances warrant rethinking of a regulatory approach, the Commission is not bound by its past practice so long as it recognizes that it is implementing a change and explains it. See *Greater Boston TV Corp. v. FCC, 444 F. 2d 841, 852 (D.C. Cir. 1970).* See also *Chisolm v. FCC, 538 F. 2d 345* (D.C. Cir.) *cert. denied, 429 U.S. 890 (1976),* FCC is not precluded from changing its mind as to the limits of its statutory authority. Nor is the validity of this conclusion diminished by the legislative history of Section 410(c) of the Communications Act. There, in the course of enacting legislation that codified state participation in the jurisdictional separations process, Congress recognized *Smith* and its influence on telecommunications regulation. I submit that a fair reading of this history does not evidence a legislative intent to enshrine *Smith* or the jurisdictional separations process, but solely an intent to ensure state participation in the process so long as it existed.

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[*393] The second likely argument against adoption of my proposal is that it would work an unwarranted interference with state ratemaking authority in violation of Section 2(b) of the Communications Act. n33 In assessing this argument, it is important to recognize the very limited degree of preemption inherent in my proposal. In effect, my proposal would remove certain NTS and TS costs from the intrastate rate base and make recovery of those costs subject to federal oversight necessary to maintain the effectiveness of our federal open entry policies. I do not propose that the Commission set the actual rates for access; this would be left to state discretion within federal guidelines.

n33 Section 2(b) was enacted in response to the Supreme Court's decision in the so called *Shreveport* case. *Houston, E. and W. Texas Ry. v. United States, 234 U.S. 342 (1914).* In that case, the Supreme Court held that the ICC could suspend rates set by a state regulatory agency in order to allow carriers to raise local rates to the level existing on similar federal routes. In enacting 2(b), Congress specifically indicated that it did not want the FCC to have such authority. See discussion *North Carolina Utilities Commission v. FCC, (NCUC I), 537 F.2d 782, 793* (4th Cir.), *cert. denied, 429 U.S. 1027 (1976); North Carolina Utilities Commission v. FCC, (NCUC II) 552 F. 2d 1036, 1047* (4th Cir.), *cert. denied, 434 U.S. 874 (1977).*

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Recent preemption caselaw indicates that this type of limited intrusion upon state ratemaking powers is permissible under 2(b). In *NCUC II,* for example, the Fourth Circuit Court of Appeals rejected an argument that the FCC's terminal equipment registration program (which facilitated customer ownership of such equipment, thus removing some of the costs of that equipment from the intrastate ratebase) was impermissible under 2(b) because it would reduce state ratemaking options. *552 F.2d at 1048.* The court concluded that the FCC's jurisdiction over jointly-used plant was primary, and thus, action intended to promote federal policy could impose limits upon state regulatory authority. *Id.*

Similarly, in its recent decision in *Computer II,* the D. C. Circuit rejected arguments that FCC ordered detariffing of all CPE (entirely removing those costs from the intrastate ratebase) violated 2(b). In that case, the Court indicated that so long as the Commission "has neither attempted to set rates for intrastate communications services or facilities nor asserted jurisdiction over matters of state concern because of intrastate discrimination against interstate [**105] business," its actions are not contrary to the purpose of 2(b). n34

n34 *693 F.2d at 216.* In fact, the FCC action that I propose is far less intrusive upon state ratemaking options than the decision to detariff CPE. In that situation, all CPE was removed from state rate regulation. Under my proposal, the states would retain significant ratemaking powers over access costs. See also *People of California v. FCC, 567 F.2d 84 (D.C. Cir. 1976) cert. denied, 434 U.S. 1010 (1978).*

Rate Structure Rules for Network Access Tariffs. I propose that [*394] the FCC prescribe general rate structure rules for recovering all NTS and TS costs involved in providing access to local exchange facilities. Such rules would grant state public utility commissions considerable discretion in setting rate *levels* for access tariff rate elements but impose general rules or "rate structure guidelines" for designing any network access tariffs. An example of such general rules would be the prohibition of inefficient price discrimination schemes based on arbitrary segmentations of customer groups. State PUCs would [**106] continue to review and approve a local carrier's revenue requirement and authorized rate of return on its rate base. The relevant rate base, however, would include all the costs associated with exchange access.

The FCC-prescribed rate structure rules would establish principles that local telephone companies must follow in designing "efficient rate structures," i.e., rate structures that track so far as possible the actual economic costs of exchange access and usage. Such guidelines might include self-selecting, two-part tariffs; nonlinear or "tapered" rate structures; premium flat rates; and other cost-based rate structures that would promote economically-efficient usage of local exchange facilities, facilitate nondiscriminatory access to local exchange plant by *all* users, and permit full recovery of all NTS and TS costs of local exchange access. n35 State PUCs would retain considerable discretion, however, in designing specific rate tapers or multi-part tariffs as prescribed by the FCC's general rate structure guidelines. Different *qualities* of local exchange access would be offered pursuant to tariffs which are separate but similar in structure to a generic "line-side" [**107] access tariff.

n35 Theoretical discussions of various rate structure options include Gerald R. Faulhaber and John C. Panzar, "Optimal Two-Part Tariffs With Self-Selection," Bell Laboratories *Economic Discussion Paper* #74, January 1977; K. W. S. Roberts, "Welfare Considerations of Nonlinear Pricing, *"Economic Journal* 84 (March 1979): 66-83, R. D. Willig, "Pareto-Superior Nonlinear Outlay Schedules," *Bell Journal of Economics* 9 (Spring 1978): 56-69, and Bridger M. Mitchell, "Alternative Measured-Service Structures for Local Telephone Service" in *Issues in Public-Utility Pricing and Regulation,* ed. Michael A. Crew (Lexington, Massachusetts: Lexington Books, D.C. Heath, 1980), pp. 107-123. A non-technical summary of some of the recent theoretical literature on efficient rate structures is provided by Duvall, "Telephone Rates and Rate Structures: A Regulatory Perspective."

Administratively, the access tariffs would be filed with the state PUCs, not the FCC. This procedure would not be burdensome, since a single tariff would replace many of the existing tariffs presently filed with state PUCs. The FCC would retain an oversight function and accept petitions that allege [**108] violations of the federal rate structure rules.

The assertion of federal jurisdiction over all costs of local exchange acces eliminates entirely the need to create artificial classifications of network access. All rate discrimination based solely [*395] on the class or identity of the user would be eliminated, since classifications of local exchange access drawn along arbitrary regulatory boundaries would no longer exist. For example, any telecommunications user accessing local exchange plant through "line-side" terminations at the central office would take such service pursuant to a uniform tariff. Thus, the current tariff classifications of residential, business, and interexchange carrier (ENFIA) would cease to exist. If such users subscribe to identical line-side access, they will be subject to the same tariff.

While this concept may appear revolutionary as applied to the pricing of telephone service that has traditionally reflected discriminatory, "value-of-service" pricing principles, it is, nonetheless, a commonplace reality in most unregulated markets. By analogy, this principle would bar a supermarket from attempting to segment its customers by sex and charging female customers [**109] one price for bread and males another. Since there is no cost difference in selling bread to males in comparison to females, such a personal price discrimination scheme -- if it could be enforced -- would be injurious to the sex forced to pay the higher price and would encourage an inefficient allocation of resources, i.e., the price of bread charged to the discriminated sex would not approximate marginal cost. Such an example of inefficient price discrimination seems almost ludicrous within the context of an unregulated market. But the long tradition of a similar type of inefficient price discrimination in the pricing of local exchange access -- business vs. residential local loop service -- has not been seen for what it is, i.e., a system of inefficient (possibly "unreasonable") price discrimination insofar as the customer classifications do not reflect significant cost differences.

The rate structure rules that I would propose would *not* prohibit price discrimination per se; only inefficient price discrimination based on the *identity* of the user would not be permitted. A tapered rate structure, for example, could include a "volume discount" such that high-volume users would [**110] pay a unit price just equal to the marginal cost of usage. At intermediate levels of usage, the unit price could be designed to exceed slightly the marginal cost of an additional minute, message, or other measure of telecommunications output. To prevent "unreasonable" volume-based price discrimination, my rules would ban any tariff restriction prohibiting resale or shared use. Of course, in a world where the transactions costs of arbitrage are zero, a volume-based price discrimination plan may be unsustainable; low and intermediate users could simply pool their network access requirements to take advantage of the high-volume discount. But organizing and managing an arbitrage arrangement *is* costly, so there does exist some flexibility to incorporate some volume discounts in the rate structure.

"Universal Service" as a State Responsibility. Permitting local telephone companies and state PUCs to include volume-based price [*396] discrimination in their local exchange access tariffs provides a source of revenue to finance below-cost network access for certain subscribers who might otherwise discontinue telephone subscribership if required to pay its full cost. This application [**111] of welfare-enhancing price discrimination could be combined with statewide pooling or rate averaging as appropriate to deal with the problem of "high cost" exchanges within a given state. n36 Subsidies *between* and *among* states, however, would be eliminated.

n36 Implementing jurisdictional subsidies through the separations mechanism typically focuses on subsidizing the *local exchange carrier* rather than the end user. However, the end user, not the carrier, is the proper target of public policy designed to maintain wide subscribership to telephone service. Neglecting this point may lead to protectionist policies toward local telephone companies rather than policies that will directly improve the economic welfare of end users.

The state PUCs could, at their option, require that the uniform rate structure include subsidized access to the local exchange. The state PUCs would accept, however, the responsibility for establishing eligibility criteria for telephone subscribers who should receive subsidized access. Such criteria (if any) would mirror the economic conditions and political importance of subsidized access in each individual state. Some states may place great [**112] emphasis on widely-available telephone subscribership while others may not. If either statewide pooling or welfare-enhancing price discrimination is inadequate to assure a high level of statewide telephone subscribership, then state legislatures should be encouraged to subsidize telephone service to targeted user groups that satisfy state-determined eligibility requirements. Moreover, each state PUC should develop its own transition plan found necessary to ameliorate only undesired rate impacts on consumers as the FCC-prescribed rate structure rules become effective. Some states will find that no transition plan is necessary and could implement the FCC rules with minimal impact on subscribers. As a general rule, I believe that the issue of subsidized access to the telephone network is ultimately a *local* issue and federal telecommunications policy should reflect this view.

A state-specific view of "universal service" may seem both radical and antithetical to the purpose of the Communications Act of 1934 ". . . to make available, so far as possible, to all the people of the United State a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate [**113] facilities at reasonable charges. . .," but I do not believe it is. As I noted earlier, the concept of universal telephone service is not a well-defined social or economic objective mandated by the Communications Act of 1934. The Communications Act directs only that telephone service be provided at "reasonable charges." In my view, reasonable charges simply means "reasonable cost." Nowhere does the Act state that reasonable charges should be interpreted to require that local network [*397] access be provided *below* cost to some network subscribers. While a "network externalities" argument can be made that suggests that the private cost of network access may exceed its social cost and, therefore, an access subsidy may be good social policy for encouraging subscribership to a *new* or *developing* network, it does not follow that this economic argument mandates that one telecommunications service, say, interstate MTS, must subsidize another. n37 Indeed, a strict application of this economic argument would require the levy of a non-distorting tax and subsidy from the federal treasury, since the economic distortions introduced by inefficient pricing of telecommunications services [**114] used to finance the subsidy may lead to other economic distortions that *exceed* the social value of the access externalities. n38 Given the existing high level of nationwide telephone subscribership, I feel confident that this is precisely the case today, i.e., the social cost of the pricing distortions in the intercity transmission market probably exceeds the social value of the externalities of local exchange subscribership provided below cost.

n37 A survey of some of the literature on the externalities of telephone service is provided by S. C. Littlechild, *Elements of Telecommunications Economics* (Stevenage, U.K.: Peter Peregrinus Ltd., 1979), Chapter 12.

n38 The National Telecommunications and Information Administration has estimated that telephone consumers in the aggregate would be better off economically by approximately $1.6 billion annually if local telephone rates fully recovered all NTS costs and MTS rates were permitted to fall following removal of local exchange NTS costs presently allocated to the interstate jurisdiction. See Comments of the National Telecommunications and Information Administration to the Federal-State Joint Board, CC Docket 80-286, Appendix D.

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While the Commission's ACP will begin to shift the source of local exchange subsidy from the price of interstate toll minutes to a carrier's-carrier charge, the concept of subsidized access to "high cost and rural areas" as a federal regulatory responsibility remains. I simply cannot accept the implicit logic of a regulatory policy that requires the ratepayers in New York state, for example, to subsidize telephone companies in Wyoming. Such federal regulatory policy is no different in my view from having the Federal Energy Regulatory Commission require electric power customers in Mississippi who enjoy relatively mild winters to subsidize the winter operating costs of electric power companies in Minnesota. If Congress, however, wants to provide *nationwide* subsidized access to the telephone network, it should do so explicitly and provide the necessary subsidy through general tax revenues. It should not simply impose a statutory requirement of subsidized network access to be funded by nationwide distortions in the pricing of telecommunications services.

Treating access to the telephone network as a state rather than federal regulatory responsibility would minimize and localize the [**116] distortions in network access pricing necessary to fund below-cost access. Both state regulators and the local telephone companies would be confronted with a binding constraint on the source of the [*398] subsidy, viz., the difference between price and cost for intermediate volume users of network access. This constraint will force state regulators to take a hard -- and perhaps uncomfortable -- look at precisely *who* should receive subsidized local exchange access and on what terms. For example, should both telephone access *and* usage be subsidized? Should users with multiple access lines receive subsidized access for *each* access line or only the first? Should both the rich as well as the poor have the right to subscribe to subsidized "lifeline" service? So long as the subsidy continues to flow from the Universal Service Fund as prescribed by the FCC and funded by all connecting intercity carriers (or, more precisely, their customers), there will be no incentive at the local level for reducing dependence on this source of subsidy or reducing the cost of local exchange service in "high cost" areas. Moreover, there will be little incentive to target the receipt of subsidized [**117] access to users that each state PUC, legislature, or other local political body might find deserving of financial support.

It must be emphasized that major beneficiaries and proponents of the universal service shibboleth have been the regulated, local franchise monopoly telephone companies. As rate base regulated entities, local telephone companies have had a powerful incentive to invest in telephone plant when given favorable treatment by state and federal regulators. Moreover, the long-standing industry practice of flat rate pricing of local telephone service has encouraged uneconomic usage of local telephone service; has encouraged the growth of rate base by requiring the building of new plant to meet peak demand accentuated by flat-rate tariffs; and has provided inaccurate price signals regarding the cost of using local exchange facilities. The mandate of universal service has provided local telephone companies with a convenient and, for all practical purposes, a compelling political argument supporting the current status of jurisdictional separations and local monopoly supply of telephone service.

It is not clear to me that the concept of nationwide universal service that thrived [**118] in a monopoly telecommunications world will continue to be in the self-interest of local telephone companies as growing competition undermines the jurisdictional subsidy mechanism and technological changes make alternative local distribution networks increasingly cost-effective. If the local telephone companies cease to be a major constituency and beneficiaries of the universal service doctrine, then the political basis of universal service as a federal responsibility may narrow considerably in the future. Approaching universal service as a state rather than federal responsibility may, therefore, be an inevitable consequence of advancing technology and economic forces at work in the telephone industry rather than a discretionary shift in the direction of telecommunications policy.

[*399] *Uneconomic Bypass of Local Exchange Facilities.* A major consequence of non-cost based rates for intercity switched transmission services is the powerful economic incentive for large users to avoid payment of telecommunications rates that exceed cost. Both advancing technology and the FCC's open entry policies have made it possible for new intercity carriers and large private users to bypass [**119] both AT&T's long haul network and, more recently, local exchange facilities as well. Uneconomic bypass of telecommunications facilities is an inevitable consequence of non-cost based pricing and poses a serious threat to the economic viability of some local exchange carriers.

The threat of uneconomic local exchange bypass is by definition a local, regional, or statewide problem. Not all local telephone companies in the nation are or will be subject to the same bypass probability. Given the localized nature of the problem, the local exchange carriers and their state PUCs are uniquely qualified to assess the likelihood of bypass in their own service areas. Consequently, the local exchange carriers and the state PUCs should accept the responsibility for balancing the goals of statewide universal service and the potential for state-specific uneconomic bypass of local exchange facilities.

Approaching the pricing of network access from a unified comprehensive perspective eliminates regulatory distinctions that cannot be sustained in a competitive environment, greatly simplifies the tariffing of network access, and recognizes the essential role of the states in resolving conflicting policy [**120] objectives. In short, my federalist approach recasts the problem of access charges as largely a state and local issue with the federal interest in interstate telecommunications competition protected by rate structure rules. Ultimately, both network subscribership and uneconomic bypass *are* a state and local concern, unlike the national defense which is clearly a federal responsibility. In my view, the federal interest can be maintained and protected by minimal federal intrusion in contrast to a complex web of rules that unnecessarily maintains a bifurcated jurisdictional responsibility for the pricing of network access.

APPENDIX:

APPENDIX A

Part 69 is added to Chapter I of Title 47 of the Code of Federal Regulations to read as follows:

Part 69. Access Charges

Subpart A: -- General

AUTHORITY: Secs. 4, 201, 202, 203, 205, 218, 403, 48 Stat. 1066, 1070, 1072, 1077, 1094, as amended, *47 U.S.C. 154,* 201, 202, 203, 205, 218, 403.

69.1. Application of access charges.

(a) This Part establishes rules for access charges for interstate or foreign access services provided by telephone companies on or after January 1, 1984.

(b) Charges for such access services shall be computed, assessed and collected and revenues from such charges shall [**123] be distributed as provided in this Part. Access service tariffs shall be filed and supported as provided under Part 61 of this chapter, except as modified herein.

69.2. Definitions.

For purposes of this Part:

(a) "Access Service" includes services and facilities provided for the origination or termination of any interstate or foreign telecommunication that is subject to regulation pursuant to Title II of the Communications Act or provided for the origination or termination of any interstate or foreign enhanced service that is exempt from tariff regulation pursuant to Subpart G of Part 64 of this chapter;

(b) "Annual revenue requirement" means the sum of the return component and the expense component;

(c) "Association" means the telephone company association described in Subpart G of this Part;

(d) "Big 4 Wage Factor" means that ratio of combined wage expense except building maintenance wage expense attributable to general office space in the following expense categories:

(1) Maintenance;

(2) Traffic;

(3) Commercial; and

(4) Revenue Accounting;

(e) "Buildings" includes investment that is described as building investment in the *Separations Manual;*

(f) "Carrier Outside Plant" or [**124] "Carrier OSP" means all outside plant that is not Customer OSP;

(g) "Central Office Equipment" or "COE" includes all equipment or facilities that are described as Central Office Equipment in the *Separations Manual;*

(h) "Commercial Expenses" includes all expenses that are described as Commercial Expenses in the *Separations Manual,* except for any expense incurred in computing, billing or collecting access charges which shall be deemed to be Revenue Accounting expense;

(i) "Current taxes" includes taxes other than property taxes that are actually accrued during the relevant period less credits attributable to past deferrals and does not include hypothetical taxes that are allowable expenses for ratemaking purposes or taxes assessed upon end users;

(j) "Customer Outside Plant" or "Customer OSP" means all lines or trunks on the customer side of a Class 5 or end office switch, including lines or trunks that do not terminate in such a switch, except lines or trunks that connect an interexchange carrier or enhanced service provider facility with such a switch;

(k) "Dedicated access line" means a WATS access line or a private line that does not terminate in customer premises equipment [**125] that is used exclusively for a particular interexchange service;

(1) "Direct Expense" means expenses that are attributable to a particular category of tangible investment described in Subpart D of this Part and includes:

(1) Maintenance;

(2) Depreciation and amortization;

(3) Rental payments for buildings, facilities or equipment; and

(4) Property taxes;

(m) "End user" means any customer of an interstate or foreign telecommunications service or enhanced service that is not a carrier or enhanced service provider except that a carrier other than a telephone company or an enhanced service provider shall be deemed to be an "end user" when such carrier or enhanced service provider uses a telecommunication service for administrative purposes and a person or entity that offers telecommunications services exclusively as a reseller shall be deemed to be an "end user" if all resale transmissions offered by such reseller originate on the premises of such reseller;

(n) "Entry switch" means the telephone company switch in which a dedicated transport line or trunk terminates;

(o) "Expense component" means the total expenses and income charges for an annual period that are attributable to a particular [**126] element or category;

(p) "Expenses" include allowable expenses in the 600 series of the Uniform System of Accounts apportioned to interstate or international services pursuant to the *Separations Manual* and allowable income charges apportioned to interstate and international services pursuant to the *Separations Manual;*

(q) "General Office Expenses" includes Executive (Account 661) expense, Treasury (Account 663) expense, Law (Account 664) expense, Other General (Account 665) expense and the portion of Accounting (Account 662) expense that is not Revenue Accounting expense;

(r) "Interexchange" or the "interexchange category" includes services or facilities provided as an integral part of an interstate or foreign telecommunications or an interstate or foreign enhanced service that is not described as "access service" for purposes of this Part;

(s) "License contract" means an agreement to reimburse an entity that is jointly owned by telephone companies or companies that own telephone companies or an entity that directly or indirectly controls or is controlled by, or is under direct or indirect control with, a telephone company, for services, facilities, patents or other know-how; [**127]

(t) "Line" or "trunk" includes transmission facilities such as microwave towers, satellites, earth stations, etc. as well as wire and cable;

(u) "Net investment" means allowable original cost investment in Accounts 100.1-100.4 and 122 that has been apportioned to interstate and foreign services pursuant to the *Separations Manual* from which depreciation, amortization and other reserves attributable to such investment that has been apportioned to interstate and foreign services pursuant to the *Separations Manual* have been subtracted and to which working capital that is attributable to interstate and foreign services has been added;

(v) "Origination" of a service that is switched in a Class 4 switch or an interexchange switch that performs an equivalent function ends when the transmission enters such switch and "termination" of such a service begins when the transmission leaves such a switch, except that:

(1) Switching in a Class 4 switch or transmission between Class 4 switches that is not deemed to be interexchange for purposes of the Modified Final Judgment entered August 24, 1982, in *United States v. Western Electric Co.,* D.C. Civil Action No. 82-0192, will be "origination" [**128] or "termination" for purposes of this Part, and;

(2) "Origination" and "termination" does not include the use of any part of a line, trunk or switch that is not owned or leased by a telephone company;

(w) "Origination" of any service other than a service that is switched in a Class 4 switch or a switch that performs an equivalent function ends and "termination" of any such service begins at a point of demarcation that corresponds with the point of demarcation that is used for a service that is switched in a Class 4 switch or a switch that performs an equivalent function;

(x) "Outside Plant" or "OSP" includes all equipment or facilities that are described as outside plant in the *Separations Manual;*

(y) "Private line" means a line that is used exclusively for an interexchange service other than MTS or WATS, including a line that is used at the closed end of an FX or CCSA service or any service that is substantially equivalent to a CCSA service;

(z) "Return component" means net investment attributable to a particular element or category multiplied by the authorized annual rate of return;

(aa) "Revenue Accounting Expenses" includes all expenses that are described as Revenue Accounting [**129] Expenses in the *Separations Manual* and expenses associated with the preparation of access charge tariffs and the distribution of access charge revenues;

(bb) "Station equipment" includes all equipment or facilities that are described as station equipment in the *Separations Manual* except station equipment that is used by telephone companies in their own operations;

(cc) "Telephone company" means a carrier that provides telephone exchange service as defined in Section 3(r) of the Communications Act of 1934;

(dd) "Traffic Expenses" includes all expenses that are described as traffic expenses in the *Separations Manual;*

(ee) "Unit of capacity" means the capability to transmit one conversation; and

(ff) "WATS access line" means a line or trunk that is used exclusively for WATS service.

69.3. Filing of access service tariffs.

(a) A tariff for access service shall be filed with this Commission for an annual period. Such tariffs shall be filed so as to provide a minimum of 90 days notice, with a scheduled effective date of January 1.

(b) The requirement imposed by paragraph (a) of this Section shall not preclude the filing of revisions to those annual tariffs that will become effective [**130] on dates other than January 1.

(c) Any access service tariff filing, the filing of any petitions for rejection, investigation or suspension and the filing of any responses to such petitions shall comply with the applicable rules of this Commission relating to tariff filings.

(d) The association shall file a tariff as agent for all telephone companies that participate in an association tariff.

(e) A telephone company or group of telephone companies may file a tariff that is not an association tariff. Such a tariff may cross-reference the association tariff for some access elements and include separately computed charges of such company or companies for other elements. Any such tariff must comply with the requirements hereinafter provided:

(1) Such a tariff must cross-reference association charges for the Carrier Common Line element or elements if such company or companies participate in the distribution of revenues from such elements;

(2) Such a tariff that cross-references an association charge for any end user access element or the transitional surcharge must cross-reference association charges for all end user access elements and the transitional surcharge;

(3) Such a tariff that [**131] cross-references an association charge for any carrier's carrier access element other than the Carrier Common Line element or elements and the transitional surcharge must cross-reference association charges for all carrier's carrier access charges other than the Carrier Common Line element or elements and the transitional surcharge;

(4) Any charge in such a tariff that is not an association charge must be computed to reflect the combined investment and expenses of all companies that participate in such a charge;

(5) A telephone company or companies that elect to file such a tariff for 1984 access charges shall notify AT&T on or before the 40th day after the release of the Commission order adopting this Part;

(6) A telephone company or companies that elect to file such a tariff for any year subsequent to 1984 shall notify the association not later than June 30 of the preceding year if such company or companies did not file such a tariff in such preceding year or cross-referenced association charges in such preceding year that will not be cross-referenced in the new tariff;

(7) Such a tariff shall not contain charges for any access elements that are disaggregated or deaveraged within [**132] a study area that is used for purposes of jurisdictional separations;

(8) Such a tariff for a company that provides extended area local exchange telephone service shall not establish any charge for a carrier's carrier access element that does not apply to the entire extended area; and

(9) Such a tariff shall not include a charge other than an association charge for an extended area that is served by two or more telephone companies without the concurrence of all telephone companies that serve such extended area.

69.4. Charges to be filed.

(a) The end user charges for access service filed with this Commission shall include charges for each of the following elements:

(1) Dedicated Access Line;

(2) Pay Telephone; and

(3) End User Common Line.

(b) Except as provided in Subpart C of this Part, the carrier's carrier charges for access service filed with this Commission shall include charges for each of the following elements:

(1) Carrier Common Line;

(2) Line Termination;

(3) Local Switching;

(4) Intercept;

(5) Information;

(6) Operator Assistance;

(7) Common Transport;

(8) Dedicated Transport; and

(9) Special Access.

(c) The carrier's carrier charges for carriers that offer a billing and [**133] collection or billing information service shall also include a Billing and Collection element.

Subpart B: Computation of Charges

69.101. General.

Except as provided in Subpart C of this Part, charges for each access element shall be computed and assesaed as provided in this Subpart.

69.102. Dedicated Access Line.

(a) A charge that is expressed in dollars and cents per line per month shall be assessed upon end users for each interstate or foreign dedicated access line.

(b) Such charge will be computed by dividing one-twelfth of the projected annual revenue requirement for the Dedicated Access Line element by the projected average number of interstate or foreign dedicated access lines in use during such annual period.

69.103. Pay Telephone.

(a) A charge that is expressed in dollars and cents per call shall be assessed upon end users for each interstate or foreign call that is placed from a pay telephone, except that collect or third number billing calls will not be assessed.

(b) Such charge shall be computed by dividing the projected annual revenue requirement for the Pay Telephone element by the projected annual number of calls that are subject to assessment.

69.104. End User Common [**134] Line.

(a) A charge that is expressed in dollars and cents per line per month shall be assessed upon end users that subscribe to local exchange telephone service. Such charge shall be assessed for each line between the premises of an end user and a Class 5 office that is or may be used for local exchange service transmissions.

(b) Charges to multi-line subscribers shall be computed by multiplying a single line rate by the number of lines used by such subscriber.

(c) Charges to party line subscribers shall be computed by dividing a single line rate by the number of users that share such line.

(d) The single line rate or charge shall be computed by dividing one-twelfth of the projected annual revenue requirement for the End User Common Line element by the projected average number of local exchange service subscriber lines in use during such annual period.

69.105. Carrier Common Line.

(a) A charge that is expressed in dollars and cents per conversation minute shall be assessed upon all interexchange carriers that use local exchange switching facilities for the provision of interstate or foreign telecommunications services.

(b) A per minute charge shall be computed by dividing the projected [**135] annual revenue requirement for the Carrier Common Line element by the projected annual conversation minutes for all interstate or international services that use local exchange switching facilities. Each minute of use of any local exchange switch by such services shall be counted for purposes of computing and assessing this charge.

69.106. Line Termination.

(a) A charge that is expressed in dollars and cents per conversation minute shall be assessed upon all interexchange carriers that use local exchange facilities for the provision of interstate or foreign telecommunications services.

(b) A per minute charge shall be computed by dividing the projected annual revenue requirement for the Line Termination element by the projected annual conversation minutes for all interstate or foreign services that use local exchange switching facilities. Each minute of use of any termination in a local exchange switch by such services shall be counted for purposes of computing and assessing this charge.

69.107. Local Switching.

(a) Charges that are expressed in dollars and cents per conversation minute shall be assessed upon all interexchange carriers that use local exchange switching facilities [**136] for the provision of interstate or foreign services.

(b) Separate charges shall be established for two categories of service. The first category, or LS 1, shall consist of local dial switching for services other than MTS or WATS that is provided through a line side termination in a Class 5 switch or through a termination in a local tandem switch. The second category, or LS 2, shall consist of local dial switching for MTS and WATS and local dial switching for a service other than MTS or WATS that is provided through a trunk side termination in a Class 5 switch.

(c) The projected annual revenue requirement for Local Switching shall be apportioned between LS 1 and LS 2 on the basis of weighted relative usage. LS 1 dial equipment minutes shall be counted as one. LS 2 dial equipment minutes shall be multiplied by the Toll Weighting Factor or TWF that is used for jurisdictional separations purposes to allocate investment in a particular type of switch.

(d) A per minute charge for the LS 1 category shall be computed by dividing the LS 1 portion of the annual revenue requirement by the projected annual LS 1 conversation minutes.

(e) A per minute charge for the LS 2 category shall be computed [**137] by dividing the LS 2 portion of the projected annual revenue requirement by the projected annual LS 2 conversation minutes.

(f) If end users of an interstate or foreign service that uses local switching facilities pay message unit charges for such calls in a particular exchange, a credit shall be deducted from the Local Switching element charges to such carrier for access service in such exchange. The per minute credit for each such exchange shall be multiplied by the monthly conversation minutes for such service to compute the monthly credit to such a carrier.

(g) If all local exchange subscribers in such exchange pay message unit charges, the per minute credit described in paragraph (f) of this Section shall be computed by dividing total message unit charges to all subscribers in a particular exchange in a representative month by the total minutes of use that were measured for purposes of computing message unit charges in such month.

(h) If some local exchange subscribers pay message unit charges and some do not, a per minute credit described in paragraph (f) of this Section shall be computed by multiplying a credit computed pursuant to paragraph (g) of this Section by a factor [**138] that is equal to total minutes measured in such month for purposes of computing message unit charges divided by the total local exchange minutes in such month.

69.108. Intercept.

(a) A charge that is expressed in dollars and cents per conversation minute shall be assessed upon all interexchange carriers that use local exchange facilities for the provision of interstate or foreign telecommunication services.

(b) A per minute charge shall be computed by dividing the projected annual revenue requirement for the Intercept element by the projected annual conversation minutes for all interstate or foreign services that use local exchange switching facilities.

69.109. Information.

(a) A charge shall be assessed upon all interexchange carriers that are connected to assistance boards through interexchange directory assistance trunks.

(b) If such connections are maintained exclusively by carriers that offer MTS, the projected annual revenue requirement for the Information element shall be divided by 12 to compute the monthly assessment to such carriers.

(c) If such connections are provided to additional carriers, charges shall be established that reflect the relative use of such directory assistance [**139] service by such interexchange carriers.

69.110. Operator Assistance.

(a) A charge shall be assessed upon all interexchange carriers that offer an operator-assisted service that uses local exchange switching facilities and uses the services of telephone company operators.

(b) If such service is provided exclusively to the carriers that offer MTS, the projected annual revenue requirement for the Operator Assistance element shall be divided by 12 to compute the monthly assessment to such carriers.

(c) If such a service is provided to additional carriers a charge that is expressed in dollars and cents per call shall be assessed upon each carrier that receives such a service.

(d) Such a per call charge shall be computed by dividing the projected annual revenue requirement for the Operator Assistance revenue requirement by the projected annual number of operator-assisted calls.

69.111. Common Transport.

(a) A charge that is expressed in dollars and cents per conversation minute shall be assessed upon all interexchange carriers that use switching or transmission facilities that are apportioned to the Common Transport element for purposes of apportioning net investment.

(b) The per minute [**140] charge shall be weighted by a distance factor that reflects the airline distance between the Class 5 or end office switch that serves an end user and the entry switch.

(c) Charges shall be designed to produce annual revenue that is equal to the projected annual revenue requirement for the Common Transport element.

69.112. Dedicated Transport.

(a) The projected annual revenue requirement for Dedicated Transport shall be divided into three parts. The revenue requirement shall be apportioned on the basis of relative net investment in the following investment categories:

(1) interface arrangements;

(2) voice grade transmission facilities; and

(3) conditioning arrangements.

(b) Appropriate subelements shall be established for the use of interface arrangements. Charges for such subelements shall be assessed and computed as follows:

(1) Such charges shall be assessed upon all interexchange carriers for the interface arrangements they use to provide interstate or foreign services;

(2) Charges for all such subelements shall be designed to produce total annual revenues that are equal to the portion of the projected annual revenue requirement for Dedicated Transport that has been apportioned [**141] to the interface arrangements subelements; and

(3) Charges for individual subelements shall be designed to reflect cost differences among such subelements in a manner that complies with applicable Commission rules or decisions.

(c) A charge for the use of voice grade transmission facilities shall be assessed upon interexchange carriers that use such facilities to provide interstate or foreign services. Such charges shall be expressed in dollars and cents per unit of capacity. Total units of capacity provided to an interexchange carrier shall be measured by ascertaining the number of conversations that could be transmitted simultaneously without producing blocking in the dedicated transport facilities. The capacity unit charge for carriers that offer MTS shall be weighted by a distance factor that reflects the airline distance between the entry switch and the interexchange facility. The capacity unit charge for other carriers shall be weighted by a distance factor that reflects the lesser or least of the airline distance between the entry switch and such carrier's interexchange facility or the airline distance between the entry switch and any interexchange facility of carriers that [**142] offer MTS that is located within 5 miles of such carrier's interexchange facility.

(d) Appropriate subelements shall be established for the use of conditioning arrangements. Charges for such subelements shall be assessed and computed as follows:

(1) Such charges shall be assessed upon all interexchange carriers that use conditioning arrangements in their provision of interstate or foreign services;

(2) Charges for all such subelements shall be designed to produce total annual revenues that are equal to the portion of the projected annual revenue requirement for Dedicated Transport that has been apportioned to the conditioning arrangements subelements; and

(3) Charges for individual subelements shall be designed to reflect cost differences among such subelements in a manner that complies with applicable Commission rules or decisions.

69.113. Special Access.

(a) Appropriate subelements shall be established for the use of equipment or facilities that are assigned to the Special Access element for purposes of apportioning net investment.

(b) Charges for all subelements shall be designed to produce total annual revenue that is equal to the projected annual revenue requirement for the Special [**143] Access element.

(c) Charges for an individual subelement shall be assessed upon all interexchange carriers or enhanced service providers that use the equipment or facilities that are included within such subelement.

(d) Charges for individual subelements shall be designed to reflect cost differences among subelements in a manner that complies with applicable Commission rules or decisions.

69.114. Billing and Collection.

(a) Billing and collection service shall be offered to all interexchange carriers if such a service is offered to any interexchange carrier. Charges shall be assessed upon all interexchange carriers that elect to use such services.

(b) Any difference in charges for such service or for a billing information service shall reasonably approximate cost differences in the service provided.

Subpart C: Computation of Transition Charges

69.201. General.

Notwithstanding sections 69.4, 69.104 and 69.105, charges for the access elements described in this subpart shall be computed in the manner described in this subpart for the period commencing January 1, 1984 and ending December 31, 1990.

69.202. End User Common Line charges.

(a) Common line charges shall consist of a minimum [**144] charge that is expressed in dollars and cents per line per month, a maximum charge that is expressed in dollars and cents per line per month, and a usage charge that is expressed in dollars and cents per conversation minute or dollars and cents per call. Except as provided for in Section 69.206, all End User Common Line charges shall be assessed upon end users.

(b) The transitional End User Common Line charges shall be computed as provided in Sections 69.203-69.205.

69.203. Minimum charges.

(a) A minimum charge shall be assessed upon each local exchange service subscriber that does not pay the maximum charge. A minimum charge may be established at any level that does not exceed the charge that would have been computed pursuant to section 69.104(d) for the year in question, provided that the minimum charge for a single line residential or party line subscriber shall not be less than $2 and the minimum charge for a single-line business local exchange service customer shall be not be less than $4 or more than 200% of the residential minimum charge.

(b) The minimum for a multi-line local exchange service subscriber shall be computed by multiplying the applicable single line rate by the [**145] number of local exchange subscriber lines such subscriber uses.

(c) For purposes of this section, a line shall be deemed to be a residential line if the subscriber pays a rate for such line that is described as a residential rate in the local exchange service tariff. All other lines shall be deemed to be business lines.

69.204. Usage charges.

(a) A usage charge shall be assessed for each originating conversation minute or originating call except originating minutes or calls for a collect MTS call, an In-WATS call or an open end FX, CCSA or CCSA equivalent call until the combined minimum and usage charges equal or exceed the maximum charge in a particular month. Third party billing calls shall be assessed to the line billed. Usage charges for a multiline local exchange service subscriber shall be attributed equally to each line for purposes of determining whether such a subscriber shall pay the maximum charge for any line in any month.

(b) The usage charge shall be computed by subtracting projected annual revenues from maximum and minimum charges and the surcharges described in Section 69.206 from the projected End User Common Line annual revenue requirement. That residual revenue [**146] requirement shall either be divided by the projected annual conversation minutes of end users that do not pay the maximum charge to compute a per minute charge or divided by the projected annual number of calls by such end users to compute a per call charge.

69.205. Maximum charges.

(a) A maximum charge may be established at any level that is not less than the charge that would have been computed pursuant to section 69.104(d) for the year in question, provided that the maximum shall not be more than the charges described in paragraph (b) of this section unless a charge described in paragraph (b) of this section is less than the applicable section 69.104(d) charge.

(b) The maximum for each transition year shall be as follows:

(1) 1984 -- the Dedicated Access Line per line rate;

(2) 1985 -- 90% of the 1985 Dedicated Access Line per line rate;

(3) 1986 -- 80% of the 1986 Dedicated Access Line per line rate;

(4) 1987 -- 60% of the 1987 Dedicated Access Line per line rate; and

(5) 1988-1990 -- 50% of the 1988 Dedicated Access Line per line rate.

69.206. Transitional surcharges.

(a) During the period that a usage charge is assessed upon end users, a surcharge shall be assessed upon interexchange [**147] carriers that offer MTS, In-WATS, FX, CCSA or CCSA equivalent service as a surrogate for usage charges upon an end user that originates a collect MTS call or originates an In-WATS call or an FX, CCSA or CCSA equivalent call that originates at the open end.

(b) If usage charges are assessed upon a per minute basis, the transitional surcharge shall be computed by multiplying the conversation minutes of such originating calls transmitted to a particular interexchange carrier by a per minute charge that is computed by multiplying the end user per minute usage charge by a factor that is equal to projected annual non-collect MTS conversation minutes of end users that do not pay maximum charges divided by total projected annual non-collect MTS conversation minutes.

(c) If usage charges are assessed upon a per call basis, the transitional surcharge shall be computed by multiplying such originating calls transmitted to a particular interexchange carrier by a per call charge that is computed by multiplying the end user per call usage charge by a factor that is equal to projected annual non-collect MTS calls of end users that do not pay maximum charges divided by total projected annual non-collect [**148] MTS calls.

69.207. Premium Access.

(a) Until the Commission determines that equivalent access arrangements are being offered to all interexchange carriers in all or almost all exchanges a portion of the Carrier Common Line revenue requirement shall be designated by Commission order as premium access. Such premium access shall be assessed to the carriers that offer MTS and WATS and shall be billed in equal monthly installments.

(b) In the absence of a Commission order designating the premium access portion, the premium access portion shall be equal to a projected annual revenue requirement for CPE other than Category 2 CPE or any surrogate for CPE costs that may be assigned to interstate and foreign services, but in no event shall premium access exceed the total annual Carrier Common Line revenue requirement.

69.208. Transitional Carrier Common Line.

Premium access revenues shall be deducted from the projected Carrier Common Line annual revenue requirement to determine the Transitional Carrier Common Line annual revenue requirement. Charges for the Transitional Carrier Common Line element shall be assessed and computed in the same manner as the post-transition Carrier Common Line element. [**149]

Subpart D: Apportionment of Net Investment

69.301. General.

(a) For purposes of computing annual revenue requirements for access elements net investment shall be apportioned among the interexchange category and access elements as provided in this subpart and expenses shall be apportioned as provided in Subpart E of this Part.

(b) The End User Common Line and Carrier Common Line elements shall be combined for purposes of this subpart and Subpart E of this Part. Those elements shall be described collectively as the Common Line element. The Common Line element revenue requirement shall be segregated in accordance with Subpart F of this Part.

69.302. Net investment.

(a) Investment in Accounts 100.1 and 122 shall be apportioned among the interexchange category and appropriate access elements as provided in Sections 69.303-69.309.

(b) Investment in Accounts 100.2-100.4 shall be apportioned in the following manner:

(1) COE investment shall be apportioned among the interexchange category and appropriate access elements in the same proportions as total Account 100.1 COE investment;

(2) OSP investment shall be apportioned among the interexchange category and appropriate access elements in [**150] the same proportions as total Account 100.1 OSP investment;

(3) Buildings investment shall be apportioned among the interexchange category and appropriate access elements in the same proportions as total Account 100.1 Buildings investment; and

(4) Investment that is not COE, OSP or Buildings investment shall be apportioned among the interexchange category and appropriate access elements in the same proportions as total Account 100.1 investment that is not COE, OSP or Buildings investment.

69.303. Station equipment.

(a) Investment in station equipment that is included in Separations Category 2 shall be assigned to the Special Access element.

(b) Investment in pay telephones and appurtenances shall be assigned to the Pay Telephone element.

(c) Investment in all other station equipment shall be apportioned between the Dedicated Access Line and Common Line elements on the basis of the relative number of equivalent lines in use. Each interstate or foreign dedicated access line shall be counted as one Dedicated Access Line. Local exchange subscriber lines shall be multiplied by the applicable interstate separations factor to determine the number of equivalent local exchange subscriber lines [**151] attributable to the Common Line element.

(d) Any investment that is apportioned to interstate and foreign services as a surrogate for customer premises equipment shall be apportioned between the Dedicated Access Line and Common Line elements in the same manner as investment apportioned pursuant to paragraph (c) of this section.

69.304. Customer OSP.

(a) Interstate and foreign private lines that are described as dedicated access lines in this Part shall be assigned to the Dedicated Access Line element. All other private lines shall be assigned to the Special Access element.

(b) Interstate WATS access lines shall be assigned to the Dedicated Access Line element. In the event that a portion of investment in interstate WATS access lines is allocated to intrastate services and a portion of intrastate WATS access lines is allocated to interstate services, the total unseparated investment in interstate WATS access lines that are described as dedicated access lines shall be assigned to the Dedicated Access Line element and investment apportioned to the Common Line element shall be adjusted to reflect the difference between unseparated interstate WATS access line investment and the WATS [**152] access line investment apportioned to interstate services pursuant to the *Separations Manual.*

(c) Investment in pay telephone lines shall be assigned to the Pay Telephone element.

(d) Investment in local exchange subscriber lines shall be assigned to the Common Line element.

(e) Investment in voice grade lines that are not in use shall be apportioned among the Dedicated Access Line, Pay Telephone, Common Line and Special Access elements on the basis of the relative number of equivalent voices grade lines in use. Each interstate or foreign dedicated access line shall be counted as one line. Pay telephone lines and local exchange subscriber lines shall be multiplied by the applicable interstate separations factor to determine the number of equivalent pay telephone or local exchange subscriber lines.

(f) Investment in unused lines that are not voice grade shall be assigned to the Special Access element.

69.305. Carrier OSP.

(a) Carrier OSP that is not used for "origination" or "termination" as defined in sections 69.2 (v) and 69.2 (w) shall be assigned to the interexchange category.

(b) Carrier OSP other than WATS access lines not assigned pursuant to paragraph (a) of this section [**153] that is used for interexchange services that use switching facilities that are also used for local exchange telephone service shall be apportioned between the Dedicated Transport and Common Transport elements. Such OSP shall be assigned to the Dedicated Transport element if it is used exclusively for the interexchange services of a particular carrier.

(c) All Carrier OSP that is not apportioned pursuant to paragraphs (a) and (b) of this section shall be assigned to the Special Access element.

69.306. Central office equipment.

(a) The *Separations Manual* categories shall be used for purposes of apportioning investment in such equipment except that any Central Office Equipment attributable to a Dedicated Transport subelement shall be assigned to the Dedicated Transport element.

(b) Category 1 COE (Manual Switchboards) shall be apportioned among the interexchange category and the Intercept, Information and Operator Assistance access elements. COE 1 of a telephone company that is not required to transfer assets pursuant to the Modified Final Judgment in *United States v. Western Electric Co.* shall be assigned to the interexchange category if such equipment would have been transferred [**154] to an interexchange carrier pursuant to that Modified Final Judgment. COE 1 that is used for intercept services shall be assigned to the Intercept element. COE 1 that is used for directory assistance service shall be assigned to the Information element. COE 1 that is not assigned to the interexchange category or the Intercept and Information elements shall be assigned to the Operator Assistance element.

(c) Category 2 COE (Tandem Switches) shall be assigned to the Common Transport element.

(d) Category 3 COE (lntertoll Dial Switching Equipment) that is deemed to be exchange equipment for purposes of the Modified Final Judgment in *United States v. Western Electric Co.* shall be assigned to the Common Transport element. All other COE 3 shall be assigned to the interexchange category.

(e) Category 4 COE (Automatic Message Recording Equipment) shall be assigned to the Billing and Collection element.

(f) Category 5 COE (Other Toll Dial Switching Equipment) that is deemed to be exchange equipment for purposes of the Modified Final Judgment in *United States v. Western Electric Co. shall be assigned to the Operator Assistance element. All other C* 5 shall be assigned to the interexchange [**155] category.

(g) Category 6 COE (Local Dial Switching) that is classified as non-traffic sensitive for purposes of jurisdictional separations shall be assigned to the Line Termination element except as provided in paragraph (a) of this section. COE 6 that is classified as traffic sensitive for jurisdictional separations purposes shall be assigned to the Local Switching element. In the event that any COE 6 is not used for local dial switching, such equipment shall be deemed to be Category 7 equipment for purposes of this Part.

(h) Category 7 COE (Special Services Switching) that is deemed to be exchange equipment for purposes of the Modified Final Judgment in *United States v. Western Electric Co.* shall be assigned to the Special Access element. All other COE 7 shall be assigned to the interexchange category.

(i) Category 8 COE (Circuit Equipment) shall be apportioned among the interexchange category and the Dedicated Access Line, Pay Telephone, Common Line, Dedicated Transport, Common Transport and Special Access elements. COE 8 shall be apportioned in the same proportions as the associated OSP except as provided in paragraph (a) of this Section.

69.307. Buildings.

(a) The *Separations* [**156] *Manual* space categories and subcategories shall be used for purposes of apportioning Buildings investment.

(b) Category 1A space investment (Manual Switchboard) shall be apportioned among the interexchange category and the Intercept, Information and Operator Assistance elements. Such investment shall be apportioned in the same proportions as COE 1 investment.

(c) Category 1B space investment (Circuit Equipment) shall be apportioned among the interexchange category and the Dedicated Access Line, Pay Telephone, Common Line, Dedicated Transport, Common Transport and Special Access elements. Such investment shall be apportioned in the same proportions as COE 8 investment.

(d) Category 1C space investment (Dial Switching) shall be apportioned among the interexchange category and the Line Termination, Local Switching, Operator Assistance, Common Transport and Special Access elements. Such investment shall be apportioned in the same proportions as combined investment in COE categories 2, 3, 5, 6 and 7.

(e) Category 2 space investment (Operator Quarters) and Category 3 space investment (General Traffic Supervision) shall be apportioned among the interexchange category and the Intercept, [**157] Information and Operator Assistance elements. Such investment shall be apportioned in the same proportions as COE 1 investment.

(f) Category 4 space investment (Commercial Office) shall be apportioned among the interexchange category and the Pay Telephone, Information and Billing and Collection elements. Such investment shall be apportioned in the same proportions as combined commercial expenses.

(g) Category 5 space investment (Used Interstate by Another Company) and Category 11 space investment (Constructed for Another Company for interstate use) shall be assigned to the interexchange category.

(h) Category 6 space investment (Revenue Accounting) shall be apportioned among the interexchange category and all access elements in the same proportions as combined revenue accounting expenses.

(i) Category 7 space investment (Garages and Storerooms) shall be apportioned among the interexchange category and the Dedicated Access Line, Pay Telephone, Common Line, Dedicated Transport, Common Transport and Special access elements. Such investment shall be apportioned in the same manner as combined OSP investment.

(j) Category 8 space investment (Rented to others) shall be assigned to the interexchange [**158] category.

(k) Category 9 space investment (General Office) shall be apportioned among the interexchange category and all access elements in the same proportions as combined General Office expenses.

(l) Category 10 space investment (Antenna Support) shall be apportioned among the interexchange category and the appropriate access elements in the same manner as the antenna supported.

69.308. Land.

(a) Investment in land other than storage space that is occupied by a building or buildings or a building or buildings under construction shall be apportioned among the interexchange category and the appropriate access elements in the same manner as the buildings on such land.

(b) Investment in parcels of land other than storage space that are contiguous with a parcel described in paragraph (a) of this section shall be apportioned in the same proportions as investment in such contiguous parcel.

(c) Investment in storage space shall be apportioned among the interexchange category and the Dedicated Access Line, Pay Telephone, Common Line, Dedicated Transport, Common Transport and Special Access elements. Such investment shall be apportioned in the same proportions as combined OSP investment. [**159]

(d) Investment in land that is not apportioned pursuant to paragraphs (a), (b) and (c) of this section shall be apportioned among the interexchange category and all access elements in the same proportions as the combined land investment that is apportioned pursuant to paragraphs (a), (b) and (c) of this section.

69.309. Other investment.

Investment that is not apportioned pursuant to Sections 69.303-69.305 shall be apportioned among the interexchange category and all access elements in the same proportions as the combined investment that is apportioned pursuant to Sections 69.303-69.305. Subpart E: Apportionment of Expenses

69.401. Direct expenses.

(a) Direct expense shall be assigned to the appropriate investment category and shall be apportioned among the interexchange category and appropriate access elements in the same proportions as the associated investment.

(b) Amortization of embedded inside wiring investment and installation of new inside wiring and any maintenance or depreciation expense that is apportioned to interstate and foreign services as a surrogate for CPE maintenance or depreciation shall be deemed to be associated with section 69.303(c) other station equipment [**160] investment for purposes of the apportionment described in paragraph (a) of this section.

69.402. Current taxes.

(a) State income taxes and state gross receipts or gross earnings taxes that are collected in lieu of a corporate income tax shall be apportioned among the interexchange category and all access elements in the same proportions as the combined Station Equipment, OSP, COE, Buildings and Land investment attributable to property that is located within the state that imposed the tax.

(b) Social Security taxes shall be apportioned among the interexchange category and all access elements in accordance with the Big 4 Wage Factor.

(c) All other current taxes including federal income taxes shall be apportioned among the interexchange category and all access elements in the same manner as Section 69.309 Other Investment.

69.403. Deferred tax expenses.

(a) Account 304 investment tax credits shall be assigned to the investment category that produced the tax credit. Credits from amortization of past investment tax credits shall be deducted from the balance for the relevant investment category. The net balance shall be apportioned among the interexchange category and appropriate access [**161] elements in the same proportions as the associated investment.

(b) Other deferred tax expenses, including Account 308.1 and 308.2 expenses and comparable expenses in Account 307, shall be assigned to the investment category that produced the hypothetical tax. Such expense shall be apportioned among the interexchange category and appropriate access elements in the same proportions as the associated investment.

69.404. Traffic expenses.

Traffic expenses shall be apportioned among the interexchange category and the Intercept, Information and Operation Assistance elements in the same proportions as COE 1 investment.

69.405. Commercial expenses.

(a) Sales, Advertising and Connecting Company Relations expenses (Accounts 642, 643 and 644) shall be assigned to the interexchange category.

(b) Local Commercial expenses (Account 645) shall be assigned to the Billing and Collection element.

(c) Public Telephone Commissions expense (Account 648) shall be assigned to the Pay Telephone element.

(d) Directory expenses (Account 649) shall be assigned to the Information element.

(e) All other Commercial Expenses shall be apportioned among the interexchange category and the Pay Telephone, Information [**162] and Billing and Collection elements in the same proportions as the combined expense apportioned pursuant to paragraphs (a)(d) of this section.

69.406. Revenue Accounting expenses.

(a) Revenue Accounting Expenses that are attributable to End User access billings shall be apportioned among the Dedicated Access Line, Pay Telephone and Common Line elements. Such expense shall be apportioned on the basis of relative investment other than revenue accounting space investment apportioned to each such element.

(b) Revenue Accounting Expenses that are attributable to carrier's carrier access billings shall be apportioned among all carrier's carrier access elements except the Common Line element. Such expenses shall be apportioned on the basis of relative investment other than revenue accounting space investment apportioned to each such element.

(c) All other Revenue Accounting Expenses shall be assigned to the Billing and Collection element.

69.407. General Office expenses.

(a) The portion of Account 665 expense that is attributable to engineering expenses shall be apportioned among the interexchange category and all access elements in the same proportions as the combined investment in Station [**163] Equipment, OSP and COE.

(b) All other General Office Expenses shall be apportioned among the interexchange category and all access elements in accordance with the Big 4 Wage Factor.

69.408. Relief and Pensions.

Relief and pensions expense shall be apportioned among the interexchange category and all access elements in accordance with the Big 4 Wage Factor.

69.409. License Contract expenses.

License contract expenses shall be assigned to expense categories in the same manner as expenses that are incurred directly by the telephone company and shall be apportioned in the same manner as such directly incurred expenses.

69.410. Other expenses.

Expenses that are not apportioned pursuant to Sections 69.401-69.409 shall be apportioned among the interexchange category and all access elements in the same manner as Section 69.309 Other Investment.

Subpart F: Segregation of Common Line Element Revenue Requirement

69.501. General.

(a) Any portion of the Common Line element annual revenue requirement that is attributable to the application of a jurisdictional separations factor that is described as a High Cost Factor or a Universal Service Factor shall be assigned to the Carrier Common Line element [**164] or elements.

(b) Any portion of the Common Line element annual revenue requirement that is attributable to CPE investment or expense or surrogate CPE investment or expense shall be assigned to the Carrier Common Line element or elements.

(c) Any portion of the Common Line element annual revenue requirement that is attributable to inside wiring investment or expense shall be assigned to the Carrier Common Line element or elements.

(d) Any portion of the Common Line element revenue requirement that is not assigned to Carrier Common Line elements pursuant to paragraphs (a), (b) and (c) of this section shall be apportioned between End User Common Line and Carrier Common Line pursuant to Sections 69.502 and 69.503. Such portion of the Common Line element annual revenue requirement shall be described as the base factor portion for purposes of this Subpart.

69.502. Base factor apportionment.

(a) The base factor portion shall be divided by the projected average number of subscriber local exchange lines in use during the relevant year in order to determine a base factor per line annual revenue requirement.

(b) If the base factor per line annual revenue requirement is $48 or less per year the [**165] base factor portion shall be assigned to the End User Common Line element.

(c) If the base factor per line revenue requirement is more than $48 per year.

(1) an amount that equals $48 multiplied by the projected average number of local exchange subscriber lines in use during the relevant year shall be assigned to the End User Common Line element; and

(2) the remainder of the base factor portion or transitional portion shall be apportioned in accordance with Section 69.503.

69.503. Apportionment of transitional portion.

(a) The transitional portion shall be assigned to the Carrier Common Line elements in 1984 access charges.

(b) In 1985 access charges 80% of the transitional portion shall be assigned to the Carrier Common Line elements. The residue shall be assigned to the End User Common Line element.

(c) In 1986 access charges 60% of the transitional portion shall be assigned to the Carrier Common Line elements. The residue shall be assigned to the End User Common Line element.

(d) In 1987 access charges 40% of the transitional portion shall be assigned to the Carrier Common Line elements. The residue shall be assigned to the End User Common Line element.

(e) In 1988 access charges [**166] 20% of the transitional portion shall be assigned to the Carrier Common Line elements. The residue shall be assigned to the End User Common Line element.

(g) The transitional portion shall be assigned to the End User Common Line element in access charges for 1989 and subsequent years.

Subpart G: Exchange Carrier Association

69.601. Exchange carrier association.

(a) An association shall be established in order to prepare and file access charge tariffs on behalf of all telephone companies that do not file separate tariffs or concur in a joint access tariff of another telephone company for all access elements.

(b) All telephone companies that participate in the distribution of Carrier Common Line revenues collected by the association shall be deemed to be members of such association.

69.602. Board of directors.

[reserved]

69.603. Association functions.

(a) The association shall not engage in any activity that is not related to the preparation of access charge tariffs or the collection and distribution of access charge revenues unless such additional activity is expressly authorized by order of the Commission.

(b) Participation in Commission or court proceedings relating to access charge [**167] tariffs, the billing and collection of access charges, or the distribution of access charge revenues shall be deemed to be authorized association activities.

69.604. Billing and collection of access charges.

(a) The association shall bill and collect all Carrier Common Line access charges including any premium access assessment.

(b) Telephone companies shall bill and collect all other End User or Carrier's Carrier access charges.

(c) All access charges shall be billed monthly.

69.605. Distribution of Carrier Common Line revenues.

(a) Carrier Common Line revenues received by the association shall be distributed monthly in accordance with this Subpart.

(b) Association expenses incurred during the month that are allowable access charge expenses shall be reimbursed before any other funds are disbursed.

(c) Except as provided in paragraph (b) of this section, payments to average schedule companies that are computed in accordance with Section 69.606 shall be disbursed before any other funds are disbursed. For purposes of this Part, a telephone company that was participating in average schedule settlements on December 1, 1982, shall be deemed to be an average schedule company except that: [**168]

(1) Any company that directly or indirectly controls, is directly or indirectly controlled by, is under direct or indirect control with, or merges with a telephone company that did not participate in average schedule settlements on December 1, 1982, shall not be deemed to be an average schedule company; and

(2) Any company that does not join in association tariffs for all access elements shall not be deemed to be an average schedule company.

(d) The residue shall be disbursed to telephone companies that are not average schedule companies in accordance with Sections 69.607-69.610.

69.606. Computation of average schedule company payments.

(a) Payments shall be made in accordance with a formula approved or modified by the Commission. Such formula shall be designed to produce disbursements to an average schedule company that simulate the disbursements that would be received pursuant to Section 69.607 by a company that is representative of average schedule companies.

(b) AT&T shall submit a proposed 1984 formula to the Commission on or before June 30, 1983. The association shall submit a proposed revision of the formula for each year after 1984 or certify that a majority of the directors [**169] of the association believe that no revisions are warranted for such year on or before June 30 of the preceding year.

69.607. Disbursement of Carrier Common Line residue.

(a) The association shall compute a monthly net balance for each member telephone company that is not an average schedule company. If such a company has a negative net balance, the association shall bill that amount to such company. If such a company has a positive net balance, the association shall disburse that amount to such company.

(b) The net balance for such a company shall be computed by multiplying a hypothetical net balance for such a company by a factor that is computed by dividing the Carrier Common Line residue by the sum of the hypothetical net balances for such companies.

(c) The hypothetical net balance for each company shall be the sum of the hypothetical net balances for each access element except the Billing and Collection element. All Carrier Common Line elements shall be deemed to be one element and all End User Common Line elements including transitional surcharges assessed to interexchange carriers shall be deemed to be one element for purposes of computing such hypothetical net balances. Such [**170] hypothetical net balances shall be computed in accordance with Sections 69.608-69.610.

69.608. Carrier Common Line hypothetical net balance.

The hypothetical net balance shall be equal to a Carrier Common Line revenue requirement for each such company that is computed in accordance with Subpart F of this Part.

69.609. End User Common Line hypothetical net balances.

(a) If the company does not participate in the association tariff for such element, the hypothetical net balance shall be zero.

(b) If the company does participate in the association tariff for such element, the hypothetical net balance shall be computed by multiplying an amount that is computed by deducting access revenues collected by such company for such element from an End User Common Line revenue requirement for such company that is computed in accordance with Subpart F of this Part by a factor that is computed by dividing access revenues collected by all such companies for such element by an End User Common Line revenue requirement for all such companies that is computed in accordance with Subpart F of this Part.

69.610. Other hypothetical net balances.

(a) The hypothetical net balance for an access element other [**171] than Billing and Collection or a Common Line element shall be computed as provided in this section.

(b) If the company does not participate in the association tariff for such element, the hypothetical net balance shall be zero.

(c) If the company does participate in the association tariff for such element, the hypothetical net balance shall be computed by deducting access revenues collected for such element from the sum of expense attributable to such element and the element residue apportioned to such company. The element residue shall be apportioned among such companies in the same proportions as the net investment attributable to such element.

(d) The element residue shall be computed by deducting expenses of all participating companies attributable to such element from revenues collected by all participating companies for such element.

Statement of FCC Commissioner James H. Quello

In Re: Report and Order in CC Docket No. 78-72, Phase 1, In the Matter of MTS and WATS Market Structure

To state that this was a difficult decision would be to carry the use of understatement to its extreme. The decision was difficult because of its complexity, to be sure, but it was made even more difficult [**172] because it is so far-reaching. It's difficult to imagine that any American will be untouched by the action the Commission has taken today. It would have been easy to resist taking any action at this time, merely postponing action until it was forced upon us. But delay would not serve the public, the telecommunications industry nor would it serve the Commission itself. The die was cast long ago and we are rapidly moving into a new era of telecommunications in this country and throughout the world. Moving toward competition and away from monopoly requires that the industry move toward cost-based pricing. Equal access to the network has been mandated by both this Commission and by the Court in its approval of the Modified Final Judgment. It is also mandated by competition and by technology. We cannot turn back the clock.

This decision was bounded by two very strong considerations. The first is the abiding concern of this Commission and the Congress that the concept of universal service not be sacrificed. In my mind, this is the overriding concern as we attempt to fashion a new rate structure. It bears very heavily upon our second constraint; i.e., the threat that the local exchange will [**173] be bypassed by large users. Bypass, while not widely understood and appreciated, provides perhaps a greater threat to universal service than do increased local rates of a magnitude far above those implied by our action today. For example, AT&T has claimed that 5 percent of its customers generate 63 percent of its revenues. By ignoring the threat of bypass, we could only encourage more and more of those large users to leave the local exchanges across the country leaving those exchanges with most of their present costs but without present revenues. Bypass is a phenomenon which feeds upon itself. As more large users leave the exchange, those which remain must bear a larger share of the costs, encouraging more bypass and even higher costs. Clearly, we do not want to encourage such a scenario.

The Report and Order, in my view, is a measured, carefully considered step along a path which will lead to an even better telecommunications service in the future without destroying what we must rely upon in the present. Is it a perfect approach to this very complex problem?

In the words of Voltaire: Perfection is attained by slow degrees; it requires the hand of time.

SEPARATE STATEMENT OF COMMISSIONER [**174] JOSEPH R. FOGARTY

In Re: MTS and WATS Market Structure, CC Docket No. 78-72, Phase I

The adoption by the Federal Communications Commission of this Access Charge Order is of historic importance. This decision marks the culmination of a long and tortuous inquiry into a proper access charge structure. n1 Because this Order prescribes the manner of compensation that all exchange carriers will receive for the origination and termination of all interstate and international telecommunications or enhanced service, every ratepayer in this country will be affected. In the first year alone, the access charge plan will require the restructuring of rates for 11 to 13 billion dollars in non-traffic sensitive (NTS) and traffic sensitive (TS) plant.

n1 *See MTS and WATS Market Structure, CC Docket No. 78-72, Notice of Inquiry and Proposed Rulemaking, 67 FCC 2d 757 (1978); Supplemental Notice of Inquiry and Proposed Rulemaking, 73 FCC 2d 222 (1979), Second Supplemental Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 224 (1980); Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980);* and *Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, 90 FCC 2d 135 (1982).*

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Given the magnitude of our decision, I believe that I am correct in asserting that the *MTS and WATS Market Structure* rulemaking is one of the most important proceedings which has come before the Commission during my tenure, if not during the entire history of the Commission. The issues before the Commission in Phase I were not only technically complex, but also raised several important and competing policy considerations. In adopting this access charge plan, the Commission has succeeded admirably in balancing these competing values. The Commission has resisted the Siren-song lure of theoretical purity, recognizing the reality of the need for reasonable rates and maintenance of universal service. In the process, we have developed a plan which advances the overall public interest and is the best solution that could be fashioned under the circumstances. I wholeheartedly support this decision.

Section 1 of the Communications Act mandates that this Commission regulate "so as to make available, so far as possible, to all the people of the United States a rapid, efficient. . . communications service with adequate facilities at reasonable charges." In my judgment, the most critical factor [**176] in this proceeding has been the need to structure an access charge plan which would protect this principle and value of universal service. While local exchange service is not so elastic as toll service, it certainly is not inelastic. n2 In the monopoly environment of the past, the FCC and the State commissions made deliberate compromises in favor of the immediate, pragmatic objective of universal service at the expense of more theoretical objectives, such as economic efficiency. The dilemma created by technological progress and competition is that such compromises have become increasingly difficult to forge, implement, and maintain. No longer are regulators free to increase the load of NTS costs on long distance users in order to keep local residential rates low. Technological advance now affords major toll users the option of bypassing the public network altogether to avoid uneconomic charges. This phenomenon of bypass, with its negative revenue consequences, must still be weighed, however, against the harm that the direct assignment of all NTS costs to end users might cause. Even though bypass would be discouraged, such a strategy of total direct assignment could result in an unacceptable [**177] loss in the subscriber base as rural users, the poor and the elderly would be put to a hard choice between essentials.

n2 *See generally,* Appendix G.

The access charge structure adopted by the Commission meets this concern by striking an appropriate balance between the need to encourage efficiency and the need to preserve universal service. Under this structure, uneconomic bypass should be discouraged while at the same time there should be no substantial service dislocations. Universal service in rural, high cost areas will be protected by the universal service factor element of the carrier common line charge. Similarly, service discontinuance by those too poor to absorb large rate increases will be discouraged by the implementation of a reasonable maximum end user charge based upon the anticipated Joint Board recommendation in Docket 80-286. n3

n3 The alternative of a government-sponsored "phone stamps" program is not viable. Among the many problems with such a plan are the fact that the program would be difficult to target and the fact that it would call for increased government expenditures at a time when such expenditures are not feasible.

In achieving this balance, [**178] the access charge plan affords both protection to ratepayers and flexibility to telephone companies. The transition period is structured so that the increase in the end user charge to its maximum cost will be gradual, starting with a $4 per month average revenue requirement. Heavy toll users will be protected by a cap on the amount that they may be charged for NTS costs. Telephone companies will be afforded the flexibility to determine how customer charges will be collected during the transition through a combination of usage and flat charges. As a consequence, those low-cost companies facing significant bypass problems and little threat of subscriber loss may move quickly to their full end user charge, while those companies with less significant bypass problems may move more slowly. In addition, the Exchange Carriers Association will allow companies the option to pool their costs in a manner somewhat reminiscent of current practice. This is crucial because for many small carriers developing and administering access charges would present an impossible burden.

Flexibility is also granted to the States as this decision permits them to recover intrastate NTS costs in any fashion they [**179] desire. This is important because the amount of NTS plant in the intrastate jurisdiction dwarfs the amount of interstate NTS plant. Further, the circumstances differ between the States, and it may be impossible to develop uniform Federal rules for the access charge treatment of intrastate NTS costs. n4 Leaving this discretion with the States will promote the regulatory flexibility and experimentation which has proved so beneficial in the past.

n4 We face a very different situation here on access charges than that which we recently confronted on depreciation policy. *See Amendment of Part 31,* on reconsideration, -- FCC 2d -- (1985).

Of even more importance is the fact that there will be a monitoring system, in place by January 1, 1984, designed to ensure that any unforeseen developments that threaten universal service are discovered in time for corrective action to be taken. This built-in flexibility is critical because of the uncertainties involved. In addition, the requirements of periodic staff reports to the Commission and further Commission action before continuing the plan beyond the fifth year will ensure the fulfilment of our statutory mandate.

In addition to striking [**180] a realistic balance between the new imperative of economic efficiency and the continuing mandate of universal service, this decision takes the long overdue step of ending what has been an intolerable discrimination between MTS/WATS and ENFIA. Under the rules we have adopted, the OCCs will finally pay the full cost of interconnection -- even during the transition. There will be no more discounts. Further, open-end Private Line and FX will also contribute fully for the first time to the recovery of common costs. This is only fair. For too long MTS and WATS ratepayers have been picking up costs which should have been borne by EFIA and open-end Private Line and FX users. n5 Although during transition AT&T will pay a premium access charge theoretically based on its superior interconnection, the differential will be smaller than the current ENFIA discount and will end at approximately the same time as the OCCs are afforded equal access under the divestiture decree. n6

n5 *See* Dissenting Statement of Commissioner Joseph R. Fogarty, *Extension of ENFIA Agreement, 90 FCC 2d 6, 20-21 (1982).*

n6 *See* Modified Final Judgment, *United States v. Western Electric Co.,* Civil Action No. 82-0192 (D.D.C., entered August 24, 1982).

[**181]

In conclusion, I believe that the Commission has succeeded in developing the best possible access charge plan -- a plan which carefully balances competing policy values and recognizes a continuing need for surveillance and possible adjustment in the public interest.

SEPARATE STATEMENT OF COMMISSIONER MIMI WEYFORTH DAWSON re: MTS AND WATS MARKET STRUCTURE

The Commission initiated this proceeding five years ago to determine whether the public interest requires that interstate toll telephone service (MTS/WATS) should be provided on a sole source basis, free from direct competition. *67 FCC 2d 757.* Of course, the Commission realized that, should competition be permitted, it would have "to determine what reimbursement interstate services should make to local operating companies for the use of local plant, on a cost causational basis; what additional charges, if any, should be levied on interstate services to support local exchange services; and whether and how these charges can be equitably imposed on all interstate services." *Id. at 759.* Having subsequently determined that unfettered competition will best serve the public interest, [**182] n1 the Commission must now decide these very difficult policy issues.

n1 *Report and Third Supplemental Notice of Inquiry and Proposed Rulemaking, 81 FCC 2d 177 (1980),* and Second Report and Order in CC Docket No. 78-72, FCC No. 82-515, released November 30, 1982.

The cornerstone of any Commission action, and this one is no exception, is Section 1 of the Communications Act, *47 U.S.C. 151.* Section 1 provides that the Commission shall "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 facilities at reasonable charges. . ." Lest there be any confusion arising from the Order that elimination of discrimination between services is the overriding objective of this decision, it is not. The objective of this proceeding is to promote efficient communications service with adequate facilities at reasonable charges.

Nonetheless, the Commission has met conflicting objectives in this proceeding because promoting efficient communication service through cost-based rates could jeopardize the availability of adequate [**183] facilities to many households. The Commission has approached this apparent conflict by asserting, for the first time, that promoting "universal service" is one of the purposes of the Act. The Commission reaches this finding because it believes a dimunition of universal telephone service would impede the Commission in meeting its Section 1 mandate to make communication service available to all people of the United States and to ensure that safety of life and property is promoted through such service.

I am troubled by this finding. At the outset, I wish to make it clear that promoting universal service may be a laudable goal in Docket No. 78-72. However, the Commission has based its statutory finding, which appears to be a novel interpretation of an Act that is almost fifty years old, upon an insufficient analysis of the Communications Act and its legislative history, and prior Commission and judicial pronouncements in this area. n2 I am therefore not prepared to find, based on the present record, that promoting universal service is an absolute goal of the Act. The Commission has also failed, in my estimation, to demonstrate any reason to establish universal service as a statutorily [**184] mandated goal which the Commission is obliged to meet. The purposes of Docket No. 78-72 could be achieved just as effectively, and without compromising other important goals, were the Commission simply to exercise its Section 1 authority.

n2 See, *e.g., Specialized Common Carrier Services, 31 FCC 2d 1106.* I am also not persuaded by the record in this proceeding that safety of life and property would be jeopardized absent universal service. Nor is it immediately obvious from my own experience that this would be the case. For example, at a recent Regional Hearing in Portland which I chaired, my staff asked the Secretary-Treasurer of the Southern Montana Telephone Company what she felt the effect of disconnects would be on the safety of life and property. She responded, "Probably would be none." Transcript from May 6, 1982, Portland Hearing (Docket No. 80-286) at 139. She explained that while large ranchers in Montana may choose to disconnect some of the main stations which they currently utilize on their property if rates increase, their telephone service would only be reduced thereby, not terminated.

This brings me to the source of my greatest concern [**185] over the universal service finding. It threatens to restrict, in this proceeding and in others, the flexibility the Commission retains and requires under its broad Section 1 mandate to achieve its overriding policy objective: the promotion of efficient service with adequate facilities at reasonable charges. I need only point out in this regard the conflict that may exist between a goal of universal service and efforts to encourage efficient service through increased competition. In pursuit of the latter policy, the Commission is now considering deregulating carriers which are non-dominant *(i.e.,* those which are constrained by the market from pricing their services above cost). n3 However, in high cost areas the cost-based rates of these carriers, that might otherwise be found to be non-dominant, could nonetheless be considered unaffordable to some customers. The universal service mandate could be interpreted in these circumstances as necessitating the continued regulation of these competitive carriers in order to avoid disconnects. n4 In sum, I believe that it is fully within the Commission's jurisdiction, and a valid communications policy, to promote universal service, provided [**186] it does not unduly infringe upon promoting efficient communication service at reasonable charges.

n3 See Further *Notice of Proposed Rulemaking (Competitive Carrier Rulemaking), 84 FCC 2d 445 (1981).*

n4 It is also unclear whether the statutory interpretation adopted in this order would impose on the Commission an obligation to ensure the development of universal service among new services, such as cellular radio and Digital Termination System (DTS).

Having said this, the question becomes what access charge structure will promote efficient communications service at reasonable charges. To begin that analysis, it is essential to realize that the Commission is dealing with the problem of deciding the appropriate price of access to local bottleneck facilities. Control of bottleneck facilities is present when a firm or group of firms has sufficient command over some essential commodity or facility in its industry or trade to be able to impede new entrants. n5 The Commission previously has determined that all exchange telephone operators control bottleneck facilities. n6

n5 See, *e.g.,* A.D. Neale, the Antitrust Laws of the United States of America: A Study of Competition Enforced by Law (1968).

n6 First Report and Order in *Competitive Carrier Rulemaking, 85 FCC 2d 1 (1980).*

[**187]

Given this setting, economic and legal precedent teaches us that cost-based rates would best serve to promote efficient service and thereby maximize consumer welfare. n7 Moreover, costs should be assigned to the cost causer in order for society to best utilize its resources. n8 Finally, cost-based access charges will serve to promote the optimal market structure for competition in both the interstate and international toll telecommunications markets.

n7 See *e.g.,* Alfred E. Kahn, The Economics of Regulation: Principles and Institutions (1970); and *Permian Basin Area Rate Cases, 390 U.S. 747 (1968).*

n8 See *e.g.,* J. Bonbright, Principles of Public Utilities Rates, 311-2 (1961).

In the telephone business, the revenue requirements for local exchange plant are divided between interstate and intrastate jurisdictions pursuant to the Commission's Separations Manual. Of course, this proceeding does not address the question of the appropriate jurisdictional separation of exchange plant. However, we at the Commission are extremely aware of the potential problems that may arise from disparate regulatory treatment of exchange access charges. n9 I personally [**188] am looking forward to reviewing the recommendations of the Joint Board, and the comments upon those recommendations, in the Commission's jurisdictional separations proceeding in Docket 80-286.

n9 One immediate problem resulting from disparate interstate and intrastate access charges is the reporting and identification of toll minutes as either interstate or intrastate. However, perhaps even more disturbing than disparate regulatory policies is the potential for exchange carriers to discriminate between intra-LATA transport charges to toll carriers and direct charges to its subscribers for completion of intra-LATA toll calls. Such a scenario will be possible unless a uniform, coordinated regulatory approach is adopted for allocating exchange telecommunications revenue requirements. One guiding rule that state and federal regulators must keep in mind is that the carrier's rate structure should be transparent to the identity of the traffic that is being transported.

The present proceeding, however, looks only to the allocation of costs which are attributed to the interstate jurisdiction. These costs include both traffic sensitive (i.e., variable) and non-traffic sensitive (i.e., [**189] fixed) costs. The fundamental finding of this Report and Order is that non-traffic sensitive (NTS) costs ultimately must be recovered on a flat basis and that traffic sensitive cost must be recovered on a usage basis -- with virtually all costs being recovered from the cost causers. n10 This approach promotes efficient communications services at reasonable prices. n11

n10 One relatively minor exception in the Commission's plan in this regard is that NTS central office equipment will be recovered on a usage basis. The Commission concludes that, because NTS central office equipment is not dedicated to particular subscribers, it should be collected on the basis of usage. This particular conclusion and its rationale, in my opinion, is inapposite.

n11 For a discussion of the appropriate pricing methodology for recovering fixed and variable costs, see, for example, J. Hirshleifer, Price Theory and Applications, p. 355 (1980).

Unfortunately, the present pricing structure does not follow this framework. Virtually all interstate costs, both traffic sensitive and non-traffic sensitive, are recovered on the basis of usage. n12 As such, the NTS costs are recovered inefficiently. I need [**190] not repeat here how such inefficiency can spur uneconomic bypass and hamper this economy's entry into the Information Age. However, in devising a plan to correct the current pricing anomalies, it is important to understand the magnitude of the problem we are dealing with. For example, in 1981, the annual interstate NTS revenue requirement was eight billion dollars, which is roughly equal to an average of $7 per access line per month.

n12 The rate structure for interstate private line services does not follow the industry norm, but rather currently appears to follow generally accepted economic principles.

In devising a plan to recover NTS costs on a flat basis, it is important to recognize that the Commission previously had addressed the regulatory treatment of both CPE and inside wiring in other proceedings. The interstate costs for CPE are smoothly being phased out over a five year transition pursuant to the Poponoe Plan. Therefore, it would be unnecessarily disruptive to impose these costs upon consumers in the form of flat subscriber charges because these flat charges would decrease as the costs were phased out. Similarly, in 1981 the Commission adopted a 10 year program for [**191] amortizing the capital costs associated with inside wiring. These costs essentially represent a one time expense as they are amortized, and therefore also will not be placed in a flat charge. With respect to the current expense attributable to inside wiring, the Commission must decide in Docket 79-105 whether to recoup these expenses on the basis of usage, switch to flat charges or deregulate entirely.

By excluding CPE and inside wiring from flat charge recovery, an average of only $4 per line per month in 1981 dollars must be recovered through flat charges. However, as depicted in Figure I, the distribution of costs on a study area basis is widely dispersed. n13 The numbers for some companies are so high as to suggest either a large number of disconnects if Mat charges are imposed to recover NTS costs, or, in the extreme, the telephone operations will cease to exist.

n13 Study areas generally coincide with state boundaries, with each individual company's costs being averaged or aggregated within the state. The estimates have been derived from data submitted in Docket No. 80-286. Observations have been reported for 506 study areas. In addition to these observations, there are roughly 800 average schedule companies that provide telephone service throughout the nation. However, the revenue requirements for these companies tend to be lower than average, and therefore the companies generally would not qualify for any subsidies.

[**192]

Figure I.

DISTRIBUTION OF FLAT CHARGES BY STUDY AREA

(Excludes CPE and inside wiring but includes pay telephones and central office equipment)

[SEE GRAPHIC IN ORIGINAL]

The Commission has addressed this problem by adopting a Universal Service Fund to provide support to high cost areas. The magnitude of this fund will be determined by the Commission in Docket 80-286. However, this decision finds that the Universal Service Fund should be supported by access charges that are assessed upon interexchange carriers.

One approach to the problem of ensuring that adequate facilities are available, so far as possible, is to provide a subsidy to offset the costs which are deemed too high to be recovered through flat charges. Figure II specifies an estimate of the annual surcharge required to subsidize consumers at various rate levels. For example, if all households were to receive a subsidy for any costs above $6, the annual cost to society would be only $250 million.

Figure II.

STATISTICS REGARDING SUBSIDIES FOR HIGH COST AREAS

(assumes subsidy of all costs above specified dollar amount)

(access lines costs are computed for each company with the data used in Figure I)

MAXIMUM ACCESS CHARGE	ANNUAL SUBSIDY REQUIREMENT	ESTIMATE OF MONTHLY SURCHARGE PER LINE

MAXIMUM ACCESS CHARGE	ANNUAL SUB-SIDY REQUIREMENT	ESTIMATE OF MONTHLY SUR-CHARGE PER LINE
$10.00	$ 63,500,000	$.06
9.00	70,000,000	.07
8.00	96,700,000	.08
7.00	152,000,000	.13
6.00	250,000,000	.22
5.00	410,000,000	.36
4.00	688,000,000	.60

[**193]

As mentioned, the Commission has decided to recover the Universal Service Fund through usage sensitive charges assessed upon long distance communications carriers. However, these funds could be allocated directly from subscribers through flat charges as shown in Column 3. This approach may promote the public interest because the elasticity of demand is much less for "dial-tone" than for toll service. Therefore, there will be less of an output distortion if the surcharge is placed in the flat charge. n14 Another rationale for a flat surcharge may be that it will be clearly visible to all subscribers, carriers and regulators. Hence, it will not be subject to any large unforeseen growth, which has been the case with SPF. Because the Commission, to my knowledge, has not received any comment on which approach would better serve the public interest, I would hope it would maintain an open mind on this subject in Docket 80-286.

n14 See, *e.g.,* R.A. Musgrave and P.B. Musgrave, Public Finance in Theory and Practice (1973).

The remainder of the Commission's access charge plan is exceedingly complex. Additionally, the particular transition plan adopted by the Commission to implement [**194] its cost-based policies has not received public comment. Therefore, I would like to highlight what might be a few problems with the plan so that the carriers and the general public can carefully examine whether it is both workable and equitable.

First, the plan reallocates on January 1, 1984, $4 per line per month from the existing charges to interstate carriers for MTS/WATS services to direct charges to telephone subscribers by exchange carriers. Of this $4 per line, minimum Mat charges of $2 to residences and $4 to businesses are mandated. The exchange carriers are given flexibility for recovering the $2 shortfall attributable to residential households (i.e., $4-$2). However, the business minimum charge cannot exceed 200% of the residential minimum charge, and no customer can be billed more than what the exchange carrier charges for dedicated facilities.

The major reason for this aspect of the plan is to give each carrier flexibility in recovering its NTS costs. Because economic circumstances vary throughout the country, the Commission believes that a standard nationwide plan would be appropriate. However, the flexibility afforded by the plan may turn out to be a double-edged sword. [**195] For example, the antitrust implications of an exchange carrier changing its pricing structure in the face of bypass are unclear. Similarly, it is unclear whether the $2 per line shortfall attributable to residential households can be accurately recovered in the first year due to unexpected shifts in demand caused by rate structure changes. For the most part, the Commission expects these costs to be recovered either on a price per call or a price per minute basis. However, the prices to large volume users will be capped at roughly $28 per line on average thereby requiring that revenues that are currently collected above the cap be recovered from another source. Since low volume users will make virtually no contribution, the bulk of the revenues will have to be derived from moderate users.

Another problem which highlights the difficulty the Commission will have in implementing its plan is that exchange carriers simply do not have the capability to determine which OCC customers have reached their maximum charge per line. Any attempt to rectify this problem will necessarily engender administrative and economic burdens. The Commission's discussion of having the exchange carriers either [**196] coordinate billing or establish surrogate charges for the OCCs only highlight the problems, but does not solve them.

The second major aspect of the plan is the method by which NTS costs are recovered from interstate services and carriers during the transition period. Currently, NTS costs are recovered from MTS/WATS services on a usage sensitive basis. AT&T pays about 7.2 cents per minute for premium interconnection and the OCCs pay about 3.3 cents per minute (at 4474 minutes per line) for standard line side interconnection. Private line services do not presently contribute to any common line NTS costs.

The Commission's access charge plan radically alters the relative NTS costs burden that these services share. Private line services that access the local exchange will, for the first time, contribute to NTS costs through a usage charge that is equivalent to that charged to MTS/WATS services. Additionally, the OCCs' contribution will be somewhat less than AT&T's because of the $1.4 billion premium access charge that is assessed to AT&T.

My greatest concern with this aspect of the Commission's access charge plan is that it leaps into the unknown. For example, we do not have any information [**197] on the effect that changing the cost allocation for private lines will have on individual subscribers' overall telephone bills. Placing a surcharge above costs upon private line users may prove to be highly inequitable to some consumers, especially in light of the fact that this surcharge will be phased out by the end of the transition. Moreover, any additional revenues that are generated may produce only very small decreases in MTS/WATS bills.

Perhaps even more troubling is the lack of analytical vigor employed by the Commission in developing the $1.4 billion premium access charge. Of course we are all aware that the correct answer to the problem of access for toll service providers is equivalent interconnection at equivalent cost-based prices. We also know that, as long as one carrier receives a premium interconnection, estimating the value or opportunity cost for that interconnection for purposes of allocating NTS costs among carriers will be highly speculative. Nevertheless, given that this proceeding was initiated to determine the appropriate "MTS and WATS Market Structure," it is crucial for the Commission to maintain a competitive environment that is suitable for new entry [**198] until equal interconnection is afforded to all.

Unfortunately, I cannot be certain that this is the case under the Commission's access charge plan. While the Commission believes that the $1.4 billion premium access charge is substantial, this charge in reality is only about $56 million because AT&T would pay about 96 percent of these costs if there were no price differential between AT&T and the OCCs. There are several ways to view the economic effect of the Commission's premium access charge plan. For example, the OCCs currently contribute roughly 60 percent less per minute than AT&T to NTS plant. Under the new access charge plan, when including an accurately billed usage charge in the end user common line rate structure, OCC customers (except for the larger customers who are "capped") will pay about 25 percent less per minute (35 percent for "capped" customers) than AT&T's MTS/WATS customers for NTS plant. Stated another way, the Commission's access charge plan will have the effect of more than doubling the OCCs' current ENFIA charges, while at the same time reducing the cost of access to AT&T.

What effect these changes will have on the market structure for MTS and WATS is unclear [**199] at this time. However, I am certain the Commission will carefully review any evidence which suggests that this part of the access charge plan will impede the development of competition in the interstate and international public switched voice markets.

In conclusion, the Commission has taken the extremely important step of bringing its costing methodologies in line with a competitive market structure. The access charge plan will promote efficient communications by adopting a cost-based approach for ratemaking, while at the same time provide subsidies to high cost areas that otherwise would be threatened with the loss of adequate facilities to many households. As such, the plan is fully in accord with the Communications Act. However, as described herein, there may be unknown problems with certain aspects of the transition plan. Because of the critical importance of this decision and its extraordinary complexity, the Commission, no doubt, will be asked to review several aspects of its decision. I will pay particular attention to those petitions that attempt to demonstrate that the transition plan is either unworkable or produces unnecessary transitional dislocations.

SEPARATE STATEMENT [**200] *OF COMMISSIONER HENRY M. RIVERA*

In re: MTS and WATS Market Structure, CC Docket No. 78-72, Phase I (Access Charge)

I write separately to emphasize my concern that any access charge plan assure that universal service is maintained. Being from a state with a low population density, I am especially mindful of how necessary telephone communications are to the health and well-being of rural America. I am delighted that the Commission apparently shares my concerns. n1

n1 The Commission has adopted a plan that recognizes that the national interest is best served if universal service is maintained. This plan accomplishes this objective by:

* the contemplated *monitoring* program and commitment to take corrective action and to undertake a formal *"revisitation"* of this proceeding to ensure immediate, appropriate modifications should any unanticipated disruptive or deteriorating effects upon the nationwide telecommunications system or upon the continued maintenance of universal service develop (paras. 124, 195-196, 366-367);

* the establishment of the *Universal Service Fund,* enabling high cost companies to maintain affordable local exchange rates that do not substantially exceed rates charged by other companies, and selective mandatory *pooling* requirements (and voluntary participation in common tariff and revenue pool arrangements) to assure continuation of universal service in rural America and other high cost areas (paras. 134-135, 308-338):

* the provision for waivers to allow *"life line"* service (paras. 136-137);

* our recognition of possible justified local *deviations* from a single national plan requiring all dedicated end user costs be recovered through flat and equal charges on all customers (para. 367);

* a *transition* with a smooth and gradual, yet flexible, pace to allow a more "comfortable" adjustment to the new economic realities (para. 172);

* the allowed rate structure *flexibility* for the exchange carrier to implement the transition in a manner, within reason, to fit its individual situation and requirements (paras. 132, 175, 182, 185); and

* the careful balancing of conflicting objectives including the elimination of unlawful discrimination and preferences, and the promotion of competition, network economic and engineering efficiencies and, importantly, universal service as mandated by Section 1 of the Communications Act (". . . to make available, so far as possible, to all the people of the United States a rapid efficient. Nation-wide . . . communications service with adequate [TEXT OMITTED BY PUBLISHER IN ORIGINAL SOURCE]

[**201]

No doubt should exist that the immediate, overriding policy concerns of the Commission for assurance of universal service and network preservation will set the future development and evolution of this plan.

SEPARATE STATEMENT OF COMMISSIONER STEPHEN A. SHARP

In the past, local telephone companies have been compensated in different ways when their plant has been used for the origination or termination of interstate or foreign communications. In general, local telephone companies receive the highest compensation when their plant is used in the provision of interstate MTS/WATS. The lowest rate of compensation is the so-called B-1 rate, which is the monthly rate, usually flat, that local telephone companies charge business customers for local exchange telephone service. Vast interstate private line networks have been created by connecting private lines to B-1 service in each area where the customer wishes to communicate; in some cases these networks rival the public switched telephone network in their coverage. Yet these networks pay only the B-1 rate for "access"; n1 in part because the B-1 rate is in most instances considerably cheaper than the rate for access that is bundled into [**202] the cost of a MTS/WATS call, n2 the same telephone call often costs the customer less on a private line network than it does under MTS/WATS.

n1 The term "access" is used henceforth to denote the use of a local telephone company's plant for the origination and termination of interstate and foreign communication.

n2 AT&T has estimated that the rate for access in an MTS/WATS call is approximately 7 cents per minute in each local exchange.

With the rise of competition, the other common carriers (OCCs) sought to utilize B-1 service for access. The established telephone industry naturally opposed this and sought to obtain compensation at the higher MTS/WATS rate. The result of this dispute was a compromise: the OCCs were charged the ENFIA rate for access, n3 which was higher than the B-1 rate but lower than that received by local telephone companies under MTS/WATS. n4

n3 As the Commission has recognized, ENFIA service is local exchange (i.e., B-1) service at a rate different from that on file with local jurisdictions for that service. *See AT&T, 89 FCC 2d 1000, 1001 n. 4 (1982).*

n4 *See ENFIA, 71 FCC 2d 440 (1979).*

The [**203] Commission seeks to resolve these rate disparities with a single federal access charge. While this is a laudable goal, I wish to point out that there are many services tariffed with the various states which can be and are being used for purposes of access. Some examples of these services are intrastate WATS and intrastate private line service. It is not always obvious or simple to determine whether these services, tariffed with the states, are in fact being used for interstate and foreign communications. And to the extent that these services are priced lower than the federal access charge, users will attempt to substitute the former for the latter. n5

n5 In page 20 of Appendix F of the order, for example, the Commission notes that in its 1981 Annual Report, Aeronautical Radio,Inc., a large user of communications services, stated that it had replaced federally tariffed private lines in its private line intercity network with cheaper private lines obtained under state tariffs.

If *all* rates including those tariffed with the states, were based upon the cost of providing the respective service, it would not be necessary to establish a federal access charge since users would be [**204] free to use *any* service, whether tariffed with this Commission or the states, for interstate or intrastate communications as they saw fit. Carriers would remain financially whole regardless of differences in the way the same service is *used.* There would be no incentives on the part of customers to substitute one service for another because of non-cost based rate disparities, and no need for either the Commission or the telephone companies to police the use to which various services were put in order to make the federal access charge workable. n6

n6 If were free to substitute other cheaper services for the federal access charge, they would have no incentive to obtain service under federal access tariffs. Under these circumstances, either the Commission or the telephone companies would have to police how substitutable services were being used in order to prevent avoidance of the federal access charge.

We know that local exchange service can be employed practically to interconnect any two points within that local calling area, including points at which access to interstate and intrastate toll can be obtained. In the long run, it appears neither reasonable nor practical to [**205] maintain differences in rates for the same service depending on the use to which local exchange service is put i.e., for interstate and foreign communication, intrastate toll communication, or local exchange communication.

It is true that different jurisdictions, in seeking to implement their own policies, may see fit to use different ratemaking approaches which can result in different charges for similar or identical products. From a practical point of view, however, as distinctions between jurisdictionally interstate and jurisdictionally intrastate communications become increasingly blurred and resale becomes more widespread, the desirability of cost-based local exchange rates for each local area will become increasingly apparent. In this way, users of telephone service will pay the same rates regardless of how they use their local service, thereby discouraging uneconomic bypass and eliminating opportunities for arbitrage based upon differing rates for the same service or services.

I hope that the Commission will keep this long term solution in mind when it revisits and reviews the progress in implementing access charges.

Legal Topics:

For related research and practice materials, see the following legal topics:
Communications LawFederal ActsCommunications ActTariffsCommunications LawTelephone ServicesLocal Exchange CarriersRatesCommunications LawTelephone ServicesLocal Exchange CarriersTariffs