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NOTE: An Erratum is attached to the end of this document.

Federal Communications Commission (F.C.C.)

Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry

IN THE MATTER OF ACCESS CHARGE REFORM PRICE CAP PERFORMANCE REVIEW FOR LOCAL EXCHANGE CARRIERS

CC Docket No. 96-262
CC Docket No. 94-1

Transport Rate Structure and Pricing

CC Docket No. 91-213

Usage of the Public Switched Network by Information Service and Internet Access Providers

CC Docket No. 96-263
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***21354** By the Commission:

***21357 I. INTRODUCTION**

A. Overview

1. In passing the Telecommunications Act of 1996 (1996 Act), [1] Congress sought to establish "a pro-competitive, de-regulatory national policy framework" for the United States telecommunications industry. [2] With this Notice, we commence the third in a trilogy of actions that collectively are intended to foster and accelerate the introduction of efficient competition in all telecommunications markets, pursuant to the mandate of the 1996 Act. In August 1996, as required by the 1996 Act, we adopted rules to implement Sections 251 and 252 of the Act, which establish the basic obligations of carriers, especially in the local exchange and exchange access markets. [3] In November 1996, pursuant to Section 254 of the Act, the Federal-State Universal Service Joint Board issued its recommendations to the Commission for reforming our system of universal service so that universal service is preserved and advanced, but in a manner that permits the local exchange and exchange access ***21358** markets to move from monopoly to competition. [4] In this proceeding, we seek to reform our system of interstate access charges to make it compatible with the competitive paradigm established by the 1996 Act and with state actions to open local networks to competition. [5]

2. The 1996 Act seeks to develop efficient competition by opening all telecommunications markets through a pro-competitive, deregulatory national policy framework. To that end, the 1996 Act eliminates state and local legal and regulatory barriers to entry, and bans state and local governmental actions that have the effect of prohibiting any entity from offering any telecommunications service. [6] The Act also requires all telecommunications carriers to interconnect directly or indirectly with other telecommunications carriers in order to facilitate the creation of a "network of networks." [7] In addition, the 1996 Act requires all local exchange carriers (LECs) to establish reciprocal compensation arrangements for the transport and termination of calls, [8] and prohibits incumbent LECs from charging more than the additional cost incurred to transport and terminate a call. [9] The Act further directs all LECs to provide number portability and dialing parity. [10] The 1996 Act confers three fundamental rights on potential competitors to incumbent LECs: the right to interconnect at rates based on cost, including a reasonable profit; the right to obtain unbundled network elements at cost-based rates; and the right to obtain an incumbent LEC's retail services at wholesale discounts in order to resell those services. [11]

3. The Act also directs the Commission, after receiving the recommendations of a Federal-State Joint Board, to define the services to be supported by federal universal service mechanisms, to support such services in a manner that is "explicit and sufficient," and to ensure that "every telecommunications carrier that provides interstate telecommunications ***21359** services shall contribute, on an equitable and non-discriminatory basis, to the specific, predictable and sufficient mechanisms ... to preserve and advance universal service." [12] The Act further provides that multiple carriers may seek and obtain designation as carriers eligible to receive universal service funds for service within a particular geographic area. [13] As a whole, these provisions of the 1996 Act, when fully implemented, should greatly reduce the legal, regulatory, economic, and operational barriers to entry in the local exchange and exchange access market.

4. The 1996 Act also ends the prohibition against provision of interLATA services [14] by Bell Operating Companies (BOCs) that was imposed by the Modification of Final Judgment. [15] BOCs were permitted immediately upon enactment of the 1996 Act to begin to provide certain interLATA services, including out-of-region and incidental interLATA services. In order to provide interLATA services originating in-region, however, a BOC is first required to obtain Commission approval. In order to approve such an application, the Commission must find that the BOC has met the requirements of the "competitive checklist," that the BOC will comply with the Act's separate affiliate requirements, and that grant of the application is consistent with the public interest, convenience and necessity. [16]

5. These fundamental changes in the structure and dynamics of the telecommunications industry wrought by the 1996 Act now necessitate that the Commission review its existing access charge regulations to ensure that they are compatible with the 1996 Act's far-reaching changes. We also seek to eliminate, either now or as soon as changes in the marketplace permit, any unnecessary regulatory requirements on incumbent LEC exchange access services. While a broad range of telecommunications industry participants, including both interexchange carriers (IXCs) and incumbent LECs, have long advocated for the Commission to commence a comprehensive review of access charges, the Act accelerates and intensifies the need for such a review. We commence this review of the Commission's Part 69 interstate access charge rules, together with its Part 61 price cap rules, to determine the ***21360** extent to which we must revise these rules to take account of the local competition and Bell entry provisions of the 1996 Act and state actions to open local networks to competition; to reflect the effects of potential and actual competition on incumbent LECs' pricing for interstate access; to implement the Act's direction to end implicit universal service subsidies in favor of a system of explicit subsidies; and to establish fair rules of competition for both the local exchange and interexchange markets, especially as carriers begin to offer service packages that bundle local and interexchange offerings.

6. We adopted our Part 69 rules at approximately the same time that AT&T divested its local exchange operations and established the seven regional Bell companies pursuant to the *MFJ*. The rules were designed to promote competition in the interstate, interexchange market by ensuring that all IXCs would be able to originate and terminate their traffic over incumbent LEC networks at just, reasonable, and non-discriminatory rates. While our Part 69 rules expressly contemplated competition in the

interexchange market, they were not designed to address the potential effects of competition in the local exchange and exchange access market. Indeed, these rules reflected the reality of the telecommunications marketplace in 1983 -- and what was mandated in some states prior to the 1996 Act -- that the incumbent LEC was the monopoly provider of local exchange and exchange access services. In adopting the Part 69 rules, the Commission did not seek to eliminate implicit support flows, but in fact incorporated such flows into the Part 69 rate structure. Our Part 69 rules are designed to be consistent with our jurisdictional separations rules that govern the allocation of incumbent LECs' expenses and investment between the interstate and state jurisdictions. [17] Consequently, the Part 69 access charge system likely reflects any jurisdictional cost misallocations mandated by our current separations rules. As such, the Part 69 rules are fundamentally inconsistent with the competitive market conditions that the 1996 Act attempts to create. We will soon begin a related proceeding to examine our jurisdictional separations rules in light of the 1996 Act.

7. Competition isolates and highlights the inefficiencies and distortions present in the current Part 69 access charge rules. Our present interstate access charge regime, for example, requires incumbent LECs to maintain rate structures that have been widely criticized as economically inefficient. In particular, even though the costs of the local loop do not vary with the amount of traffic carried by the loop, our current rules require incumbent LECs to recover a portion of those costs through traffic-sensitive carrier common line (CCL) charges imposed on IXCs. While Part 69 mandates per-minute charges for local switching, the portion of local switching costs that is associated with ports appears to be driven by the number of lines connected to the switch, not by the number of minutes of traffic routed by the switch. The transport interconnection charge (TIC) is a non-facilities-based, per-minute charge imposed on all switched access customers regardless of whether they use the incumbent LEC's transport facilities. Rather than fostering efficient pricing and competition, ***21361** these mandatory rate structures inflate usage charges and reduce charges for connection to the network, in essence overcharging high-volume end users in order to reduce rates for low-volume end users.

8. Although these inefficient rate structures might have been sustainable in a local monopoly environment, the introduction of competition from providers operating their own network facilities or leasing network facilities as unbundled network elements may undermine these access rate structures. A competing provider of exchange access services entering a market can use its own facilities or lease unbundled network elements to target selectively the incumbent LEC's high-volume end users with efficiently priced access service offerings. This places the incumbent LEC at a regulatorily-imposed disadvantage in competing for high-volume end users, and jeopardizes the source of revenue that permits the incumbent LEC to cover its costs of providing service to low-volume end users. At the same time, these inefficient rate structures and implicit support flows also create artificial impediments to any new entrants that might seek to serve the subsidized end users, because they must attempt to do so without the benefit of a subsidy. As a result, these access rate structures may inhibit the development of competition for service to low-volume end users.

9. Competition also allows entrants to arbitrage between different pricing systems. For example, if transport and termination rates are lower than access charge rates, a competitor would have an incentive to funnel interexchange terminating access traffic through transport and termination arrangements where possible. Whether traffic originates locally or from a distant exchange, transport and termination of traffic by a particular LEC involves the same network functions. Ultimately, the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance should converge. As a legal matter, however, transport and termination of local traffic by an incumbent LEC are different services from access service provided by that incumbent LEC for long-distance telecommunications. Transport and termination of local traffic are governed by 251(b)(5) and 252(d)(2), while access charges for interstate long-distance traffic are governed by sections 201 and 202 of the Act.

10. This Commission has previously examined the impact of state-led reforms in New York and Illinois on the existing access charge rate structures, and has concluded that some interim modifications to the incumbent LECs' rate structures were warranted where states had implemented market-opening measures similar to those mandated by the 1996 Act. The Commission concluded that competitive developments in the New York City, Chicago, and Grand Rapids LATAs justified granting NYNEX and Ameritech limited waivers of our access charge rules to allow them to recover the TIC on a geographically deaveraged basis and to ***21362** bulk bill some of their common line costs rather than recovering them through the per-minute CCL charge. [18]

11. In addition to their criticisms of the access charge rate structures, IXCs, in particular, have insisted that the rate levels of access charges are excessive and must be reduced. AT&T asserts, for instance, that the current average per-minute access rates of the BOCs are nearly seven times the forward-looking economic cost of providing that service, and that total interstate access charges collected today from interexchange carriers exceed forward-looking economic cost by $11 billion, or 70 percent of the total. [19] IXCs argue that, if access prices are allowed to remain at current levels, they will face an anticompetitive disadvantage both in the local exchange market and in the interexchange market whenever an incumbent LEC also provides interexchange services. [20]

12. In this item, we first adopt two initial steps toward reforming our system of access charges. In the sections that comprise the Third Report and Order in the Price Cap Performance Review for Local Exchange Carriers, we eliminate the lower service band indices, which unnecessarily restrict the ability of price cap LECs to lower their access prices. Under our existing rules a price cap LEC must specifically justify a proposal to lower its access charges below the pricing floors established by the indices. Thus, our rules currently discourage price cap LECs from lowering prices even when it would be economically efficient to do so. These rules also hamper a price cap LEC in responding to lower-priced access service offerings by competing access service providers. To encourage the development and prompt deployment of new switched access services, we also streamline the process for price cap LECs to offer such services.

13. In the Notice of Proposed Rulemaking portion of this item, we initiate a comprehensive review of our interstate access charge regime. We propose a series of reforms to the existing access charge rate structure rules that are designed to eliminate the inefficiencies summarized above. Our goal is to end up with access charge rate structures that a competitive market for access services would produce.

***21363** 14. We also outline in this item two possible approaches for addressing claims that existing access charge levels are excessive, for establishing a transition to access charges that more closely reflect economic costs, and for deregulating incumbent LEC exchange access services as competition develops in the local exchange and exchange access market. The first is a market-based approach under which we would rely on potential and actual competition from new facilities-based providers and entrants purchasing unbundled elements to drive prices for interstate access services toward economic cost. Under this approach, we would gradually relax and ultimately remove existing Part 69 rate structure requirements and Part 61 restrictions on rate level changes as marketplace forces provide the discipline on incumbent LEC access prices that our rules are currently needed to apply. The second is a more prescriptive approach to access reform under which this Commission would specify the nature and timing of the changes to the existing rate levels. These approaches could be employed singly or in combination. We emphasize, however, that under either approach, our ultimate goal is the same -- adoption of revisions to our access charge rules that will foster competition for these services and enable marketplace forces to eliminate the need for price regulation of these services.

15. Under the market-based approach to access reform, we propose two intermediate phases, each of which would require an incumbent LEC to demonstrate that certain circumstances exist in order to obtain greater pricing flexibility than the current rules permit. We also propose that an incumbent LEC's access services be deregulated, that is, removed from price cap and tariff regulation, once they are subject to substantial competition. At the first phase, an incumbent LEC would have to show that its local market has been opened to competition and potential rivals are able to enter through any of the three avenues mandated by the 1996 Act -- interconnection, unbundled network elements, and resale. We ask whether an incumbent LEC making such a showing should be permitted to deaverage geographically its rates for interstate access services, to offer volume and term discounts, and to offer contract-based tariff offerings for interstate access. We also ask whether new services should be deregulated at that phase. At the second phase in our market-based approach, an incumbent LEC would have to show that it faces actual competition in the local exchange marketplace. We ask whether, at that phase, we should eliminate service categories within baskets, permit incumbent LECs to engage in differential pricing of access to residential, single-line business, and multi-line business customers, and eliminate mandatory rate structures for local switching and transport. We also seek comment on combining the trunking and traffic-sensitive baskets at that stage.

16. A second option for access reform is a more prescriptive approach. Marketplace forces alone may not be sufficient to drive access rates to forward-looking economic costs. Under this approach, we ask whether we should require incumbent LECs to move prices for interstate access in their service areas to more economically-efficient levels pursuant to rules adopted in this proceeding. As with a market-based approach, we also propose under this ***21364** prescriptive approach that we remove incumbent LEC access services subject to substantial competition from price cap and tariff regulation.

17. In Section II, below, we seek comment on issues affecting the scope of this proceeding. In Section III, we propose changes to our existing interstate access charge rate structures to make them more conducive to economic efficiency. We also discuss in Section III the reassignment of certain network facilities costs that under current rules are allocated to the Transport Interconnection Charge for recovery. In Section IV, we summarize our two basic approaches to access reform and propose eliminating price cap and tariff regulation for services subject to substantial competition. We also there seek comment on whether and when one approach or the other is preferable, or if a combination of these approaches should be used, and also, how such a combined approach should be structured. In Section V, we discuss in detail a market-based approach to access reform. In Section VI, we outline a more prescriptive approach to access reform.

18. In Section VII, we first discuss adjustments to the current interstate access charge regime that may be required due to actions taken in the Federal-State Universal Service Joint Board proceeding. We also raise in that section the issue of whether there is a significant difference between embedded incumbent LEC costs currently allocated to the interstate jurisdiction and recovered through access charges, and the forward-looking economic costs of interstate access. To the extent that implementation of access charge reform is expected to cause a significant reduction in incumbent LEC access revenues from current levels, we seek comment on whether such LECs are entitled or should be permitted to recover some or all of that difference through a temporary special recovery mechanism.

19. In Section VIII, we seek comment on possible additional changes to our access charge rules that may be necessary to make them compatible with the competitive market envisioned by the 1996 Act, including whether there is any special need for regulating terminating interstate access service and "open-end" services, whether provided by incumbent LECs or new entrants. We also discuss possible changes to our existing treatment of the use by interstate information service providers, such as Internet service providers, of incumbent LEC switched access networks to originate interstate traffic. In Section IX, we issue a Report and Order implementing the changes to the LEC price cap rules discussed above that were proposed in the *Price Cap Second FNPRM.* [21]

***21365** 20. Finally, in Section X, we issue a Notice of Inquiry to examine fundamental issues about the implications of usage of the public switched network by information service and Internet access providers.

B. Background

1. Regulation of Interstate Exchange Access Service

21. For much of this century, most telephone subscribers obtained both local and long distance services from the same company, the pre-divestiture, integrated Bell System, owned and operated by AT&T. Although some telephone subscribers received local telephone service from non-Bell independent companies, AT&T still provided long distance service to these customers. AT&T compensated its Bell Operating Company subsidiaries for originating and terminating interstate calls through revenue division arrangements and compensated the independent companies for access pursuant to settlement agreements. In the 1970s, MCI and other IXCs (then called "other common carriers," or OCCs) began to provide switched long distance services in competition with AT&T Long Lines by attaching their own switches to local business lines purchased from the incumbent LECs and reselling AT&T services. [22] In 1979, AT&T and the OCCs, under Commission supervision, entered into a comprehensive interim agreement, known as Exchange Network Facilities for Interstate Access (ENFIA), to replace the local business rates with a different set of rates AT&T would charge OCCs for originating and terminating interstate traffic over the facilities of its local exchange affiliates. [23] AT&T Long Lines continued to compensate its local exchange affiliates and the independent

exchange carriers for the use of their facilities pursuant to their division of revenues and settlements arrangements. Following a lengthy proceeding, the Commission in 1983 adopted uniform access charge rules that govern the provision of interstate access services by all incumbent LECs, BOCs as well as independents. [24]

22. The costs that incumbent LECs recover through interstate access charges are determined by a multi-step process. Incumbent LECs first record all their booked expenses and their cost of investment in the accounts prescribed by the Commission's Part 32 Uniform ***21366** System of Accounts (USOA). [25] They next divide the recorded investment and expenses between regulated and nonregulated services, pursuant to Part 64 of our Rules. Incumbent LECs then divide regulated expenses and investment between state and interstate jurisdictions pursuant to the separations procedures contained in Part 36 of the Commission's rules. [26] Incumbent LECs then apportion their regulated interstate costs among the interstate access and interexchange service categories. Finally, to recover their access costs, incumbent LECs charge IXCs and end users for access services in accordance with the Part 69 access charge rules and, for incumbent LECs under price cap regulation, with the provisions of the Part 61 price cap rules.

23. Commentators have pointed out that, because each of these divisions of costs occurs pursuant to regulation rather than through operation of a competitive marketplace, these divisions are subject to distortions. [27] In particular, commentators have focused on the separations process, which apportions costs between the intrastate and interstate jurisdictions. These commentators suggest that separations allocation, in particular allocation of common plant, reflects not only economic considerations, but also public policy considerations related to universal service and the desirability of low local rates. [28] To the extent these allocation decisions have resulted in greater allocations to interstate services than would be economically justified, these distortions flow through Parts 69 and 61 into access charges.

24. Part 69 establishes two basic categories of access services: special access services and switched access services. Special access services do not use the local switch; they use dedicated facilities that run directly between the end user and the IXC's point of presence (POP). [29] By contrast, switched access services use the local exchange switch to route originating and terminating interstate toll calls. The special access category includes a wide ***21367** variety of services and facilities, such as wideband data, video, and program audio services. [30] The Commission does not prescribe specific rate elements for special access services in Part 69. [31] Part 69 does, however, establish specific switched access elements and a mandatory switched access rate structure for each element tailored to the nature of each service in order to promote competition in the interexchange services market and eliminate discrimination within or among services. In general, we have attempted to move toward rate structures that create incentives for the most efficient utilization of all telecommunications facilities. [32] These elements generally correspond to the components of switched access service, as shown in Figure 1.

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***21368** 25. Interoffice transmission services, known as transport services, carry interstate switched access traffic between an IXC's POP and the end office that serves the end user customer. Incumbent LEC transmission facilities that carry interstate traffic between an IXC's POP and the incumbent LEC end office serving the POP (called the serving wire center or SWC) are known as entrance facilities. Part 69 requires incumbent LECs to impose flat-rate charges on IXCs to recover the costs of entrance facilities. Incumbent LECs currently offer two types of interstate switched transport service between a SWC and an end user's end office. Under the first service, direct-trunked transport, calls are transported between the SWC and the end office by means of a direct trunk that does not pass through an intervening switch. To recover the costs of direct-trunked transport facilities, Part 69 requires incumbent ***21369** LECs to impose a flat-rate charge on IXCs. [33] The second service, tandem-switched transport, routes calls from the SWC to the end office through a tandem switch located between the SWC and the end office. Traffic travels over a dedicated circuit from the SWC to the tandem switch, and then, over a shared circuit that carries the calls of many different IXCs, from the tandem switch to the incumbent LEC end office. [34] For tandem-switched transport, Part 69 prescribes a per-minute tandem-switching charge and a per-minute transmission charge assessed on IXCs. [35]

26. Incumbent LEC end offices serving end users switch interstate traffic between the transport trunks carrying traffic to and from the IXC POPs and the end users' local loops. Our Part 69 rules require incumbent LECs to recover the costs of the local switch through a per-minute local switching charge assessed on IXCs. [36] Part 69 also requires incumbent LECs to impose a per-minute TIC on interstate switched access traffic. [37] We note that an incumbent LEC's provision of transport and local switching for terminating interstate traffic is functionally the same as its provision of transport and termination service under the 1996 Act.

27. Finally, incumbent LECs assess end users a flat end user common line charge (EUCL), also known as the subscriber line charge (SLC), to recoup part or all of the local loop costs allocated to the interstate jurisdiction. The SLC currently may not exceed the lesser of the actual interstate loop cost, or $6 per month for multi-line business customers and $3.50 for residential and single-line business customers. [38] In addition, IXCs are assessed a per-minute CCL charge to recover the remaining interstate allocation of loop costs that is not recovered through SLCs. [39] IXCs with at least .05 percent of the total common lines presubscribed to IXCs in all study areas are also assessed Universal Service Fund and Lifeline ***21370** service charges based on each IXC's share of presubscribed access lines. [40] In addition, Part 69 identifies several other charges, including those for signalling and database queries. [41]

28. The specific access charges currently assessed on interexchange carriers and end users under our rules vary among incumbent LECs because their embedded costs, on which access charges (even for price cap incumbent LECs) are based, vary from state to state. Significant differences in factors that affect a carrier's cost of providing service, such as the topography and population density of its service area, are reflected in different prices for access service.

29. The total regulated revenues of Class A incumbent LECs by service rate elements are shown in Table 1, below. [42] As indicated there, more than 25 percent of the incumbent LECs' total regulated revenues are derived from interstate access services. In addition, of the $11.9 billion in interstate switched access revenues that incumbent LECs recover from IXCs, approximately 90 percent ($10.8 billion) is recovered through per-minute charges (*i.e.*, CCL, TIC, and local switching).

Table 1
Class A Incumbent Local Exchange Carriers'
1995 Total Regulated Revenues
(in Billions) [43]

Interstate Revenues		
Subscriber Line Charge	$ 7.1	
Per-Minute Switched Access Charges		
Carrier Common Line	$ 3.7	
Transport Interconnection Charge [44]	$ 2.9	
Local Switching (and other T-S)	$ 4.2	
Total Per-Minute Switched Access Charges	$10.8	
Transport (Facilities)	$ 1.1	
Special Access	$ 3.1	
Information	$ 0.3	
Miscellaneous [45]	$ 1.0	
TOTAL INTERSTATE ACCESS REVENUES [46]		$23.4
Intrastate Revenues		
Basic Local Exchange Service	$32.0	
Intrastate Access	$ 7.3	
Other Intrastate Services [47]	$28.0	
TOTAL INTRASTATE REVENUES		$67.4

TOTAL REGULATED REVENUES **$90.8**

***21372** 30. The Part 61 price cap rules give incumbent LECs that are subject to price cap regulation -- generally the largest incumbent LECs [48] -- a degree of flexibility in establishing the actual levels of their access rates. Incumbent LEC price cap regulation is designed to promote economic efficiency by easing restrictions on overall profits while setting price ceilings at reasonable levels. [49] The incumbent LEC price cap plan is designed to simulate some of the efficiency incentives found in competitive markets and to act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary. [50] Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings.

31. The price cap rules split interstate access services into three discrete groups, called baskets. [51] Two baskets are further grouped into narrower service categories and subcategories. Price cap incumbent LECs have some ability to raise and lower the charges for elements or services that are included in the same basket as long as the actual price index (API) for the basket does not exceed the price cap index (PCI) for that basket. This pricing flexibility is limited by banding rules that establish separate upper and lower pricing bands for each service category or subcategory within a basket. The price cap for each basket and the pricing bands for each service category and subcategory are adjusted annually based on defined formulas. [52] The price cap rules place services subject to different competitive pressures into different baskets, service categories, and service subcategories. These measures limit the incumbent LECs' ability to offset reductions in service prices that are subject to competition with increases in service prices that are not subject to competition.

***21373 2. The 1996 Telecommunications Act**

32. The 1996 Act seeks to open for all carriers the local and long distance telecommunications markets to competition by removing economic, regulatory, and operational impediments that have protected monopolies in the local exchange market. The 1996 Act requires incumbent LECs to open their networks to competition, and permits the BOCs, upon meeting certain conditions, to enter the interLATA market within their respective service areas. [53] The 1996 Act also requires the Commission to forbear from applying any regulation or any provision of the Communications Act to telecommunications carriers or telecommunications services, or classes thereof, if the Commission determines that certain specified conditions are satisfied. [54]

a. Local Competition

33. The local competition provisions of the 1996 Act added new sections 251, 252, and 253 to the Communications Act. Section 251 establishes general interconnection obligations for all telecommunications carriers, [55] delineates further obligations for LECs, [56] and prescribes additional requirements for incumbent LECs. [57] Sections 251(c)(2) and (c)(3) require that incumbent LECs' "rates, terms, and conditions" for interconnection, unbundled network elements be "just, reasonable, and nondiscriminatory in accordance with ... the requirements of sections 251 and 252." [58] Section 252 generally sets forth the procedures that state commissions, incumbent LECs, and new entrants must follow to implement the requirements of section 251 and establish specific interconnection arrangements. Finally, ***21374** Section 253 bars state and local regulations that prohibit or have the effect of prohibiting entities from offering telecommunications services. [59]

34. The terms and conditions under which such facilities and services are made available by incumbent LECs may be the subject of negotiated agreements between an incumbent LEC and a requesting carrier. [60] If an incumbent LEC and requesting carrier are unable to reach a negotiated agreement, either party may ask a state to arbitrate the disputed issues.

35. As required by the 1996 Act, incumbent LECs must provide interconnection and nondiscriminatory access to network elements on an unbundled basis. In implementing the Act, we identified the following minimum set of network elements that incumbent LECs must provide to requesting telecommunications carriers, many of which are analogous to interstate access

rate elements: network interface devices; local loops; local and tandem switches (including all software features provided by such switches); interoffice transmission facilities; signalling and call-related database facilities; operations support systems and information; and operator and directory assistance facilities. [61] States may require unbundling of additional elements.

b. Universal Service

36. Section 254, added by the 1996 Act, for the first time codifies the role of universal service in federal telecommunications regulation. [62] Section 254 directs the Commission to commence a proceeding to implement sections 254 and 214(e) of the Act, and to refer such proceeding to a Federal-State Joint Board. The Joint Board was given nine months to make recommendations to the Commission, including a definition of the services to be supported by federal universal service support mechanisms and a timetable for the implementation of such recommendations. We initiated the Joint Board proceeding in March 1996, [63] and the Joint Board issued its *Recommended Decision* in November 1996.

***21375** 37. The 1996 Act established several requirements for federal universal service support mechanisms. The Commission, after receiving the recommendations of the Joint Board, is to designate specific services for federal universal service support. [64] Such support is to be available for the provision, maintenance and upgrading of facilities and services for which the support is intended, and not for other purposes. [65] Such support is to be available to all eligible telecommunications carriers. [66] Such support is to be explicit, [67] and, as the Conference Report makes clear, shall not be implicit. [68] Such support is also to be funded on an equitable and non-discriminatory basis by all telecommunications carriers that provide interstate telecommunications services. [69]

38. In its *Recommended Decision,* the Federal-State Joint Board concluded that several universal service mechanisms currently implemented through the jurisdictional separations and access charge structures must be replaced or modified in order to meet the Act's requirements that support mechanisms be explicit, specific, predictable and sufficient to preserve and advance universal service. Accordingly, the Joint Board recommended that changes be made to the high cost assistance fund, [70] and that the Dial Equipment Minutes (DEM) weighting program [71] and Long Term Support (LTS) [72] be phased out, eliminated, and replaced by a new explicit universal service mechanism. [73] If the Commission adopts the Joint Board's recommendations, our access charge rules must be adjusted to reflect these changes, to prevent incumbent LECs from recovering the same costs twice, and to provide the same ***21376** subsidies to non-incumbent LECs as are provided to incumbent LECs for serving high-cost or low-income subscribers. [74]

39. At the same time, we must also examine other features of our access charge system to determine whether they contain implicit universal service support, in contravention of the Act's requirement that all universal service support be explicit and its requirements as to funding of federal universal service support. In our *Universal Service NPRM,* we asked whether the CCL charge is an implicit universal service support mechanism. [75] While the Joint Board did not reach this question, it suggested that it would be desirable for the CCL charge to be restructured to be collected on a flat-rate rather than a per-minute basis because per-minute collection is economically inefficient. [76]

40. We continue to recognize that, because of the role that access charges have played in funding and maintaining universal service, it is important to implement changes in the access charge system together with complementary changes in the universal service system. In Sections III.B., below, we discuss whether the CCL charge must be restructured to comply with the Act's universal service requirements.

3. Need for Access Reform

41. There is a consensus among virtually all participants in the telecommunications industry on the need to reform our interstate access charge rules. IXCs and incumbent LECs, for example, agree that current per-minute interstate access charges exceed

economically efficient levels and that, consequently, per-minute interstate access charges must be reduced.[77] They differ, however, as to the reasons why current charges exceed forward-looking economic cost, the aggregate amount by which current charges exceed economic cost, and the effects of particular factors (*e.g.*, alleged excessively-long prescribed depreciation schedules, separations distortions, strategic investments, and operational inefficiency). They also disagree on what portion, if any, of the difference between forward-looking economic cost and the portion of embedded costs allocated to the interstate jurisdiction incumbent LECs should be permitted to recover.

42. Current access charges distort competition in the markets for local exchange access. Our access charge rules create incentives for IXCs to bypass the LEC switched access ***21377** network for reasons that have nothing to do with the economics of operating an access network. This uneconomic bypass may occur for a variety of reasons; rates may be too high, or our access charge rules may require rates for a LEC access service to be too high in relation to the rates for an alternative LEC service or for a comparable service offered by an alternative supplier. Inefficient entry may occur if the price for a package of jointly-provided services is above economic cost, even if the LEC would actually be the most efficient provider of the service. Conversely, if a package of jointly-provided services, including access, is priced too low because of regulatory requirements, efficient entry by an otherwise efficient provider may be precluded. In either case, the total cost of telecommunications service will not be as low as it could be if all services were priced at economic levels, thereby providing accurate price signals to all market participants. High access charges may also keep long-distance rates higher than they would otherwise be, which restricts demand for service and harms long-distance consumers. We describe more fully some of the causes of uneconomic bypass below.

43. Inefficient, mandatory rate structures are one reason that per-minute interstate access charges exceed the economic cost of providing service to certain customers. One example is the recovery through a per-minute CCL charge of part of the allocated interstate costs for incumbent LECs to provide local loops to end users. Recovering on a per-minute basis the cost of the local loop, which is a fixed cost that does not vary with usage, results in high-volume toll users paying charges to their IXCs that exceed the cost of serving those customers, while some low-volume toll users may pay rates that are below cost. Mandatory per-minute charges for local switching, which probably has significant fixed costs, also results in IXCs paying access charges for high-volume toll users that exceed the cost of serving those customers. Finally, the requirement that most rates be averaged on a "study area" basis (*i.e.* generally, state-wide) precludes incumbent LECs from setting rates to reflect cost differences in high-density and low-density areas, leaving incumbents vulnerable to niche entry in high-density areas, and precluding entry by firms that might otherwise seek to serve low-density areas.

44. Assignment of costs to the wrong elements may also contribute to high per-minute interstate access rates. As discussed in Section III.E. below, the TIC currently recovers some costs that may be appropriately included in the rates for services in the trunking basket. This also results in higher-volume switched access toll users paying rates that exceed cost.

45. Incumbent LECs, and to a lesser degree others such as AT&T, argue that another reason current interstate access charges exceed forward-looking economic cost is the over-allocation of costs to the interstate jurisdiction in the separations process, which allocates costs between the interstate and intrastate jurisdictions.[78] According to these parties, the revenues now recovered through interstate switched access rate elements in the traffic-sensitive basket ***21378** exceed the cost of providing interstate switched access services, while intrastate rates do not recover enough to cover the economic cost of providing intrastate exchange and exchange access services.

46. A major focus of the IXCs, on the other hand, is the contention that current interstate access charges exceed economic cost levels because the incumbent LECs are inefficient.[79] As a result, they argue, the incumbent LECs' unseparated rate base is higher than it should be, and all prices in both the interstate and intrastate jurisdictions exceed economic cost-based levels that an efficient provider would charge.

47. Several parties, including AT&T and MCI, argue that, to the extent access services are not available to IXCs at their forward-looking economic cost, incumbent LECs and their long-distance affiliates will have an unfair competitive advantage in the market for long-distance services.[80] According to these IXCs, this is because the incumbent LEC's affiliate's effective cost of obtaining "in region" access service is the incremental cost that its affiliated LEC incurs in providing access. If an

incumbent LEC that also provides long-distance service can charge unaffiliated IXCs access prices that are significantly higher than forward-looking economic cost, the IXCs argue that the incumbent LEC may be able to create a "price squeeze" by raising rivals' costs. Under these circumstances, the incumbent LEC affiliate could lower its retail price to reflect its cost advantage, and competing unaffiliated IXCs would be forced either to match the price reduction and absorb profit margin reductions or maintain their prices at existing levels and accept reductions in their market shares.

48. Additionally, to the extent that unbundled network elements become available from incumbent LECs at economically efficient prices, IXCs will have the ability to avoid paying access charges by purchasing such elements to provide both local exchange and exchange access service to end-user customers. IXCs may also take access service from a competitive LEC that either provides its own facilities or takes unbundled elements from the incumbent LEC. The availability of unbundled network elements at their forward-looking economic cost would appear to reduce the danger of a price squeeze insofar as IXCs can use those elements to provide their own access to customers for whom they are the local service provider. There may, however, be limits on the extent to which access charges can be replaced by unbundled elements in either the short or long-term, because an IXC may have to take access service for those end-user customers for which it does not provide local service. [81]

***21379** 49. Apart from any revisions to our rules that we may adopt in this proceeding, the availability of this alternative to interstate access service may force incumbent LECs to move their access charges to more economically efficient levels, and may necessitate relief from mandatory access charge rate structures that are not economically efficient. We seek in this proceeding to explore ways in which we can harness competitive forces to further our efforts to make our system of interstate access charges more economically rational and compatible with competitive local markets. We also seek to adopt rules and policies that will facilitate a smooth transition from the current system to one that can be sustained in competitive local markets.

II. ACCESS REFORM FOR INCUMBENT LOCAL EXCHANGE CARRIERS

A. Application of Reforms to Price Cap Carriers and Non-Price Cap Carriers

50. Because our access charge rules apply only to dominant LECs, the focus of this proceeding is reform of our access charge regime that currently applies to incumbent LECs. [82] Although many of the reforms we propose in this Notice may be desirable changes to our regulation of non-price cap incumbent LECs, we are limiting the scope of this proceeding to incumbent LECs subject to price cap regulation, [83] with limited exceptions discussed below.

51. We note that price cap regulation governs almost 91 percent of the interstate access charge revenues [84] and more than 92 percent of the total incumbent LEC access lines. [85] Currently, all ten of the incumbent LECs with more than two million access lines and 13 of the 17 non-NECA incumbent LECs with more than 50,000 access lines are subject to price cap regulation. [86] The remaining incumbent LECs are telephone companies subject to various forms of rate-of-return regulation. [87] Therefore, even though this proceeding applies only to ***21380** price cap incumbent LECs, it would nonetheless affect the vast majority of all access lines and interstate access revenues.

52. The need for access reform is most immediate for those incumbent LECs that may soon be subject to competition from the availability of unbundled network elements. These are primarily the price cap incumbent LECs. Many, if not all, non-price-cap incumbent LECs may be exempt from, or eligible for a modification or suspension of, the interconnection and unbundling requirements of the 1996 Act. [88] By contrast, all incumbent LECs that are ineligible for section 251(f) exemptions, suspensions, or modifications are incumbent price cap LECs. [89] Because the latter incumbent LECs must fulfill the section 251(b) and (c) duties to provide interconnection and unbundled elements to new entrants, [90] these incumbent LECs are likely to face significant competition in the interstate exchange access market from new entrants using unbundled network elements before the small and mid-sized rate-of-return incumbent LECs face such competition. Thus, we conclude that we should focus our efforts here on the immediate task of reforming the access charge regime for price cap incumbent LECs. We plan to initiate a separate proceeding in 1997 to undertake comprehensive review of our regulation of rate-of-return incumbent LECs. That inquiry will

take up the issue of whether substantial changes in our Part 69 cost allocation rules for the development of access charges for rate-of-return carriers are needed. [91]

53. We propose, however, limited exceptions to our decision to confine this proceeding to price cap incumbent LECs. Specifically, we propose to apply to all incumbent LECs the rules discussed in Section VII.A, which addresses allocation of universal service support to the interstate revenue requirement, and Sections III.D and E, which propose reforms to the transport rate structure, including the TIC. Because rate-of-return incumbent LECs will collect revenues from the new universal service support mechanism, we need to ***21381** determine in this proceeding how these payments should alter the access charges currently assessed by such incumbent LECs. Moreover, any changes we adopt to the TIC pursuant to the court's remand in *CompTel v. FCC* [92] should also apply to rate-of-return incumbent LECs because their transport rules were subject to the rates that were remanded by the court in that decision. In Section III.B, we seek comment on whether we should also apply our proposed changes to the common line rate structure to rate-of-return incumbent LECs. In Section VIII.C., we seek comment on updating the Part 69 access rules in light of various developments. We seek comment on these tentative conclusions regarding the scope of this proceeding. We further invite parties to comment on the effect of these proposals and tentative conclusions on small business entities, including small incumbent LECs and new entrants. [93]

B. Applicability of Part 69 to Unbundled Elements

54. Pursuant to our jurisdiction over interstate access charges under section 201 of the Act, we tentatively conclude that unbundled network elements should be excluded from the Part 69 access charge regime, regardless of whether the carrier that purchases unbundled network elements uses those elements to provide local exchange services or exchange access services. [94] Thus, when using unbundled network elements to originate and terminate interstate calls, requesting carriers should not be required to pay the Part 69 access charges corresponding to those elements. The 1996 Act permits telecommunications carriers that purchase access to unbundled network elements from incumbent LECs to use those elements to provide all telecommunications services to customers, including access in order to originate and terminate interstate calls. [95] The 1996 Act in turn requires requesting carriers to pay cost-based rates to compensate incumbent LECs for all such use of the unbundled network elements. [96] Thus, the requesting carrier has already paid for the ability to originate and terminate interstate calls. Nothing in the text of the 1996 Act compels telecommunications ***21382** carriers that use unbundled elements to pay interstate access charges, nor limits these carriers' ability to use unbundled elements to originate and terminate interstate calls. Nothing in sections 201-205 of the Act requires a contrary result. We seek comment on this tentative conclusion. We also note that the Part 69 interstate access charge rules do not apply to the transport and termination of local traffic provided pursuant to section 251(b)(5). [97]

III. RATE STRUCTURE MODIFICATIONS

A. Overview

55. We tentatively conclude that several provisions in Part 69 of our rules compel incumbent LECs to impose charges for access services in a manner that does not accurately reflect the way those LECs incur the costs of providing those services. For example, generally the costs associated with the local loop are non-traffic-sensitive (NTS), but our rules require incumbent LECs to recover a portion of those costs through per-minute CCL charges. Similarly, at least some portion of the costs of local switching is NTS, but our rules require incumbent LECs to recover all local switching costs through per-minute charges. In these and other cases, our rate structure rules do not send accurate pricing signals to customers, and consequently, encourage inefficient use of telecommunications services. These inaccurate pricing signals encourage uneconomic bypass of incumbent LEC facilities and could very well skew or limit the development of competition in the markets for telecommunications services. Furthermore, these rates may not be sustainable in the long run if unbundled network elements are made available at cost-based prices and used to provide exchange access services.

56. We propose to revise our rate structure requirements for switched access service by eliminating some rate structure requirements, prescribing some new requirements, or a combination of both. We tentatively conclude that, regardless of which of the approaches to access reform discussed in Section IV we choose, establishing more economically rational rate structure rules is a necessary first step in the new procompetitive era. We seek through these changes to establish rate structures for interstate access services that send more accurate pricing signals to both consumers and competitors. Below, we invite comment on proposals for rate structure rule changes to be applicable to all price cap incumbent LECs. Specifically, we invite comment on rate structure rule changes for common line, local switching, and transport. We then seek comment on a number of proposals for phasing out the transport interconnection charge, and on establishing rate structure rules for SS7 signalling services. With the exception of the transport rule revisions considered in Section III.D, and the revisions to the TIC considered in Section III.E, we propose applying the rate structure rule changes discussed in Section III only to incumbent price cap LECs. As noted in Section II, ***21383** rate structure revisions for non-price cap incumbent LECs will be addressed in a separate proceeding.

B. Common Line

1. Background

57. Common line costs are the costs associated with the line connecting the end user's premises with the local switch that have been assigned to the interstate jurisdiction through the jurisdictional separations process. These costs are not traffic-sensitive. [98] A portion of the incumbent LEC's common line costs are recovered through EUCL charges, also called SLCs. These charges currently are limited to the actual cost of the interstate portion of the local loop or $3.50 per month for residential and single line business users, and $6.00 per month for multi-line business users. [99] The remaining common line costs, if any, are recovered through carrier common line charges, which are per-minute rates imposed on access customers. [100]

58. The current common line rate structure, in which only a portion of common line costs are recovered through flat monthly rates, does not reflect the manner in which loop costs are incurred. As a result, the common line rate structure forces incumbent LECs to recover costs in an economically inefficient manner, and so may cause inefficient use of the network and uneconomic bypass, as discussed in Section III.A, above. Furthermore, in the original *Access Charge Order,* the Commission found that recovering NTS costs through flat monthly charges imposed on end users by incumbent LECs would promote optimal utilization of telecommunications facilities. [101] The Commission decided at that time, however, to place a limit on the SLC, and, consequently, required incumbent LECs to recover the remainder of their common line costs through per-minute CCL rates. [102] The current CCL charge has been uniformly criticized by both incumbent LECs and IXCs because it discourages efficient use of the network and encourages uneconomic bypass. We invite comment below on alternative common line rate structures.

***21384 2. Alternative Methods of Recovery of CCL Portion of Subscriber Loop Costs**

59. The Joint Board in its *Recommended Decision* recognized that the current, traffic-sensitive CCL charge structure is economically inefficient because the charge requires incumbent LECs to recover a non-usage-sensitive cost in part through a usage-sensitive charge. [103] The Joint Board suggested that the Commission change the existing rate structure so that incumbent LECs are no longer required to recover any of the NTS cost of the local loop from IXCs on a per-minute basis. [104] The Joint Board noted that it would be preferable for costs related to the loop to be recovered in a manner that is consistent with the manner in which the costs are incurred. [105] Because the cost of a loop generally does not vary with the minutes of use transmitted over the loop, [106] the Joint Board concluded that the current CCL charge that mandates recovery of a portion of loop costs through per-minute charges is an inefficient cost-recovery mechanism.

60. We seek comment on possible revisions to the current CCL charge structure so that incumbent price cap LECs are no longer required to recover any of the NTS costs of the loop from IXCs on a traffic-sensitive basis. One possible alternative, mentioned by the Joint Board, involves permitting incumbent LECs to recover the costs not recovered from SLCs through a flat, per-line

charge paid by IXCs. [107] An administratively simple mechanism for recovery of such a flat-rate charge would be to assess it against each customer's presubscribed interexchange carrier (PIC). If carriers seek to pass on that charge to end users, however, such an approach might encourage end users not to select a PIC. To resolve this problem, the Joint Board suggested that the Commission allow incumbent LECs to collect the flat-rate charge that would otherwise be assessed against the PIC directly from any customer who elects not to choose a PIC. [108] We seek comment on this approach and invite parties to discuss the potential problem created when end-user customers have selected PICs but use other IXCs for Internet, fax, interexchange or other interstate services by "dialing-around" the PIC.

***21385** 61. The Competition Policy Institute (CPI) has suggested several other alternatives to the per-minute recovery of interstate NTS loop costs. [109] For example, interstate NTS loop costs may be recovered through "bulk billing," in which carriers are assessed a charge based upon their percentage share of interstate minutes of use or revenues. An additional possible approach to recovering interstate NTS loop costs is a "capacity charge" assessed on carriers based upon the number and type of trunks that they purchase from the incumbent LECs. Alternatively, LECs could assess a "trunk port charge" to each carrier based upon the number of trunk-side ports, or connections it has to the local switch. Another possibility is a "trunk port and line port" charge, which would be based upon the number of trunk-side ports and the number of line-side ports. We seek comment on these approaches to recovery of interstate NTS local loop costs and ask parties to propose other efficient recovery mechanisms. We invite parties to comment on whether any changes that we adopt to the recovery of interstate NTS local loop costs for price cap LECs should be extended to rate-of-return LECs, and the relationship of interstate NTS loop cost recovery under access charges to the *Joint Board Recommended Decision.* Interested parties should address how such an extension to rate-of-return LECs would affect small business entities, especially small incumbent LECs. [110]

62. Parties should also address whether, in the event that we eliminate the SLC cap for lines used by multi-line business customers and residential lines beyond the primary residential line as discussed below, we need to adopt an alternative mechanism for recovering common line costs currently recovered through the CCL charge imposed on such lines. We also seek comment, in conjunction with our market-based approach to access reform, on the circumstances under which we should grant LECs rate structure flexibility in their recovery of interstate common line costs from IXCs. Interested parties should also address the extent to which any proposed alternative recovery mechanism for recovering common line costs currently recovered through the CCL charge will affect small business entities, including small incumbent price cap LECs and new entrants. [111]

63. Finally, we seek comment on whether there are any limitations on our authority to assess flat-rated CCL charges on IXCs. In particular, we note that section 254(g) also requires IXCs to charge their subscribers in rural and high cost areas within a state the same rates they charge to their subscribers in urban areas in that state. Section 254(g) also requires IXCs to charge their subscribers in each state rates no higher than the rates charged to ***21386** subscribers in any other state. [112] Would this requirement preclude an IXC from charging its customers the flat monthly rate assessed for that line if the amount of that charge varied among states, or between urban and rural areas within a state? If so, do conditions exist sufficient to require the Commission to forbear from the application of section 254(g) to IXC recovery of flat-rate CCL charges? Parties should also address the effect of section 254(g) if CCL charges vary among the states, but end-user rates may not vary.

3. Alternative Methods of Recovery of SLC Portion of Subscriber Loop Costs

64. In its *Recommended Decision,* the Joint Board determined that eligible carriers should receive support for designated services carried on the initial connection to a customer's primary residence and single-line business customers. [113] The Joint Board, however, recommended that universal service support should not be provided for multi-line business or residential connections beyond the primary residential connection. [114] The Joint Board further concluded that the current $3.50 SLC cap for primary residential and single-line business lines should not be increased, but did not state that the SLC cap should be maintained for multi-line business or residential connections beyond the primary residential connection. [115] Loop costs not recovered from the current multi-line business SLCs, and SLCs for residential lines in addition to the primary connection, are recovered through usage-sensitive CCL charges, which in turn are recovered from toll users. Since end user customers of multi-line business and

multiple-line residential services do not necessarily make large numbers of toll calls, the toll payments of these end users may not cover the portion of loop costs not recovered through the SLC. Moreover, toll rates are higher than they otherwise would be, which discourages demand for such services.

65. For these reasons, we propose to increase the cap on the SLC for the second and additional lines for residential customers and for all lines for multi-line business customers to the per-line loop costs assigned to the interstate jurisdiction. This would allow incumbent LECs to recover interstate common line costs for multi-line business customers and for ***21387** residential connections beyond the primary residential connection in a manner consistent with the way costs are incurred. Alternatively, we could eliminate the cap for multi-line business customers and for residential connections beyond the primary connection, especially where the incumbent LEC has entered into interconnection agreements and taken other steps to lower barriers to actual or potential local exchange competition. Under that approach, we would not prohibit an incumbent LEC from charging a SLC for second and additional lines for residential customers and for all lines for multi-line business customers that exceeds the per-line loop costs assigned to the interstate jurisdiction. We emphasize that this proposal would not affect the current cap of $3.50 on the SLC that is charged to a residential customer's primary line and to a single-line business customer. We invite parties to comment on this proposal. We also invite parties to comment on whether any changes that we adopt to the cap on SLCs for price cap LECs should be extended to rate-of-return LECs, and the relationship of any such changes to the *Joint Board Recommended Decision.* Interested parties should address how applying such a cap on SLCs to rate-of-return LECs would affect small business entities, especially small incumbent LECs. [116]

66. In the event we decide to increase or eliminate the cap on SLCs for multi-line business lines and residential lines in addition to the primary line, we also solicit comment on whether we should establish a transition mechanism for this increase, whether such a transition could be implemented consistent with section 254, and if so, how long this transition period should be. We propose establishing no transition period if the increase in the SLC is less than one dollar, and establishing a three-year transition period if the increase is one dollar or more, but we invite comments on other alternatives in addition to these.

67. Finally, we seek comment on whether we should permit or require incumbent LECs to deaverage SLCs as part of the baseline rate structure that would be imposed on all incumbent price cap LECs. [117] In particular, we note that section 254(e) requires us to adopt only explicit support subsidies for universal service support. We seek comment on whether geographic averaging of SLCs is an implicit subsidy that is inconsistent with the requirements of section 254(e), and thus on whether we are required to deaverage SLCs.

***21388 4. Assessment of SLCs on Derived Channels**

68. Integrated services digital network (ISDN) services permit digital transmission over ordinary local loops through the use of advanced hardware and software. [118] ISDN offers data transmission at higher speeds and with greater reliability than standard analog service. Most incumbent LECs currently offer two types of ISDN service, Basic Rate Interface (BRI) service and Primary Rate Interface (PRI) service. BRI service allows a subscriber to obtain two voice-grade-equivalent channels and a signalling/data channel over an ordinary local loop, which generally is provided over a single twisted pair of copper wires. [119] PRI service allows subscribers to obtain 23 voice-grade-equivalent channels and one data signalling channel over two pairs of twisted copper wires. [120] BRI service generally is used by individuals and small businesses, and PRI service generally is used by larger businesses. LEC services other than ISDN use derived channel technology to provide multiple channels over a single facility. [121] The LECs also use derived channel technologies within their networks, for example, to provide customers with individual local loops. In such situations, the end user generally is not aware that the LEC is using this technology.

69. In the *ISDN SLC NPRM,* we noted that the application of SLCs under our existing rules to ISDN services may discourage demand for these services, and we sought comment on ***21389** whether more than one subscriber line charge should be applied to ISDN services, and if so, how many charges. [122] Several parties submitted comments in response to that Notice, and those parties are listed in Appendix A. [123] All of the commenting parties except AT&T oppose our current rule that assesses a SLC

per derived channel. [124] Almost all of the LECs, user groups, equipment manufacturers, IXCs, and other commenters support a rule that would assess a SLC for each pair of copper wires, [125] or a SLC for each ISDN facility. [126] Under such a rule, LECs would assess one SLC for BRI service and one or two SLCs for PRI service. Many parties, including at least one BOC, support assessing SLCs for ISDN based on the relative NTS costs of providing ISDN service compared to standard analog service. [127]

70. As shown in Table 2 below, the cost data submitted in response to the *ISDN SLC NPRM* [128] indicates that the ratio of NTS costs of BRI ISDN to standard analog service is approximately 1.24 to 1. The ratio of NTS costs of PRI ISDN to standard analog service, excluding NYNEX's data, is roughly 10.5 to 1. As shown in Table 3, NYNEX's data appear to be outliers and are therefore excluded from the calculation of the average ratio for PRI ***21390** ISDN to standard analog service because the ratios of its outside plant and NTS costs for PRI ISDN to standard analog service are almost twice those of other incumbent LECs. Interested parties filed their comments in the *ISDN SLC* proceeding prior to the enactment of the 1996 Act. We ask for comment on the effect of the 1996 Act on determining how many SLCs should be applied to ISDN services. Finally, we solicit comment on whether mandatory rate structures or rate caps should be prescribed for ISDN service or other derived channel services.

***21391 TABLE 2**

Ratio of Costs of Standard Analog Service to BRI ISDN Service

	Outside Plant (loop only) costs	**All NTS costs**
Ameritech	1:1.07	1:1.45
Bell Atlantic	1:1.01	1:1.36
NYNEX	1:0.85	1:1.23
Pacific Bell	1:1.05	1:1.13
US West	1:0.80	1:1.07
Average ratio of costs	**1:0.96** [a]	**1:1.24** [a]

TABLE 3

Ratio of Costs of Standard Analog Service to PRI ISDN Service

Outside Plant (loop only) costs	**Outside Plant (loop only) costs (excluding NYNEX)**	**All NTS costs**	**All NTS costs (excluding NYNEX data)**	
Ameritech	1:5.68	1:5.68	1:8.9	1:8.9
Bell Atlantic	1:4.13	1:4.13	1:15.80	1:15.80
NYNEX	1:10.94	excluded	1:27.74	excluded
Pacific Bell	1:4.67	1:4.67	1:8.70	1:8.70
US West	1:5.33	1:5.33	1:10.60	1:10.60
Average ratio of costs	**1:6.5** [a]	**1:4.95** [a]	**1:15.13** [a]	**1:10.5** [a]

***21392 C. Local Switching**

71. The local switch connects a call coming in on one line or trunk to another line or trunk connected to the switch. A local switch consists of line and trunk cards, and an analog or digital switching system. Line cards provide interfaces between subscriber lines and the switch. Trunk cards or “ports” provide interfaces between the switch and interoffice trunks. Because line cards, as well as trunk cards, are deployed within the central office, they are accounted for in the switching accounts of the USOA.

These costs are therefore included in the switching category for separations and cost allocation purposes. The central processing portion of the switch performs the routing function based on the telephone numbers dialed by the end user placing the call.

1. Non-Traffic-Sensitive Charges

72. Currently, Section 69.106 of our rules requires incumbent LECs to charge per-minute rates for local switching. [129] A significant portion of local switching costs, however, likely do not vary with usage. For example, the costs associated with line cards or line-side ports appear to vary with the number of loops connected to the switch, not with the level of traffic over the loops. We tentatively conclude that it is more reasonable and economically efficient to recover dedicated line card costs through flat charges. [130] We solicit comment on establishing a flat rate element for NTS local switching costs. We also invite commenters to recommend methods of identifying line card costs and other NTS local switching costs.

73. The central processing portion of the switch, and many trunk-side ports, are shared local switching facilities because they are used to carry the traffic of several access customers, and so should be priced on a usage-sensitive basis. By contrast, because trunks for dedicated transport service are dedicated to individual IXCs, ports for dedicated transport service also appear dedicated to individual customers, and, consequently, the charges for such facilities should be flat-rated. While flat rates appear reasonable for recovering costs associated with dedicated ports and line cards, it is not clear what rate structure would best reflect the manner in which incumbent LECs incur costs associated with shared local switching facilities. If all shared local switching costs are driven by the number of lines and trunks served by the switch, flat rates would appear appropriate. [131] On the other hand, usage- ***21393** sensitive charges might better reflect the way incumbent LECs incur costs for shared local switching facilities. Finally, a combination of flat-rate and usage-sensitive charges may best reflect cost causation principles. AT&T and MCI have argued that a substantial portion of local switching costs are non-usage-sensitive, and the local switching rate structure, therefore, should include both usage-sensitive and non-usage-sensitive rate elements. [132] Ameritech has stated that, for a majority of the switches in its network, more than 40 percent of switching costs are NTS. [133] We seek comment generally on this analysis, and on how we should establish an appropriate, efficient rate structure for switching. We note that states may be considering this same issue in the context of establishing rates for unbundled local switching, and we seek comment on, and analysis of how, states are addressing these issues under Section 252.

2. Traffic-Sensitive Charges

74. In the following paragraphs, we seek comment on a number of specific proposals for rate structures governing rates designed to recover usage-sensitive local switching costs. Interested parties should discuss which of these rate structure proposals most accurately reflect traffic-sensitive local switching costs, and whether we should permit or require incumbent LECs to assess these traffic-sensitive charges. Parties advocating a particular rate structure should address all the issues raised by that approach. We also invite parties to propose other rate structures.

a. Call-Setup Charges

75. Call setup is the process of establishing a transmission path over which a phone call will be routed. We could permit or require incumbent LECs to develop call-setup charges if we find that usage-sensitive charges might better reflect the way they incur certain costs for shared local switching facilities. The per-minute rate structure prescribed by Part 69 for local switching does not separately address costs that incumbent LECs may incur for call setup and takedown. Call-setup costs would be incurred for each call regardless of its duration or whether it is completed. Because no separate charge exists for call setup, incumbent LECs must recover these costs through the per-minute local switching charges, or possibly through other rate elements. [134] Thus, longer-duration calls recover a greater portion ***21394** of call-setup costs than shorter calls even if they do not impose greater call-setup costs. A per-call rate element for call setup would more rationally reflect these costs.

76. In the past, the Commission has rejected incumbent LEC petitions for waiver of Part 69 for purposes of imposing a call-setup charge, on the grounds that such proposals should be considered in a broader rulemaking. [135] Accordingly, we now seek comment on whether we should permit or require incumbent LECs to include a call-setup charge in their local switching rate structures. We also request comment on the extent to which the current local switching rate element recovers costs that vary with the number of calls, rather than their duration. Should a call-setup charge apply to all call attempts, or only to completed calls? We seek comment on whether incumbent LECs incur different call-setup costs depending on whether a call is delivered via direct-trunked or tandem-switched transport service, and on the different costs incurred when multifrequency (MF) and SS7 signalling are used for call setup. Finally, we invite comment on whether any of these cost differences should be reflected by establishing different charges for different kinds of call setup. To the extent that parties support a separate charge for SS7 call setup, those parties should explain how such a charge would be consistent with the rate structure for other SS7 services we discuss below.

b. Peak and Off-Peak Pricing

77. We could direct or allow incumbent LECs to develop peak and off-peak pricing for shared local switching facilities. When incumbent LECs select the types of switches that they will deploy in their networks, they base their decisions on the anticipated peak demand. [136] Thus, incumbent LECs arguably should be permitted to establish separate rate elements for local switching provided during peak periods and off-peak periods. The peak prices would be per-minute rates, and designed to recover the costs of additional capacity that an incumbent LEC must install to meet the peak demand. Because off-peak traffic requires no additional capacity, the costs of this traffic are lower, and accordingly, the access charges for that traffic should be lower as well.

78. We previously sought comment on peak and off-peak pricing in the *LEC/CMRS NPRM,* [137] and addressed those comments in the *Local Competition Order.* [138] We recognized ***21395** in the *Local Competition Order* that there might be practical problems with a rate structure that had different peak and off-peak pricing. [139] Therefore, we did not mandate a peak-sensitive rate structure for unbundled network elements, [140] although we also did not preclude use of peak/off-peak pricing. Parties supporting requiring rather than merely permitting peak and off-peak pricing for local switching should explain why this rate structure is more suitable for access rates than it is for unbundled network elements. [141]

c. Current Rate Structure

79. As another alternative, we could retain the existing per-minute local switching rate structure. Because a significant portion of local switching costs may not vary with minutes of use, however, the existing rate structure may be less desirable than the other options discussed above. We invite parties supporting the current rate structure to explain why they believe that it adequately reflects the manner in which traffic-sensitive local switching costs are incurred.

D. Transport

1. Background

80. Transport service is the component of interstate switched access service corresponding to the transmission and switching of traffic between incumbent LEC end offices and IXC POPs. Part 69 of our rules requires incumbent LECs to develop charges for transport service that may not reflect in some cases the manner in which they incur the costs of providing these services. [142] Thus, as we discussed with respect to local switching charges above, it may be necessary to revise our Part 69 rate structure requirements for transport services.

***21396** 81. Since December 1993, transport has been provided pursuant to interim rules [143] that replaced the "equal charge per unit of traffic" requirement of the *MFJ.* [144] We required incumbent LECs to establish flat rates for: (1) "entrance facilities,"

transport service from the IXC POP to the SWC, and (2) "direct-trunked transport," transport service from a SWC to an end office on dedicated facilities without switching at a tandem switch. [145] In addition, incumbent LECs were directed to establish usage-based charges for "tandem-switched transport," a transport service from the SWC to the end office that provides switching at a tandem switch. The tandem-switched transport service charge includes an interoffice transmission charge, and a charge for the tandem switch. [146]

82. The initial rate levels for direct-trunked transport were generally presumed reasonable if they were based on rates for comparable special access services. [147] The per-minute tandem-switched transport transmission charge was based on assumptions about average monthly DS1 and DS3 usage. [148] The charge for the tandem switch was initially set to recover 20 percent of the Part 69 tandem revenue requirement. [149] Finally, to make the restructure revenue neutral initially, we required incumbent LECs to establish a non-cost-based transport interconnection charge (TIC), to recover the revenue difference between what the LECs would have realized under the equal charge rate structure and what they would realize from the interim facility-based transport rates, including the remaining 80 percent of the tandem revenue requirement. [150]

***21397** 83. Subsequently, in the *First Transport Reconsideration Order,* the Commission required incumbent LECs to offer two pricing options for tandem-switched transport service. First, an IXC may purchase tandem-switched transport at usage-sensitive rates with any mileage component computed on the basis of the distance between the SWC and the end office, regardless of the actual physical routing. Second, an IXC may purchase direct-trunked transport between the SWC and the tandem office and usage-rated tandem-switched transport between the tandem office and the end office, with any tandem-switched transport mileage component computed on the basis of the distance between the tandem office and the end office. [151]

84. In this section, we seek comment on whether to revise the facility-based components of the transport rate structure. In the following section, we seek comment on phasing out the TIC. Unlike the other rate structure rules we consider in Section III, we contemplate imposing any rules adopted relating to the transport rate structure or the TIC on all incumbent LECs. We propose, for reasons articulated in the *First Transport Order,* [152] that the transport rate structure be divided into three parts: (1) charges for entrance facilities; (2) charges for direct-trunked transport service; and (3) charges for tandem-switched transport service. We seek comment on adopting this basic framework for the transport rate structure rules. In commenting on the transport issues in this section, parties should bear in mind the interrelationship of these issues with those relating to the TIC, which is discussed in Section III.E, below.

85. We also seek comment here and in Section III.E on the issues remanded in *CompTel v. FCC,* in which the court remanded the Orders in which we established the transport rate structure rules. [153] The court held that we did not adequately explain our decision to require incumbent LECs to charge a non-cost-based TIC. [154] The court remanded our decision to set the tandem-based transport rate element to recover 20 percent of the Part 69 tandem revenue requirement and to allocate the remaining revenue requirement to the TIC, because the Commission did not adequately explain why 20 percent would be more equitable than some other allocation. [155] The court also found that we did not explain our decision to require incumbent LECs to allocate a greater proportion of overhead costs to the tandem- ***21398** switched transport switching charge than to direct-trunked transport service rates. [156] We address the TIC issue in Section III.E below, and the other two remand issues in this section.

2. Entrance Facilities and Direct-Trunked Transport Services

86. For entrance facilities and direct-trunked transport service, we tentatively conclude that the transport rate structure rules should mandate flat-rated charges. These transport facilities appear to be dedicated to individual customers, and we believe that flat rates reflect the way incumbent LECs incur costs for dedicated facilities. We invite comment on this tentative conclusion. We also seek comment on whether incumbent LECs should be permitted to offer transport services differentiated by whether the LEC or the IXC is responsible for channel facility assignments. [157] In the past, Ameritech and Bell Atlantic have sought waivers of our Part 69 rules to offer such a switched access service, alleging that it would permit them to utilize the access

network more efficiently. [158] We seek comment on whether any rules beyond those included in the interim rules are necessary to govern rate levels for these services.

3. Tandem-Switched Transport Services

a. Rate Structure

87. We present several options for the rate structure associated with tandem-switched transport service facilities. The first option would maintain the interim rate structure's treatment of the tandem-switched transport charge, which gives IXCs a choice of two pricing alternatives for purchase of tandem-switched transport service. IXCs may elect to pay a single usage-sensitive charge, with distance measured in airline miles from the SWC to the end office, if applicable. Alternatively, IXCs may choose a flat-rated charge for a dedicated facility from the SWC to the tandem office, and a usage-sensitive charge for tandem-switched ***21399** transport service from the tandem office to the end office, with mileage computed separately for the two segments, if applicable. [159]

88. The second option would eliminate an IXC's ability to select the first choice and require incumbent LECs to assess flat-rated charges for the circuit between the SWC and the tandem, which typically is a dedicated circuit, and to apply usage-based rates to the tandem-to-end office link. This was the original transport rate structure the Commission established in 1983 in the *Access Charge Order.* [160]

89. In conjunction with either of the two options for pricing tandem-switched transport service transmission facilities, we could treat tandem switching similarly to one of our proposals for the local switching rate structure, discussed in Section III.C above. As with the end-office switch, the tandem switch may include equipment dedicated to particular customers, such as the network ports through which a particular IXC's traffic enters and leaves the tandem switch. Thus, we could require incumbent LECs to develop usage-sensitive charges for shared facilities (the tandem switching functions and the ports on the end office side of the tandem switch), and a flat-rated charge for the dedicated ports on the SWC side of the tandem switch. Alternatively, shared tandem switching costs may be driven by the number of trunks on the end-office side and the SWC side of the tandem switch, just as shared local switching costs may be driven by the number of lines and trunks connected to the switch. [161] If this is the case, then flat monthly rates may better reflect shared tandem switching costs. Parties are invited to comment on whether tandem switches differ in any fundamental way from end office switches with respect to the division of costs associated with shared and dedicated facilities.

90. In addition to any of the tandem-switched transport service options discussed above, we could permit or require incumbent LECs to develop peak load pricing for tandem-switched transport service. Most small IXCs use tandem-switched transport service for all or most of their access traffic, while larger IXCs may use tandem-switched transport service on relatively fewer routes, or may use it only to handle their overflow traffic during peak hours. Thus, some portion of tandem costs may be attributable to the need to accommodate this overflow traffic from direct-trunked transport facilities. We invite comment on whether to permit or require incumbent LECs to develop peak and off-peak pricing for tandem switching. We also invite comment on whether some portion of tandem switching costs should be ***21400** recovered from direct-trunked transport service customers, if in fact a portion of tandem switching capacity is necessary to meet demand from direct-trunked transport customers during peak period. Parties advocating peak pricing should propose a method to determine the peak period. Because some access customers may use some SWC-side trunks and ports to carry overflow traffic, and the costs of those ports are not traffic-sensitive, flat rates may better recover the tandem-switched transport costs generated by that overflow traffic. We invite comment on this analysis.

91. We seek comment on the benefits and detriments of each of the above options for reforming the tandem-switched transport rate structure. Parties are specifically asked to discuss whether any of these options accurately reflect the way incumbent LECs incur tandem switching costs. For example, we seek comment on the extent to which tandem-switched and direct-trunked transport use the same or different physical routing, and in light of this, on whether the distance component of setting tandem-

switched transport rates is most appropriately measured between the SWC and the end office, or in two charges, one for the SWC-to-tandem circuit and one for the tandem-to-end office circuit. We invite parties to identify and quantify the specific NTS costs associated with the tandem switch that they believe are currently recovered through the usage-sensitive tandem charge. We also invite parties to suggest additional options for the tandem-switched transport charge.

b. Rate Levels

92. We seek comment on how to establish a reasonable tandem switching charge in light of the court's remand. [162] The interim transport restructure rules, which the court remanded, required incumbent LECs to base their initial tandem switching charge on 20 percent of the interstate revenue requirement for tandem switching, with the remaining 80 percent to be recovered through the TIC. [163] Thus, both the tandem charge and some portion of the TIC were designed to recover the costs included in the tandem-switched transport revenue requirement. The Commission found in the *First Transport Order* that this revenue requirement included some SS7 signalling cost, in addition to tandem switching costs. [164] In Section III.E, below, we propose to reassign costs included in the TIC to those rate elements to which they are related, including the different transport rate elements. We seek comment on what costs are appropriately associated with the tandem switching function. Parties commenting on this issue should address how their proposals are consistent with the court's remand directives. We also ask parties to comment on whether, if we permit direct-trunked transport or entrance facility rate structure options based on whether the channel facility ***21401** assignment is done by the IXC or the LEC, a similar option should be available for tandem-switched transport. We ask parties to comment on the interrelationship of the rate level issue and how any decision on transport rate levels affects the options for phasing out the TIC that are discussed in the following section.

93. The court in *CompTel v. FCC* also directed us to explain why we permitted incumbent LECs to load a relatively large portion of their transport overhead costs to tandem-switched transport rates, and to base their direct-trunked transport overhead loadings on the lower overhead loading factors used for special access. [165] Our resolution of the transport overhead loadings issue remanded by the court is also affected by our treatment of the TIC. If we decide to reallocate costs currently recovered through the TIC to other rate elements, this could change the amount of overhead costs allocated to both direct-trunked transport and tandem-switched transport. It is possible that reallocating costs from the TIC to direct-trunked transport and tandem-switched transport charges would result in cost-based direct-trunked transport and tandem-switched transport charges, that is, direct-trunked transport and tandem-switched transport charges that recover a proportionate amount of overhead costs. Thus, reallocating costs from the TIC could contribute to correcting any imbalance in overhead cost allocations between transport rate elements. We invite parties to discuss what other regulatory requirements are necessary to comply with the court's mandate on transport service overhead loadings.

94. Furthermore, initial tandem-switched transport transmission rates were presumed reasonable if set as a weighted average of the per-minute cost of DS3 and DS1 rates calculated using 9000 minutes of use per month. [166] We note that USTA has alleged that the number of actual minutes traversing tandem circuits is significantly below 9000 minutes per month. We solicit comment on whether we should revise any transport rate structure requirement, either as a result of *CompTel v. FCC,* or for any other reason.

95. Finally, we solicit comment on the relationship between our transport rate structure rules and the market-based access reform proposals we discuss in Section IV, and on the relationship between the transport rate structure rules and the prescriptive access reform proposals we discuss in Section V. Is our goal of driving interstate access rates to forward-looking economic cost consistent with retaining rules governing transport rate level relationships? Is it possible to comply with the court's mandate with regard to the tandem switching charge and transport overhead cost allocations without retaining some rules governing transport rate level relationships?

***21402 E. Transport Interconnection Charge**

1. Background

96. Under our Part 36 separations rules, certain costs of the incumbent LEC network are assigned to the interstate jurisdiction. The Part 69 cost allocation rules allocate these costs among the various access and interexchange services, including transport. In the *First Transport Order,* [167] we restructured interstate transport rates for incumbent LECs. The restructure created facility-based rates for dedicated transport services based on comparable special access rates as of September 1, 1991, derived per minute tandem-switched transport transmission rates from those dedicated rates, established a tandem switching rate, and established a TIC that initially recovered the difference between the revenues from the new facility-based rates and the revenues that would have been realized under the preexisting "equal charge rule." The TIC was intended as a transitional measure that initially made the transport rate restructure revenue neutral for incumbent LECs and reduced any harmful interim effects on small IXCs caused by the restructuring of transport rates. [168] Approximately 70 percent of incumbent LEC transport revenues are generated through TIC charges, or approximately $2.9 billion out of $4.0 billion in transport revenues.

97. The TIC is a per-minute charge assessed on all switched access minutes, including those of competitors that interconnect with the LEC switched access network through expanded interconnection. The usage-rated TIC increases the per-minute access charges paid by IXCs and long-distance consumers, thus artificially suppressing demand for such services and encouraging customers to bypass the LEC switched access network, particularly through the use of switched facilities of providers other than the incumbent LEC. In addition, to the extent that any portion of the TIC should properly be included in LEC transport rates, other than the TIC, the TIC provides the LECs with a competitive advantage for their interstate transport services because incumbent LEC transport rates are priced below cost while the LECs' competitors using expanded interconnection must pay a share of incumbent LEC transport costs through the TIC.

98. Our goal in this proceeding is to establish a mechanism to phase out the TIC in a manner that fosters competition and responds to the court's remand. The resolution of the TIC issues is also related to the resolution of three other issues. First, the Universal Service Joint Board recently recommended establishing a universal service support mechanism. In Section VII.A, below, we seek comment on how any support amounts should be allocated to reduce interstate rates. Some of those support amounts may reduce the amount that would otherwise be recovered through the TIC. Second, the adoption of either the market-based or ***21403** prescriptive approach to access reform will establish the extent to which incumbent LEC costs will be recovered through facility-based access charges. Third, if we conclude that incumbent LECs should be permitted to recover some embedded access costs for some period in a competitively neutral manner, as discussed in Section VII.B, below, some of those costs may be costs that are currently included in the TIC. Consequently, resolution of these issues may reduce the costs currently included in the TIC.

99. As we discuss more fully below, the costs now recovered in the TIC could be addressed in several different ways. Some incumbent LECs have urged us to give them significant pricing flexibility and allow market forces to discipline the recovery of the TIC, either alone, or in conjunction with a phase-out of the TIC. A second method of eliminating the TIC would be to quantify and correct all identifiable cost misallocations and other practices that result in costs being recovered through the TIC. A third approach would be a combination of these approaches. For example, we could address directly the most significant and readily-corrected misallocations, and then rely on a market-based approach to reducing what remains of the TIC. Finally, we could provide for the termination of the TIC over a specified time period, such as three years.

100. We address below some explanations for the amounts in the TIC, and then seek comment on possible means of reducing or eliminating the TIC.

2. Possible Sources of Costs in the TIC

101. In the Notice included in the *First Transport Order,* the Commission sought comment on the nature of the costs included in the TIC so that those costs could be reallocated. [169] Parties in the *Transport* proceeding and in more recent *ex parte* filings have offered various explanations of the composition of the costs included in the TIC. We summarize below several of the more significant explanations presented by the parties. Our discussion of these comments is divided into two parts. One group

of comments describes the costs included in the TIC as the result of transport rate setting choices. The other group of comments describes the costs as related to potential cost misallocations.

a. Transport Rate Setting

102. *Tandem Switching and SS7 Costs.* In the *First Transport Order,* we concluded that the interim transport rate structure should include a tandem element that would initially recover 20 percent of the interstate revenue requirement associated with the tandem switch, while the remaining 80 percent of the interstate revenue requirement would be assigned to the TIC. We took this action because of our uncertainty about the specific sources of the costs that were in the tandem switching revenue requirement and because of our concern about ***21404** possible adverse impacts on small and medium IXCs as the new rate structure was introduced. [170]

103. USTA submits that the portion of the tandem interstate revenue requirement that is included in the TIC includes some costs incurred in the provision of SS7 signalling, line information database (LIDB), and other related signalling services. [171] These costs bear no particular relationship to the operation of the tandem switch. As discussed below, under the interim transport rate structure, LECs recover a portion of their SS7 costs through a flat-rated dedicated signalling transport charge assessed on a per-line basis and a flat-rated STP port termination charge. The costs associated with other signalling functions, such as transporting SS7 messages within the signalling network, are not recovered through any facility-based rate element, having generally been incorporated in the transport function, and thus are presumably embedded in the TIC. These SS7 costs relate to services used by all LEC transport customers, and, in the future, potentially to users who are not LEC transport customers. The costs associated with the provision of signalling services are related to the new signalling rate elements discussed below, and if we establish such signalling rate elements, they would not need to be recovered through the TIC. [172]

104. *Tandem-Switched Transport Rate Setting.* The Commission employed several assumptions in setting tandem-switched transport rates, which USTA alleges understate the rates for tandem-switched transport. [173] First, under the interim transport rules, per minute tandem-switched transport transmission rates between the SWC and the end office were presumed reasonable if they were based on a weighted mix of DS1 and DS3 special access rates and assumed 9000 minutes of use per voice grade circuit per month. USTA argues that the Commission's assumption of 9000 minutes of use per circuit per month for tandem-switched transport circuits resulted in tandem-switched transport rates that were too low. [174] It contends that the actual usage on tandem circuits can be measured and often is far less than the 9000 minutes assumed by the Commission. Second, USTA contends that the use of a per minute tandem-switched transport transmission rate from the SWC to the end office ignores that the SWC-to-tandem segment of tandem-switched transport is provided over a circuit that ***21405** is dedicated to an IXC. [175] It argues that the failure to price the SWC-to-tandem segment of tandem-switched transport on a flat-rated basis led to some of those costs being included in the TIC. Third, USTA also alleges that tandem-switched transport uses low-density routes between small end offices and tandem switches and thus does not use DS3 circuits to the same extent that DS3 circuits are used for direct-trunked transport service. [176] Thus, according to USTA, the tandem-switched transport rate applicable to these low-density routes is too low. Finally, USTA asserts that distance-sensitive tandem-switched transport rates are too low because the rules used airline miles from the SWC to the end office rather than measuring distance through the tandem office. [177] Each of these assumptions has been said to result in tandem-switched transport rates that produce revenues that are less than costs, with the difference being assigned to the TIC.

105. *Host-Remote Trunking Rate.* The interim transport rules require incumbent LECs to assess tandem-switched transport rates for the carriage of traffic between a host switch and its remote. As with the tandem-switched transport rate itself, USTA argues that the 9000 minutes of use per circuit reflects more usage than actually transits a circuit, and that the trunks do not exhibit the ratio of DS3-DS1 relationship that was employed in setting the tandem-switched transport rate. USTA contends that the rate therefore does not recover all the costs of host-remote trunking.

106. *Multiplexing Costs.* USTA asserts that the existing transport rates for transmission facilities do not account for all multiplexing costs in two instances, and that this results in costs being recovered through the TIC rather than in appropriate facility-based rates. [178] First, it alleges that none of the transmission rates reflects the cost of the DS1/DS0 multiplexing needed to access those end office switches that cannot handle DS1 interfacing, such as analog electronic switches. Such switches constitute approximately 25 percent of the BOC switches. [179] Second, USTA contends that the TIC also includes the two additional multiplexers needed in order to multiplex a DS3 circuit down to a DS1 level before being switched at the tandem, and then back up to DS3 afterward for transmission to an end office. To the extent that analog tandem switches exist, two additional DS1/DS0 multiplexers are needed to achieve the voice-grade interface with the tandem switch.

***21406** 107. *Direct-Trunked Transport Rate.* In the *First Transport Order* we established initial direct-trunked transport rates that generally were presumed reasonable if set at the LECs' September 1, 1992, rates for comparable special access services. USTA and other incumbent LECs argue that this resulted in costs being included in the TIC because facilities-based transport rates are too low outside high-volume, low-cost areas. These LECs argue that high-capacity special access is provided primarily in high-volume, low-cost areas, making special access rates a good surrogate for transport rates only in such areas. [180] They assert that transport in low-volume areas has significantly higher costs that are not recovered by rates for transport facilities because those rates were based on rates for special access service, which is more heavily concentrated in low-cost urban areas than is transport. SBC, for example, contends that a study of its interoffice facilities indicates that transport may cost over five times more in low-density areas than in high-density areas. [181] These parties submit that these higher costs are included in the TIC.

b. Possible Cost Misallocations

108. As we noted above, the Commission's Part 36 separations and Part 69 cost allocation rules assign costs to access categories, including transport. Some of these costs were included in the TIC when it was established in 1993. Some LECs have indicated that some of the costs included in the TIC result from cost misallocations in these processes, as described below.

109. *Central Office Equipment (COE) Maintenance Expenses.* USTA alleges that the TIC includes costs allocated to transport by current separations and cost allocation procedures that are properly excluded from facility-based transport rates. For instance, the separations rules allocate all expenses for maintaining central office equipment (including circuit equipment, switches, and operator services equipment) among the separations categories for circuit equipment, switching, and operator service on the basis of the apportionment of total COE investment that is allocated to each of those three categories. The separations expense allocations are then carried over into Part 69 and allocated among the interexchange and access categories. These parties contend that a more cost-causative approach would allocate each of these three types of expense based on the allocation of the investment associated with that type of expense. For example, they would allocate circuit equipment maintenance expenses between the jurisdictions and among the Part 69 elements based on the allocation of ***21407** circuit equipment investment. [182] The LECs allege that this change would move costs primarily from the TIC to the local switching category. [183]

110. *Use of Circuit Terminations in Separating Costs Between Private Line and Message Services.* Some parties contend that costs are included in the TIC because the separations procedures do not allocate costs to special access and transport categories in the same way, even though, as we concluded in the *First Transport Order*, the two categories of service use similar facilities. Specifically, these parties argue that the use of circuit termination counts in allocating trunking facilities under-allocates costs to the private line separations category. This occurs because a DS1 circuit (which generally carries 24 voice-grade circuits) used for private line service is counted as having only two terminations, while a similar circuit used for switched message services is counted as having 48 terminations (two per voice-grade circuit). Because the Commission used special access rates to establish the initial facility-based transport rate levels, and the TIC was derived from those rates, any under-allocation of costs to special access could result in the TIC containing costs that may be more appropriately recovered through facility-based special access rates.

111. *Over-allocation of costs to the interstate jurisdiction.* Some parties also allege that the TIC recovers costs allocated to the interstate jurisdiction that should properly be allocated to the intrastate jurisdiction. [184] These parties contend that such costs were not included in the special access rates that were the basis for the initial transport rates, and that these costs therefore were included in the TIC.

3. Possible Revisions to the TIC

112. As we have noted earlier, our goals are to move towards significantly more cost-based access rates and competition in the access and interexchange markets. The development of a competitive access market will be distorted by the assessment of the TIC as a surcharge on local switching. The TIC therefore will be unsustainable. In this section we describe several approaches for revising the TIC and raise specific questions concerning the various approaches.

113. As discussed further below, one approach to revising the TIC that has been suggested by some incumbent LECs would be to give them significant pricing flexibility, ***21408** thereby permitting them to address the TIC problem in a manner consistent with the dictates of the market. These LECs argue that the presence of unbundled elements makes it possible for competitors to reach all customers immediately and warrants significant pricing flexibility. They request various types of pricing flexibility now, including deaveraged rates, consolidation of price cap baskets, contract carriage, and access rates based on end-user customer class distinctions.

114. Ameritech and NYNEX have made such proposals. [185] Ameritech favors phasing the TIC down over a short transition period of three to five years. Under this plan, the TIC reductions would not affect the basket PCI and thus rate increases for other services would be possible within the current bounds of the price cap rules. NYNEX claims that, if given sufficient pricing flexibility for facility-based rates and the TIC, it will be able to manage access pricing in a way that permits it a reasonable opportunity to recover its costs, while minimizing the effect on the competitive marketplace. For example, NYNEX would deaverage its rates downward in high-density areas to permit it to respond to competition, while leaving its other rates unchanged in order to permit it to continue recovering the existing contribution included in those rates. NYNEX does not propose any specific phase out of the TIC, because it asserts that the market will discipline its pricing practices.

115. We ask parties to comment on the need for some transitional mechanisms given that approximately seventy percent of interstate transport revenues are currently generated from TIC charges. We seek comment on what would constitute a sufficient reason to use a transition mechanism. For example, should any transition consider the extent to which IXCs must make significant adjustments to their network configurations in response to any revised TIC recovery methods? We also seek comment on the duration of any transition period.

116. Alternatively, we could revise the TIC by quantifying and correcting all identifiable cost misallocations and other practices that cause costs to be included in the TIC. This approach would require difficult, detailed analysis of individual LEC cost data and probably would not provide an explanation for all the costs in the TIC. Furthermore, it would undoubtedly identify cost allocation problems that we could not remedy in this proceeding because of the need to refer jurisdictional costs allocation issues to a Federal-State Joint Board. Once identified and quantified, the costs comprising the TIC could be: (1) left in the TIC subject to market pressures; (2) reassigned to various access services (including transport facility-based elements) and to nonregulated activities, as appropriate; (3) recovered in a competitively-neutral manner as a matter of public policy; or (4) removed from the regulated books of account. In evaluating these options, we would bear in mind that the incumbent LECs are in the best position to identify and quantify the reasons costs are in the TIC, and we ***21409** would therefore place the burden on them to justify particular treatment of TIC costs. As with the preceding approach, we seek comment on the need for, and the duration of, any transition period.

117. As a third method, we could combine the forgoing alternatives. That is, we could reassign some costs to facility-based elements when warranted by forward-looking cost indicia and address the remaining costs in the TIC through a phase-out methodology. Under this approach, we could, for example, reassign those costs that were readily identifiable and quantifiable,

or necessary to respond to the court's remand directives, and phase out the remainder of the TIC under either the market-based or prescriptive approach to access reform. We tentatively conclude that this approach better serves the public interest than would an attempt to determine exhaustively the sources of the costs included in the TIC because it is administratively simpler, and it is likely that we could not establish the causes for all the costs included in the TIC. We seek comment on the relationship of this method to whether we select a market-based or prescriptive approach to rate levels, as discussed further below. As with the preceding two approaches, we seek comment on the need for, and the duration of, any transition period.

118. Finally, as a fourth option, we could establish a schedule under which the costs included in the TIC are phased out. Under this option, we would establish a fixed time period during which incumbent LECs could in succeeding years recover a declining portion of the amounts included in the TIC. At the conclusion of the period, LECs could no longer recover any TIC revenues. In conjunction with the option of phasing out of the TIC, a LEC's PCIs, or SBIs, could be adjusted to reflect the phase-out of the TIC, or they could be left unchanged. Again, we seek comment on the relationship of this method to whether we select a market-based or prescriptive approach to rate levels, as discussed further below.

119. We seek comment on the extent to which the above approaches to revising the TIC will achieve the goals of this proceeding. Parties should address the relative merits of each, or of other approaches that they may suggest. In particular, they should address how each plan would accommodate any universal service or residual cost amounts that might be allocated to the TIC. We also seek comment on how each of the above approaches affects small business entities, including small LECs and new entrants. [186] Below, we inquire about specific issues concerning these approaches.

120. In evaluating possible approaches to recovery of the TIC, parties should address the possible explanations set out above for the sums in the TIC, including the reasonableness and significance of each of the explanations. We invite incumbent LECs to quantify the amounts attributable to each explanation. Parties presenting data to quantify amounts in the TIC should include sufficient detail to permit the Commission and interested parties to ***21410** evaluate the procedures used and to adjust the results, if necessary, to address concerns raised in the record. Parties are also asked whether there are any additional explanations for the amounts included in the TIC. Parties should quantify their explanations to the extent possible. Finally, we ask parties to comment on whether any interstate costs are included in the TIC that the LECs should be required to write off their regulated books of account as not prudently invested, no longer used and useful, or for some other reason. Any party believing that such costs exist should explain why they should be written off, and provide the legal basis and methodology for doing so. In this connection, they should comment on the approaches discussed in Section VII.B.3, below regarding possible disallowances.

121. In Section V, below, we discuss giving incumbent LECs additional pricing flexibility as certain triggers are satisfied. We ask parties to comment on the relationship of those pricing flexibility approaches to the need for pricing flexibility in conjunction with revising the TIC under any of the methods discussed above, or suggested by any party. For example, because some of the costs in the TIC may result from facility-based rates not reflecting the full costs of serving rural or low-density areas, we ask parties to comment on whether deaveraged pricing is essential to the achievement of our goals with respect to the TIC. We also seek comment on whether other forms of pricing flexibility are essential to reform of the TIC. We invite parties to comment on how any pricing flexibility needed for this purpose would affect the competitive development of the broader access market. We invite parties to comment on whether any public policy reasons would support retaining some costs in the TIC.

122. Any reallocations that may be necessary to implement the elimination or revision of the TIC will give rise to exogenous cost adjustments for price cap LECs under our price cap rules. Parties therefore are asked to comment on whether any special exogenous cost adjustment procedures are necessary to adjust the affected PCIs, APIs, or SBIs. Parties are asked to comment on whether any downward exogenous cost adjustments resulting from access reform should be targeted to the TIC. We also ask parties to comment on what modifications to our access charge rules for rate-of-return LECs are necessary to address any revisions to the TIC that may be adopted. Finally, we ask whether any modifications to the rules applicable to special access services are necessary to accommodate any of the modifications discussed in this section of the Notice.

***21411 F. SS7 Signalling**

1. Background

123. SS7 is the international standard network protocol currently used to transmit signalling information over common channel signalling (CCS) networks, [187] and consequently those networks are often described as "SS7 networks." The Part 69 rate structure for SS7 services or facilities may not currently reflect the manner in which incumbent LECs incur SS7 costs, and so may skew the development of competition for SS7 services. Therefore, we seek comment in this section on whether and how to revise the rate structure for SS7 services.

124. SS7 networks consist of high-speed packet switches and dedicated circuits that are separate from, but interconnected with, the telecommunications networks over which telephone calls are carried. Incumbent LECs typically use SS7 networks for three purposes: (1) for call setup; (2) to obtain information from remote databases, such as billing information that must be obtained from the line information database (LIDB) to determine whether a calling card is valid, or information identifying the designated carrier of a toll-free 800 service subscriber; and (3) to transmit the information and instructions necessary to provide custom local area signaling services (CLASS features), such as automatic call back and caller ID. The SS7 signalling networks will also play an important role in the implementation of intelligent network (IN) functionality in incumbent LEC networks. [188]

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***21412** 125. As illustrated in Figure 2 above, incumbent LEC CCS networks generally include the following basic components. Dedicated network access lines (DNALs) are dedicated circuits that transmit queries between incumbent LECs' signalling networks and the signalling networks of other carriers, such as IXCs. The DNAL can be provided by the incumbent LEC or by the other carrier, although incumbent LECs generally provide the DNAL under their current SS7 tariffs. The DNAL is connected to a port on an incumbent LEC's signal transfer point (STP), a specialized packet switch that performs screening and security functions, and switches SS7 messages within the incumbent LEC signalling network. Messages within the incumbent LEC signalling network travel over signal transport links, which are typically dedicated DS1 circuits. SS7 messages are formulated within the incumbent LEC signalling network at service switching points (SSPs), which are generally end office and tandem switches with the necessary software. Finally, service control points (SCPs) are computer databases that respond to network signalling queries and perform related functions. An additional term that is often used in describing SS7 networks is a signalling point (SP), which refers to any point on an SS7 network that formulates or switches signalling queries.

126. Under the interim transport rate structure, incumbent LECs charge IXCs and other access customers a flat-rated charge (called "dedicated signalling transport" in Part 69 of the rules) for the use of dedicated facilities to connect to the incumbent LECs' signalling networks. [189] This rate element is composed of two subelements: a flat-rated signalling link charge for the DNAL, and a flat-rated STP port termination charge. Most other SS7 ***21413** signalling costs, including those for switching messages at the local STP, for transmitting messages between an STP and the incumbent LEC end office switch or tandem switch, and for processing and formulating signal information at an end office or tandem switch, are not recovered through facility-based charges, and thus most, if not all, of these costs are presumably embedded in the TIC and the local switching charge. At SCPs, such as the 800 and LIDB databases, incumbent LECs typically assess a per-query charge for the retrieval of information and the transmission of the query to and from the database. [190] Incumbent LECs also recover costs associated with the provision of certain signalling information necessary for third-parties to offer tandem switching through the "signalling for tandem switching" rate element. [191]

2. Ameritech's SS7 Rate Structure

127. On March 27, 1996, the Common Carrier Bureau granted Ameritech a waiver to restructure the manner in which it recovers its SS7 costs. The rate structure established by Ameritech pursuant to that waiver recovers costs associated with the provision of SS7 signalling services through four unbundled charges for the various functions performed by incumbent LEC CCS networks: (1) signal link; (2) STP port termination; (3) signal transport; and (4) signal switching. [192] We invite comment on using the waiver granted to Ameritech as a model for a revised SS7 rate structure for the industry as a whole.

128. Signal Link. We seek comment on whether costs associated with the DNAL -- the dedicated facility connecting an SS7 customer's network to a dedicated port on the incumbent LEC's STP -- should continue to be recovered through a flat-rated distance-sensitive signal link charge. [193] Flat-rated cost recovery appears reasonable because the DNAL is a dedicated circuit serving a single SS7 customer, similar to those circuits used to provide special access or direct-trunked transport. Incumbent LECs' SS7 customers could provide their own DNAL, or purchase a DNAL from the incumbent LEC by paying the signal link ***21414** charge. We also seek comment on whether the signal link should remain in the transport service categories in the trunking basket. [194]

129. STP Port Termination. We seek comment on whether the costs associated with the dedicated port on the incumbent LEC's local STP that connects to a customer's DNAL should be recovered through a flat-rated charge. This charge would include the portion of costs currently recovered through the STP port termination subelement associated with the STP port, but not the costs recovered through that subelement today associated with the screening and switching functions of the STP, which we understand are not performed by the port. Because the STP port termination costs are dedicated to a particular SS7 customer, we ask whether they should be recovered on a flat-rated basis.

130. We also seek comment on whether the STP port termination element should be placed in a new service category in the traffic-sensitive basket. Although STP port termination rates today are in the same service category as the signalling link, these two services are subject to different competitive conditions. Specifically, although interconnectors can provide their own signal link, the STP port is part of the incumbent LEC's STP and therefore must be purchased from the incumbent LEC. Consequently, incumbent LECs could offset reductions in their charges for the signal link with increases in the STP port charges if STP port termination and the signal link remained in the same service category. The STP port termination element appears analogous to the dedicated line cards and trunk cards discussed in the local switching rate structure discussion above, and therefore we seek comment on whether it should be placed in a new "signalling" service category in the traffic-sensitive basket. Recognizing that STP port costs may be relatively small compared to signal link costs, we seek comment on whether the benefits we have identified outweigh the administrative burdens of implementing such a system and creating a new price cap service category. Another alternative would be to remove the STP port termination element, and other non-competitive SS7 elements essential for interconnection, from price caps entirely, as we have done for expanded interconnection. We seek comment on this option.

131. Signal Transport. The circuits that carry SS7 queries between STPs, switches, and SCPs within incumbent LEC signalling networks are comparable to the shared circuits incumbent LECs use to provide transport between end office and tandem switches. SS7 queries associated with many different calls traverse the same signal transport links simultaneously, and so a usage-sensitive charge for these shared facilities appears appropriate. As with signal switching, discussed below, the costs of signal transport appear most closely related to the number of queries, and therefore we seek comment on whether this charge should be assessed on a per-query basis. We also seek comment on whether incumbent LECs should be permitted to charge distance sensitive rates for signal transport, and the appropriate level of distance sensitivity that should be allowed.

***21415** 132. It appears that signal transport is a form of transport, and therefore we invite comment on placing this service in the trunking basket. We also invite comment on placing signal transport in the existing "signalling for tandem switching" service category. In addition, interested parties may discuss whether to place this service in a separate service category from the signal link, because the signal link may be provided by other carriers while signal transport generally must be performed by the incumbent LEC.

133. Signal Switching. We seek comment on whether costs related to processing and switching by the STP should be recovered on a per-query, usage-sensitive basis. [195] These costs are similar to the costs incurred in switching telephone calls at end office and tandem switches. Unlike end office and tandem switches, however, STPs switch only data, and a single call may involve multiple instances of signal switching. Because the costs associated with signal switching relate more to the number of SS7 queries switched than to the number or duration of calls, we ask whether the signal switching charge should be assessed based on the number of SS7 messages switched. For the reasons we have identified above in the context of central office and tandem switching, we seek comment on whether peak load pricing would be appropriate for signal switching.

134. We propose to place this service in the traffic-sensitive basket. We further seek comment on whether to place this service in the same service category as the STP port termination charge, or whether to create a new service category for signal switching.

3. Other SS7 Issues

135. We also invite parties to suggest alternative rate structures for SS7 signalling. For example, we permitted Ameritech to implement rate elements for signal tandem switching, signal formulation, and optional parameters. We also seek comment on whether incumbent LECs should be permitted to impose separate charges for ISDN User Part (ISUP) messages, which are used in setting up and taking down calls, and Transaction Capabilities Application Part (TCAP) messages, which are used primarily for database queries and CLASS services such as enhanced caller ID, or whether some other differentiation should be made between charges for different types of SS7 messages. [196] Although such differentiation could be economically justified on the basis of the different average lengths of ISUP and TCAP queries (and therefore the differential load they tend to place on the SS7 network), we ***21416** question whether we should do so in the interests of rate structure simplicity. To the extent that parties contend that differentiated charges for TCAP and ISUP messages should be adopted, we ask those parties to provide specific information and data to support such a claim. Parties that favor an alternate structure are asked to provide details of any such alternatives, and to explain how such alternatives would be consistent with the goals of this proceeding. In particular, we ask parties to discuss ways in which the SS7 rate structure we have proposed could be simplified. The desire for rate structure simplicity may conflict with the goal of economic cost-causation, and we seek comment on the appropriate manner in which we should strike this balance for SS7 signalling.

136. We seek comment on whether the pricing for facility-based signalling rate elements should be determined under the price caps new services test. As we discussed in the *Ameritech SS7 Waiver Order*, although the proposed SS7 rate elements would probably be considered restructured services under our price cap rules, we tentatively conclude a requirement of revenue neutrality and the cost showing specified under the new services test would serve the public interest in this context. [197] The different SS7 elements are likely to be subject to different competitive pressures, and the current rate structure does not provide a sufficient basis, absent a cost showing by incumbent LECs, on which to base the rates for these new charges.

137. Incumbent LECs may need to install additional monitoring equipment in order to bill properly for unbundled SS7 services. Some incumbent LECs may not currently have the capacity to meter any SS7 traffic, and some incumbent LECs may only have such metering capacity at STPs, not at signalling points in tandem offices. [198] We seek comment on the feasibility and cost of mandating a rate structure for SS7 services that would require incumbent price cap LECs to install equipment for metering SS7 traffic in their networks. We also invite comment on whether and the extent to which the costs of any equipment needed to comply with our proposed rules warrant exogenous cost treatment under our price cap rules. [199] In the *800 Database* proceeding, the Commission permitted incumbent LECs exogenous treatment of the reasonable costs they incurred specifically to provide basic 800 ***21417** database service. [200] Unlike the rules we adopted in the *800 Database* proceeding, however, the SS7 rules we are contemplating here would not require incumbent LECs to provide any service they are not currently providing. The rules instead would require incumbent LECs to recover the costs of any SS7 service they choose to provide in a fashion that reflects the way they incur those costs. Thus, the costs of SS7 metering equipment may not warrant exogenous cost treatment.

138. We tentatively conclude that, under the proposal described above, the existing charge incumbent LECs assess on third party tandem switching providers (TSPs) for the provision of signalling codes necessary for those TSPs to interconnect their tandem switches with incumbent LEC transport networks should be eliminated and replaced by charges for the specific SS7 functions associated with providing this signalling information. Although this charge serves a particular purpose, this service appears to use the same basic SS7 functions as other signalling services. Thus, although the "signalling for tandem switching" service category would remain in the trunking basket, that category would include only the newly-created signal transport element, and would be renamed as the "signalling transport" service category. We seek comment on this analysis. Even if we do not eliminate the existing signalling for tandem switching charge, we have proposed to place several new rate elements into the existing signalling for tandem switching service category that recover some costs not related to tandem switching. Signal transport, for

example, recovers costs for signalling associated both with tandem-switched and with direct-trunked calls. In order to avoid confusion, we tentatively conclude that the signalling for tandem switching service category in the trunking basket should be renamed as the "signalling" service category.

G. New Technologies

139. Developments in switching and transmission technology are producing new telecommunications capabilities that offer the potential for new services and lower prices in the future. [201] These include synchronous optical networks (SONET), [202] Asynchronous ***21418** Transfer Mode (ATM) [203] switching, and advanced intelligent networks (AIN). [204] We seek comment on whether, and how, we should take these new technologies into account in adopting access charge rules. We also invite parties to recommend specific rate structure rules that would reflect the manner in which incumbent LECs incur costs when providing services using these technologies. We also seek comment on whether we should adopt access charge rules to govern rate structures for services employing any other new technologies.

IV. APPROACHES TO ACCESS RATE REFORM AND DEREGULATION

A. Different Approaches to Access Reform

140. Our overriding goal in this proceeding is to adopt revisions to our access charge rules that will foster competition for these services and eventually enable marketplace forces to eliminate the need for price regulation of these services. In addition to the rate structure changes discussed above, we suggest in this Notice two different approaches to access reform -- a market-based approach and a more prescriptive approach. We could adopt a market-based approach to access reform under which we would let marketplace pressure move interstate access prices to competitive levels. This approach could be implemented incrementally, first eliminating certain regulatory constraints as incumbent price cap LECs demonstrate through credible, verifiable evidence that the conditions necessary for efficient local competition to develop in their service areas exist. Then, as incumbent LECs show that competition has emerged, additional regulatory constraints, including mandatory rate structures, would be eliminated to allow those LECs to adjust their interstate access rates. Finally, when substantial competition has developed, price regulation would be eliminated.

141. Some parties, however, may contend that a market-based approach will allow incumbent LECs to continue indefinitely to assess inflated prices for some or most access ***21419** services in some or most geographic areas. [205] These parties would urge us to adopt a prescriptive approach to access reform. Under this approach, we would require incumbent LECs to move their prices to specified levels and allow such LECs limited pricing flexibility until they can demonstrate they face actual competition for access.

142. A market-based approach has a number of advantages. It creates incentives for incumbent LECs to act quickly to open the local exchange and exchange access market to competition, by making that a condition for having additional flexibility to respond to competition from facilities-based competitors. It allows marketplace forces, rather than regulation, to determine how quickly prices move to cost-based levels. A market-based approach also has some disadvantages. Marketplace forces may not require incumbent LECs to assess cost-based prices for access prices as quickly as a prescriptive approach. It may also be difficult to develop reliable, administratively simple criteria for assessing evidence of competitive entry and determining the existing regulatory constraints that should be relaxed based on such a showing.

143. Conversely, the advantages to a prescriptive approach are that the Commission can move prices to cost-based levels quickly and avoid the need to develop criteria for determining whether competition is sufficient to allow incumbent LECs additional pricing flexibility. The principal disadvantage to a prescriptive approach is that it requires the Commission to make detailed determinations of appropriate price levels for multiple services throughout the country. Another disadvantage is that, in the event an incumbent LEC can show its embedded costs are significantly higher than its forward-looking costs, the Commission

would be required to determine how much of the difference incumbent LECs should be given a reasonable opportunity to recover and the method for that recovery.

144. We set forth below both a market-based approach and a more prescriptive approach. We seek comment on whether we should: select one of the two approaches as our exclusive method of reforming access charges in a manner that is most likely to lead to the conditions that will enable us to deregulate access charges; adopt both approaches as alternatives; or merge the two approaches in some fashion. For example, if barriers to competition are not eliminated, a market-based approach to access reform likely would not work. If a market-based approach were adopted, we might nonetheless seek to ensure that prices move toward economic cost even though barriers to competition are not eliminated within a reasonable time for certain services or in some geographic areas, by adopting an alternative prescriptive approach for those services or geographic areas.

145. Commenters advocating a merger of both a market-based approach and a prescriptive approach should describe how the two approaches can be melded. For example, ***21420** what criteria should be used for determining whether to impose prescriptive access reform and at what time? How would a combination of the two approaches work if barriers to competition were eliminated, but later reinstituted?

146. Commenters proposing a melding of both approaches should also discuss any regulatory safeguards that may be needed. For example, an incumbent LEC might face different regulatory regimes in different parts of its service region, or for different access services. This may create an incentive for incumbent LECs to increase costs artificially for the services or areas that are subject to prescriptive regulation or less competition. Incumbent LEC incentives to misallocate costs in this manner would depend on whether such cost changes would affect incumbent LEC rates under prescriptive regulation, and on the magnitude of any such effect.

147. We have previously faced issues that arise when an incumbent LEC is subject to different regulatory regimes for different access services, in the context of the BOCs' provision of enhanced services. Specifically, the Commission decided not to regulate enhanced services because the market for such services is competitive. [206] The Commission currently employs accounting safeguards designed to prevent common carriers from shifting costs from nonregulated to regulated services, without precluding them from taking advantage of any economies of scope. [207] We adopted the "all or nothing" rule in the *LEC Price Cap Order* to address similar concerns about incumbent LECs shifting costs from affiliates governed by price cap regulation to affiliates governed by rate-of-return regulation. [208] Should similar safeguards be adopted if a combination of market-based access reform and prescriptive access reform is adopted? We also invite comment on whether there are any other issues raised by applying different regulations to different services or areas.

148. We also seek comment generally on how incumbent LEC provision of in-region interLATA services -- either by independent incumbent LECs or potentially by BOCs upon FCC approval under section 271 -- should affect our choice of a market-based or prescriptive approach, or the phases for implementing each approach. Conversely, we seek comment on ***21421** how our selection of a market-based or prescriptive approach should affect, if at all, our consideration, of BOC applications, for in-region provision of interLATA services. As discussed earlier in Section I.B, IXCs argue that, to the extent access services are not available to IXCs at their forward-looking economic cost, incumbent LECs and their long-distance affiliates will have an artificial competitive advantage in the market for long-distance services that may distort the effects of competition and result in inflated retail prices. We ask parties concerned about a possible "price squeeze" to identify the conditions under which we should be concerned. We ask parties to comment on whether the availability of unbundled network elements at their forward-looking economic cost would reduce the danger of a price squeeze insofar as IXCs might use those elements to provide their own access to customers for whom they are the local service provider.

B. The Goal -- Deregulation in the Presence of Substantial Competition

1. Objectives

149. Regardless of the specific approach that we adopt in this proceeding -- market-based, prescriptive, or some combination of the two -- our goal is to foster the development of substantial competition for interstate access services. Once substantial competition is present for a particular service in a particular area, we propose to remove that service from price cap and tariff regulation for that area.

150. Our plan to remove from price cap regulation interstate access services that are subject to substantial competition is consistent with prior decisions in which the FCC gradually removed AT&T's services from price cap regulation. [209] Our analysis of whether AT&T's services were subject to substantial competition rested on considerations of market share, demand responsiveness, supply responsiveness, and AT&T's pricing behavior. We recognize, that unlike AT&T, incumbent LECs control bottleneck facilities, particularly the loop. Nevertheless, the 1996 Act seeks to erode this source of market power by requiring incumbent LECs to make unbundled network elements and resale available. In view of the similarities between the structure of and purposes behind the AT&T and the LEC price cap plans, the analytical framework that we used to streamline AT&T's services would appear to be an appropriate method for effectively deregulating incumbent LEC services. We also propose to eliminate tariff filing requirements for services subject to substantial competition. [210] We seek comment on whether these actions are appropriate under these conditions, and whether we should adopt any other deregulatory measures when an incumbent LEC service is ***21422** subject to substantial competition. Below, we seek comment on the factors used in examining AT&T's pricing behavior. We invite comment on which of these, alone or in conjunction with these or other factors, could be used to determine when to remove incumbent LEC access services from price cap regulation.

151. We propose that the substantial competition analysis should be considered on a service-by-service basis so that, for example, directory assistance could be removed from price cap regulation where substantial competition exists for directory assistance, even if not for local switching. Such an approach is consistent with our approach to removing AT&T's services from price cap regulation, and would allow incumbent LECs to price competitively where competition has developed, while not permitting incumbent LECs to raise prices for services for which competition has not developed sufficiently. [211]

152. We ask commenters to address whether, instead of requiring the presence of substantial competition, we should remove from price cap regulation services for which the incumbent LEC cannot influence price movements. There may be circumstances in which incumbent LECs cannot affect price changes in the market, even in the absence of substantial competition. Our public interest concern is whether incumbent LECs can adversely affect price movements. Using such an approach may remove an incumbent LEC's services from price cap regulation even if no competitors enter the market, but the incumbent LEC has complied with the requirements of the 1996 Act.

153. We further ask whether high-capacity special access services, *e.g.*, those special access services offered at speeds of DS1 or higher, should be removed immediately from price cap regulation. Many incumbent LECs contend that for certain geographic markets these special access services are already subject to intense competitive pressures that today discipline incumbent LEC pricing of such services. If these allegations are correct, our pro-competitive goals could be served by removing these services from price caps. We ask parties to address the degree of competition that exists for such services, including any quantification that may be available. We invite parties to comment on whether any other incumbent LEC services in particular geographic areas are already subject to substantial competition and therefore should be removed from price cap regulation. [212]

154. We solicit comment on the procedures that an incumbent LEC should follow to demonstrate that one or more services are subject to substantial competition. Parties should ***21423** discuss whether an incumbent LEC should file a petition for waiver, a petition for declaratory ruling, or some other filing, and how the incumbent LEC should satisfy its burden of proof. In addition, we tentatively conclude that we should adopt rules governing the recalculation of the price cap indices when one or more services in a basket are removed. Such rules would speed the review of the tariffs that incorporate the recalculated indices. We invite parties to comment on this tentative conclusion, and to propose particular rules that we should adopt.

155. We also seek comment on what geographic area should be used in examining whether a service is subject to substantial competition. The level of competition for different services likely will vary by geographic area, even within the same state. Thus, we propose not to rely on a statewide analysis of competition. We seek comment on whether the relevant geographic areas

should conform to the areas implemented by the relevant state in making unbundled network elements available to competitors. Because the costs of competitors using unbundled network elements will be affected by these geographic areas, it may be appropriate that incumbent LEC access prices vary according to them. We acknowledge that it is possible that competition can vary significantly even within such a zone.[213] Alternatively, should we require that the geographic areas coincide with the zones adopted in the Universal Service proceeding to determine high cost areas?[214] A third approach would be to use the same geographic areas that we might select for geographic deaveraging if we were to adopt the market-based approach set out in Section V, below. We seek comment on these options.

***21424 2. Competitive Factors**

a. Demand Responsiveness[215]

156. Incumbent LECs may seek to demonstrate that the market for particular interstate access services is competitive through evidence indicating that, where comparable access services are available to the incumbent LECs' customers, a significant number of those customers have the ability to evaluate the full range of market options available to them, and the customers do in fact exercise these options. We therefore propose that the demand responsiveness of the incumbent LECs' customers should be an important factor in assessing the level of competition for incumbent LEC services for purposes of determining whether a service should be removed from price cap regulation. We seek comment on this proposal. Parties should identify the relevant factors that should be used in determining whether an incumbent LEC's customers are demand-responsive; the data and information that would be necessary and relevant in determining whether an incumbent LEC's customers are demand-responsive; and whether the fact that incumbent LECs have relatively few customers that account for most of their interstate access demand affects the usefulness of demand-responsiveness as a factor in determining the level of competition. Alternatively, we seek comment on the proposal that a LEC need only provide evidence that comparable access services are available from other carriers and need not provide evidence specifically on demand responsiveness.

b. Supply Responsiveness[216]

157. We invite comment on whether supply responsiveness should be a factor in determining the level of competition for purposes of determining whether specific interstate access services should be removed from price cap regulation. If so, we ask parties to identify the factors that are relevant in determining whether an incumbent LEC's competitors have enough readily-available supply capacity to constrain the incumbent LEC's market behavior and inhibit it from charging excessive rates; and the data and information that would be necessary and relevant in determining whether an incumbent LEC's competitors are supply- ***21425** responsive.[217] Supply elasticities of an incumbent LEC's competitors may be important in assessing the level of competition for incumbent LEC services. However, we tentatively conclude that the ready availability of unbundled network elements at forward-looking economic cost decreases the cost of entry for access services. Their ready availability would indicate a high supply elasticity in the access market.

c. Market Share%

158. As we observed in the *Price Cap Second FNPRM*, at the time we considered giving AT&T streamlined regulation for certain long-distance services, we determined that a high market share does not necessarily confer market power.[218] A company that enjoys a very high market share will be constrained from raising its prices above cost if the market is characterized by high supply and demand elasticities at prices even slightly above competitive levels.[219] An analysis of the level of competition for incumbent LEC services based solely on an incumbent LEC's market share at a given time may not provide sufficient evidence for us to conclude that substantial competition truly exists. While we do not propose to ignore market share data in assessing the level of competition for incumbent LEC services, we propose to consider market share in conjunction with other factors, including, but not necessarily limited to, supply and demand elasticities and pricing trends. We ask parties whether market share

should be a factor in determining the level of competition for purposes of determining whether services should be removed from price cap regulation. If so, we ask parties to discuss how market share should be measured.

d. Pricing of Services Under Price Cap Regulation

159. Evidence that a price cap LEC is pricing services below the price cap ceiling over a sustained period may indicate that such services are subject to competitive pressures, particularly in markets with high supply and demand elasticities. An incumbent LEC's below-cap pricing of services, however, is not necessarily a reliable measure of competition. ***21426** While below-cap pricing may indicate a market with high supply and demand elasticities, it could also occur because the incumbent LEC is behaving strategically in order to be relieved of regulation. Pricing at the cap may be evidence of a lack of competition, or that the cap is close to the forward-looking economic cost of the service. How much significance should we give to evidence that a price cap LEC is pricing services below the price cap ceiling over a sustained period?

e. Other Factors

160. We invite comment and discussion on whether there are other factors in addition to those discussed above that we should consider in an evaluation of the competition faced by an incumbent LEC, for example elimination of barriers to entry in the event it is not otherwise required. Parties that suggest other factors to assess the level of competition for incumbent LEC services should discuss what data and information would be necessary to assess the relative importance of these factors.

V. MARKET-BASED APPROACH TO ACCESS REFORM

A. Introduction

161. In this section, we seek comment on an approach to access reform that relies on marketplace forces to move interstate access prices to more economically efficient levels. Under this approach, our primary role would be to remove regulatory requirements that inhibit the operation of market forces. In the Third Report and Order, below, we begin this process by adopting two immediate changes: we eliminate the price caps lower service band indices; and we ease substantially the requirements necessary for the introduction of new interstate access services. [220] In Section III, above, we propose rate structure changes designed to make the baseline regulatory scheme more efficient. In this section, we propose a plan for reducing regulation in two phases as competitive benchmarks are achieved short of substantial competition. [221]

162. Using a competitive paradigm, the issue becomes one of identifying the market conditions that should trigger the removal of existing regulatory constraints. Under the procedure we propose in this section, we would implement regulatory reforms as incumbent ***21427** LECs demonstrate that their local markets have achieved pre-defined, specific transition points, or " competitive triggers." We are seeking comment on removing uneconomic regulatory constraints in two preliminary phases before a finding of substantial competition for access services in specific areas permits the detariffing of access services.

163. We seek comment on whether Phase 1, potential competition, would be achieved when an incumbent LEC has opened its network by removing the most immediate barriers to competitive entry. At this stage, we are seeking comment on targeted reforms that remove uneconomic regulatory requirements that inhibit incumbent LECs from charging access prices that reflect the cost differentials in serving different geographic areas, from lowering access prices non-predatorily, and from pricing optional new services based on market considerations. We are seeking comment on whether an incumbent LEC should be required to show that some or all of the following conditions exist to trigger Phase 1: (1) unbundled network element prices are based on geographically deaveraged, forward-looking economic costs in a manner that reflects the way costs are incurred; (2) transport and termination charges are based on the additional cost of transporting and terminating another carrier's traffic; (3) wholesale prices for retail services are based on reasonably avoidable costs; (4) network elements and services are capable of being provisioned rapidly and consistent with a significant level of demand; (5) dialing parity is provided by the incumbent LEC to competitors; (6) number portability is provided by the incumbent LEC to competitors; (7) access to incumbent LEC rights-

of-way is provided to competitors; and (8) open and non-discriminatory network standards and protocols are put into effect. We anticipate that at least some incumbent LECs reasonably should be able to satisfy these conditions during 1997. We also invite comment on whether the first three possible conditions, which relate to the pricing of uses of the incumbent LECs' networks other than access, might be sufficient to permit certain of the access pricing reforms about which we are seeking comment.

164. We invite comment on whether Phase 2 would be met when an actual competitive presence has developed in the marketplace. For an incumbent LEC to demonstrate that Phase 2 has been achieved for a particular service or within a given area, we invite parties to comment on the following tests: (1) demonstrated presence of competition; (2) full implementation of competitively neutral universal service support mechanisms; and (3) credible and timely enforcement of pro-competitive rules. We also seek comment on whether an incumbent LEC should instead be eligible for Phase 2 treatment if it has made its facilities and services available in a reasonable and nondiscriminatory fashion, but no competitors have entered to serve the incumbent LEC's service area. [222] Would this be sufficient to address the public interest considerations involved in implementing the Phase 2 reforms?

***21428** 165. We invite comment on this general approach to access reform, and on the specific regulatory reforms proposed and their respective competitive benchmarks. We also seek comment on whether these or other regulatory reforms should be implemented without the achievement of any competitive benchmarks, or upon the achievement of benchmarks different from those proposed.

166. The 1996 Act became law after we issued the *Price Cap Second Further NPRM*. Because many of the issues raised in that Notice are closely related to issues central to this proceeding, we here re-notice many of the proposed provisions to remove regulatory burdens contained in the *Price Cap Second FNPRM*. In developing this Notice we have considered the comments we received in response to the *Price Cap Second FNPRM*. Because of the intervening passage of the 1996 Act, however, we will limit the record in this proceeding to the comments received in response to this Notice. Parties who filed in response to the *Price Cap Second FNPRM* should not rely on those comments, but instead should file anew. [223]

167. As discussed in Section II.A, above, the removal of regulatory constraints considered in this section is applicable to incumbent LECs subject to price cap regulation. Arguably, small incumbent LECs are affected in the sense that regulatory constraints are not being removed for them as are some of the constraints for price cap incumbent LECs. [224] Small incumbent LECs will not be otherwise affected by the proposals contained herein. While these proposals may indirectly affect small entities, especially competitive LECs and access customers, we anticipate that they will not have an impact on small entity reporting, record keeping, or other compliance requirements. [225] We invite parties to comment on this analysis. [226]

B. Phase 1 -- Potential Competition

168. We propose to eliminate four significant regulatory constraints when an incumbent LEC can demonstrate that it faces potential competition for interstate access services in specific geographic areas: the prohibition against geographic deaveraging within a study area; the ban on volume and term discounts for interstate access services; the current prohibition against contract tariffs and individual request for proposals (RFP) responses; and ***21429** various restraints on the ability of incumbent LECs to offer new, innovative access services. [227] We note that Ameritech has proposed conditioning simplification of price cap regulation upon the achievement of certain competitive triggers. [228] We propose these changes because, once a LEC satisfies the triggers we have identified, competitive forces should come most quickly to bear on the provision of interstate access in low-cost geographic areas and to large customers. Removing these restraints should permit LECs greater ability to price economically and therefore bring more competitive pressures, including lower prices, in areas and for services where we expect competitive forces initially to be strongest. Such reforms would have the goal of fostering efficient and effective competition, to the benefit of customers, wherever possible. Without such reform, continuing uneconomic regulation may serve primarily to permit inefficient new entrants to gain market share among the most attractive customers rapidly. We seek comment generally on this analysis and specifically on the conditions and pricing reforms set out below. We also seek comment on whether we should modify any other of our regulatory pricing constraints at the time the Phase 1 competitive triggers have been met.

1. Trigger and Geographic Scope

169. We propose that the Phase 1 rule changes take effect when an incumbent LEC's network has been successfully opened to competition. The proposed Phase 1 rule changes remove restrictions that limit the ability of incumbent LECs to re-price access services in ways that respond to competitive pressure, but do not impede competitive entry. We seek comment on whether some or all of the tests described below provide the necessary and sufficient criteria for us to determine, for this purpose, whether an incumbent LEC's network has been opened to competition. We also seek comment on whether we should use any other test instead of, or in conjunction with, those we propose.

170. *Unbundled Network Elements.* The first condition we propose is that unbundled network elements be available at forward-looking economic cost, i.e., on the basis of the TELRIC of the network element (also known as Total Element Long Run Incremental Cost), plus a reasonable allocation of common cost. Unbundled elements provide a ubiquitous substitute for access service. Where access charges exceed forward-looking economic cost (due to the structure or level of access being inefficient), IXCs have an artificial incentive to ***21430** "win" the customer and provide both local and toll service using unbundled elements. We expect that availability of unbundled elements at TELRIC prices as a substitute for access charges will ultimately require the LEC to set its charges in an economically efficient manner so as to give customers the most economic value consistent with covering costs. Will the availability of unbundled network elements at forward-looking economic costs drive LECs' access charges to efficient levels and structures? Or will it only tend to constrain the overall level of charges, and give incumbent LECs incentives to choose inefficiently high or inefficiently structured access charges, thus disadvantaging IXCs that are not effectively integrated into local service, and thus driving the market, possibly inefficiently, towards one-stop shopping? Commenters are asked to outline the specific mechanism by which such competition will affect access rates. Those who believe competition from unbundled network elements will not affect access rates should explain why.

171. In order for unbundled elements to promote ubiquitous competition effectively, prices for unbundled network elements must be geographically deaveraged. Costs may vary across geographic areas based on the density of the area served, topography, or other characteristics of the area. When the prices of elements that vary materially in cost are averaged, the ability to substitute unbundled elements for access will not drive access rates to their efficient level, because such prices will understate the cost of providing services over the elements in high-cost areas and overstate the cost of providing services over the elements in low-cost areas. When element prices have been deaveraged to reflect cost differences, any divergence between element prices and access charges required by regulation creates an artificial incentive to substitute unbundled elements for access.

172. We seek comment on whether, for purposes of implementing market-based access reform, an incumbent LEC should not be deemed to have satisfied the Phase 1 competitive triggers unless and until rates for unbundled network elements are available at geographically deaveraged, forward-looking economic costs in a manner that reflects the way costs are incurred. For the purpose of determining whether deaveraging has occurred, we tentatively conclude that there should must be at least three geographic zones.

173. *Transport and Termination.* The next condition we propose for Phase 1 is that transport and termination be available for local traffic at cost-based rates. Because unbundled network elements only act as an effective substitute for switched access where the requesting carrier can provide both local and interexchange service to the end user, a carrier must be able to offer ubiquitous local service at competitive rates. This requires transport and termination on the LEC network to be available at the incumbent LEC's additional cost. Even assuming rates are reciprocal, transport and termination rates that exceed cost impede efficient entry and limit the extent to which competitive LECs will compete for customers in local exchange and exchange access markets. Where a customer makes more calls than he receives, inflated transport and termination rates will impede competition for that customer. We seek comment on whether we should begin to implement market-based access reform for an incumbent LEC ***21431** before that incumbent LEC has complied with the statutory requirement to provide transport and termination at cost-based rates.

174. *Resale.* We also propose that, in order to gain Phase 1 treatment, an incumbent LEC must offer its retail services to resellers at a wholesale price, which is equal to the retail price minus the reasonably avoidable cost of providing wholesale rather than

retail service. Congress provided that incumbent LECs should make their retail services available to new entrants at the retail rate less costs that will be avoided. [229] Although resellers do not compete with incumbent LECs in the provision of access, this requirement is a "stepping stone" in the provision of other forms of competition. Resale should provide new entrants with a vehicle for rapid entry into the local exchange retail marketplace and with the ability to compete throughout an incumbent LEC's service area. We seek comment on this proposal.

175. *Availability of Elements and Services.* Fourth, we propose that incumbent LECs be required to demonstrate that competitors are able actually to order and receive elements and services in a commercially reasonable manner and in necessary quantities. Provisioning limits and provisioning delays must not materially limit the flow of customers from the incumbent LEC to its rivals. Incumbent LECs must create well-functioning and adequately sized provisioning systems, both for resale and for unbundled elements. We invite parties to comment on this proposal.

176. *Other Factors.* We propose several other factors for determining whether a LEC has made its network available to competitors; namely, whether an incumbent LEC provides dialing parity and number portability, whether an incumbent LEC gives competitors access to its rights-of-way, and whether network standards are open and non-discriminatory. For example, without the provision of dialing parity, competitors' customers must dial additional digits. Without number portability, a customer's desire to keep his phone number becomes a barrier to new entrants. We seek comment on these factors, and invite parties to comment on the availability of any factor that should be taken into account in determining whether the Phase 1 trigger has been met.

177. We tentatively conclude that it is important to use objectively measurable criteria for determining whether an incumbent LEC has achieved the Phase 1 trigger, so as to avoid delay caused by protracted proceedings and to minimize administrative burdens for all parties. In determining whether an incumbent LEC meets the Phase 1 criteria, we tentatively conclude that the incumbent LEC seeking Phase 1 treatment offer us objective evidence of the existence of these conditions. After receiving the incumbent LEC's filing, we propose to allow for public comment. We propose that we would then issue our decision within 90 days after the comment period has ended. We seek comment on this proposed review mechanism.

***21432** 178. We solicit comment on the procedures that an incumbent LEC should follow to demonstrate that it has met the Phase 1 competitive trigger. Petitioners should discuss whether an incumbent LEC should file a petition for waiver, a petition for declaratory ruling, or some other filing, and how the incumbent LEC should satisfy its burden of proof. Because incumbent LECs are required to open their networks throughout each state in which they offer service, we propose to require that incumbent LECs meet this competitive trigger on a state-by-state basis in order to qualify for this relief. We ask, however, whether incumbent LECs should be able to seek Phase 1 treatment by geographic area, as discussed in Section IV.B., above, even though these areas would be smaller than study areas. We seek comment on this proposal.

179. We also invite parties to comment on what actions the Commission should take in the event that it is shown that a LEC that has received approval for Phase 1 or Phase 2 relief, or has demonstrated that substantial competition exists for a particular service, no longer satisfies the applicable criteria. [230] We particularly invite comment on whether the Commission's complaint process is the appropriate vehicle for parties to demonstrate the necessary changed circumstances and the specific remedies the Commission should employ in the event that an incumbent LEC no longer meets the applicable Phase 1 or Phase 2 criteria, or can no longer demonstrate the existence of substantial competition for a particular service.

2. Reforms

a. Geographic Deaveraging

180. Our Part 69 rules generally require that an incumbent LEC's charges for access elements be averaged within each of its study areas. [231] We have developed, however, a system of density pricing zones, which may be used by an incumbent LEC to deaverage geographically its rates for special access and switched transport services if that incumbent LEC meets certain threshold interconnection requirements. [232] We instituted this density zone ***21433** pricing in response to the emergence of

competition in markets for those services. In this Notice, we propose allowing incumbent LECs that have met the Phase 1 trigger to deaverage rates geographically for all access charge elements other than the SLC. We ask generally whether incumbent LECs should also be able to deaverage the SLC geographically. In the case of first residential lines and single-line business lines, should incumbent LECs be permitted only to make geographically-deaveraged reductions in the SLC, in light of the Joint Board's recommended decision that there be no increases in the SLC for those lines? [233]

181. Incumbent LECs addressing this issue in response to the *Price Cap Second FNPRM* generally supported immediate geographic deaveraging of their charges for access elements. They asserted that costs vary significantly between urban and rural areas. They argued that the Commission should allow incumbent LECs to begin to deaverage their rates across geographic regions because non-cost-based, averaged rates cannot be maintained when their markets are open to competition. [234] Other commenters, particularly IXCs, opposed geographic deaveraging of access charges, arguing that incumbent LECs had not presented evidence that zone pricing would result in the reduction of prices towards cost. In particular, AT&T opposed zone pricing for local switching, arguing that local switching was not subject to competition, and that it is unlikely that the costs of local switching vary with volume or geography in a manner similar to transport costs. [235] As a result, AT&T predicted that geographic deaveraging of the remaining access charge elements would lead to higher margins between price and cost and would perpetuate uneconomic cross-subsidies.

182. In this Notice, we propose to permit price cap incumbent LECs that satisfy the Phase 1 eligibility requirements to deaverage geographically their access charge elements. We note that the availability of geographically deaveraged unbundled network elements is proposed as a prerequisite for Phase 1 relief. Where unbundled network elements are deaveraged, continuing to require access rates to be averaged across the study area would foreclose the incumbent LEC from meeting competition from unbundled network elements in low-cost areas, while still requiring the incumbent LEC to charge below-cost access rates in high-cost areas. As discussed in Section III.B, above, we seek comment on whether section 254(e) requires geographic deaveraging. We also seek comment on the relationship between geographic deaveraging of access charges and section 254(g). [236]

***21434** 183. Moreover, such discrepancies between price and cost distort competition by creating incentives for entry in low-cost areas by carriers whose cost of providing service is actually higher than the incumbent LEC's cost of serving that area. Similarly, geographic averaging across large geographic areas distorts the operation of markets in high-cost areas when we require incumbent LECs to continue offering services in those areas at prices substantially lower than their costs of providing those services. Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC. Therefore, we propose that once the requirements under Phase 1 have been met, incumbent LECs should be permitted to deaverage geographically rates for access elements.

184. We note that, pursuant to the *Special Access Expanded Interconnection Order* and the *Switched Transport Expanded Interconnection Order*, incumbent LECs currently may deaverage access charges for special access and switched transport services when one cross-connect has been taken within the study area. [237] Phase 1 deaveraging would be broader -- extending to all access elements other than the SLC, not just special access and switched transport -- and complementary to deaveraging under our *Expanded Interconnection* orders. Thus, for any incumbent price cap LECs that have not already met the one cross-connect threshold for transport deaveraging, we propose to permit geographic deaveraging for special access and switched transport when one cross-connect has been taken in the study area or when Phase 1 has been met, whichever is earlier.

185. We seek comment on the variability of the costs of providing access charge elements. In particular, we ask parties to submit evidence indicating whether per-line and/or per-minute costs of local switching services vary geographically. We also seek comment on the number and size of zones that should be required or allowed. One possible method is to permit or require that the geographic areas for access deaveraging match those implemented by each state pursuant to the 1996 Act. Because the prices for competitors using incumbent LEC unbundled network elements will differ among these density zones, it would seem necessary to permit incumbent LECs to price their own access services using the same areas. If the states deaverage network elements and the Commission does not deaverage access, IXCs would only purchase network elements in low-cost areas, and

would only take access in high-cost areas. We seek comment on alternative approaches for ensuring that geographic zones generally reflect cost differences and that the zones for unbundled network elements, universal service, and access charges are compatible. [238] We also ask whether any other ***21435** geographic areas would be more appropriate than either of these options. Further, we seek comment on whether incumbent LECs should be permitted or required to change the density zones established for special access and switched transport to coincide with the zones we ultimately adopt in this proceeding. In considering how best to deaverage geographically the remaining access elements, we seek to minimize administrative burdens for incumbent LECs and the Commission.

186. Finally, we note that section 254(g) requires IXCs' rates to subscribers in rural and high cost areas to be no higher than the rates for subscribers in urban areas. [239] We therefore invite parties to comment on how IXCs would be affected by incumbent LECs geographically deaveraging their rates for access elements.

b. Volume and Term Discounts

187. In this section, we consider permitting incumbent LECs to offer volume and term discounts for all of their access charge elements upon achievement of the Phase 1 competitive conditions. Volume and term discounts are permitted for special access services without any competitive showing or waiver of Part 69 of the Commission's rules. [240] We currently permit volume and term discounts on certain transport services when incumbent LECs can show a certain level of competition, as evidenced by a specified demand for their expanded interconnection services. In the *Switched Transport Expanded Interconnection Order,* we permitted incumbent LECs, once a specified threshold of interconnection was met, to offer reasonable volume and term discounts on entrance facilities and interoffice facilities and tandem-switched transport, including pricing that reflects speeds greater than DS3. We noted that, as a general matter, such discounts should be permitted if they are justified by underlying costs, and are not otherwise unlawful, because they encourage efficiency and full competition. [241] Term discounts recognize cost savings that result from the certainty of longer-term arrangements, and volume discounts reflect the lower per-unit cost of providing higher traffic volumes on high capacity facilities. [242] We have previously concluded that volume and term discounts can reasonably recognize certain efficiencies that flow from volume or term commitments made by purchasers. [243]

***21436** 188. The Commission currently allows an incumbent LEC to offer volume and term discounts on switched transport when one of the following conditions has been met: (1) 100 DS1-equivalent cross-connects for switched transport service were taken by an interconnector in the incumbent LEC's zone 1 offices in a study area, or (2) an average of 25 DS1-equivalent switched transport cross-connects per zone 1 office have been taken. [244] These thresholds were designed to balance the incumbent LECs' need for flexibility in light of growing competition with the need to give incumbent LECs incentive to act cooperatively in implementing expanded interconnection. [245] We found that discounted switched transport service constituted a new service under the price cap rules, thereby necessitating the filing of cost justification by the incumbent LEC. [246] We also required that discounted switched transport tariff filings be made 120 days in advance of their effective date, rather than 45 days in advance, as required for other new services. [247]

189. Incumbent LECs commenting on volume and term discounts in response to the *Price Cap Second FNPRM* generally supported the use of volume and term pricing on the ground that such pricing plans more accurately reflect the costs of providing access services to higher volume and longer term customers. [248] In particular, NYNEX stated that we should revise the Part 69 rules to permit volume and term discounts for usage-based switched access charges once barriers to entry into the market in local service had been removed, because "it will begin facing additional competition for these usage-based rates from CLECs who will offer their own Switched Access services." [249] AT&T, on the other hand, argued that volume and term discounts for switching are unjustified, and asserted that "the costs of switching generally do not vary with volume in the same way as the costs of transport, and therefore (unlike for transport), any economies of scale for switching are likely to be minimal or nonexistent." [250]

***21437** 190. Because of our current inefficient rate structures, incumbent LECs face pressure from high-volume customers due to the availability of bypass facilities. The condition that incumbent LECs make available unbundled network elements at forward-looking economic costs, including substantial scale and scope economies, will place additional pressure on access prices that do not also reflect forward-looking economic costs. We recognize the significant benefits that may result from volume and term discounts, including the possibility that volume and term discounts may enable an incumbent LEC to reflect its actual costs more accurately. However, we do not propose permitting incumbent LECs to offer volume and term discounts without first meeting a competitive condition because we remain concerned that such discounts may serve to inhibit competition if employed by incumbent LECs before competitors can offer volume and term discounts of their own. By "locking in" customers with substantial discounts for long-term contracts and volume commitments before a new entrant that could become more efficient than the incumbent can offer comparable volume and term discounts, it is possible that even a relatively inefficient incumbent LEC may be able to forestall the day when the more efficient entrant is able to provide customers with better prices.

191. Because of this concern, we therefore propose that incumbent LECs be permitted to offer volume and term discounts only if they have met the Phase 1 conditions. The existence of competition from the availability of unbundled elements makes it less likely that an incumbent LEC could lock in particularly desirable customers with long-term plans before competitors can respond. Instead, it seems more likely that the competitors will be able to use unbundled network elements to offer services at significant, pro-competitive volume and term discounts. Precluding volume and term discounts for access service rates would require the incumbent LEC to offer local switching services purchased in high volume or for long terms at prices greater than the incumbent LEC's costs for providing those services, which would impede the full development of effective competition. We seek comment on this proposal to give incumbent LECs the authority to provide volume and term discounts, and on the extent to which it might affect the emergence of competition in markets for exchange access services. We seek comment on whether these discounts need to be cost justified.

192. On the other hand, we tentatively conclude that it would not be in the public interest to permit incumbent LECs to offer "growth discounts" for particular access services at Phase 1. Growth discounts refer to pricing plans under which incumbent LECs offer reduced per-unit access service prices for customers that commit to purchase a certain percentage above their past usage, or reduced prices based on growth in traffic placed over an incumbent LEC's network. [251] We are concerned that because BOC affiliates will begin with existing relationships with end users, name recognition, and no subscribers, they will grow much more ***21438** quickly than existing IXCs and other new entrants. Thus, incumbent LECs could circumvent the nondiscrimination provisions of section 272 by offering growth discounts for which, as a practical matter, only their affiliates would qualify. Some incumbent LECs argued in comments filed in response to our *Price Cap Second FNPRM*, that growth discounts could benefit smaller IXCs that do not qualify for volume discounts. These incumbent LECs, however, failed to provide evidence that growth discounts would be cost-justified. [252] We invite parties to provide evidence that growth discounts would not circumvent the safeguards of section 272, and are, in fact, justified by reduced costs of providing service. We also seek comment on whether the development of competitive access markets would be enhanced if incumbent LECs were permitted to offer growth discounts.

c. Contract Tariffs and Individual RFP Responses

193. In the *Interexchange Order*, the Commission adopted rules permitting IXCs to offer common carrier services pursuant to individually negotiated contract tariffs. AT&T, then deemed as a dominant carrier, was permitted to offer services under contract tariff rates only for those services that we had found to be subject to substantial competition. [253] We required AT&T to file a tariff setting forth the terms of each negotiated contract, and to make the same terms and conditions generally available to similarly situated customers under substantially similar circumstances so as to comply with the nondiscrimination provisions of the Communications Act. [254]

194. In the *Price Cap Second FNPRM,* we proposed to apply similar contract carriage rules to access services that the Commission finds to be subject to substantial competition, provided the contract rates were made generally available to similarly

situated customers under substantially similar circumstances. A range of industry commenters generally concurred with that proposal. [255] CompTel articulated a more cautious approach, however, submitting that contract carriage would be appropriate only after "all functionally similar services are subject to substantial competition," and should never be permitted between a LEC and an affiliated IXC. [256] Time Warner argued that, if contract carriage is permitted, public ***21439** access to detailed information about those contracts (including access by competitors) is an important safeguard against abusive exercises of market power. Several incumbent LECs, on the other hand, contended that incumbent LECs should be permitted to offer contract carriage and, in particular, individualized responses to RFPs without having to satisfy competitive triggers. GTE, USTA, and U S West proposed that incumbent LECs be permitted to offer contract carriage in response to any RFP, provided that at least one other carrier first responds to the RFP. [257]

195. We propose to permit incumbent LECs to offer contract tariffs when Phase 1 has been met. Incumbent LECs would be required to make each contract tariff both publicly available through a tariff filing setting forth the contract's terms, and generally available to similarly-situated customers on the same terms and conditions. The availability of contract carriage should lead to lower prices for those customers using contract tariffs. Under our price cap rules, contract tariffs at reduced prices could allow incumbent LECs to raise prices for those customers not taking service subject to these contract tariffs due to the way the actual price indices (APIs) are calculated. At Phase 1, the entry barriers to competition will have been removed, but competition may not yet be sufficient to constrain the incumbent LECs from raising prices unreasonably for those customers not under contract tariffs. Thus, as suggested by Pacific Bell, we also propose to remove contract carriage service when calculating incumbent LECs' APIs in our price cap system. [258] We note that parties will be negotiating, or obtaining arbitration of individual arrangements before the states, under section 252, and that certain interconnection arrangements may be substitutable for access services. This may well place greater competitive pressure on prices for incumbent LEC access services at an earlier phase in the development of competition than existed for AT&T. Parties advocating that we should delay contract carriage until Phase 2 or until substantial competition has been reached should identify and quantify their concerns with implementing this reform at Phase 1.

196. We also propose to remove the prohibition against incumbent LECs offering competitive response tariffs when the requirements of Phase 1 have been met. A competitive response tariff is a contract tariff that a LEC initiates when it responds to a competitor's offer to an end user, or in response to a request for proposal. [259] By requiring that a competitor be ***21440** present, competitive response tariffs by definition provide an additional justification for being made available at this phase. To the extent that parties disagree with our proposed treatment of contract tariffs offered in response to requests for proposals, we invite comments demonstrating why different conclusions would be in the public interest.

d. Deregulating New Services

197. We also seek comment on whether to permit incumbent LECs to offer certain access services outside price cap regulation upon achievement of the Phase 1 trigger. Such treatment might be possible because a baseline access offering exists that ensures continued provision of a core service at reasonable rates. The ability of incumbent LECs to offer some access services outside price caps could create incentives for incumbent LECs to introduce services using the capabilities of new technologies. Modifications to our regulatory regime along these lines for such services could increase customer choice, streamline regulation, and increase consumer welfare by increasing incentives for innovation.

198. As BOCs are permitted to enter the long-distance market, however, their long-distance affiliates may well be purchasing many of these new services, as long-distance carriers with LEC affiliates may well today. We seek comment on whether this may give rise to circumstances in which the LEC could reduce the effects of competition if it offered certain new services outside price cap regulation. If so, when? We also ask whether the section 202 prohibition against discrimination and, with respect to the BOCs, the section 271(c) checklist and the section 272(e)(3) requirement that a BOC charge its long-distance affiliate an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers, provide sufficient protection against possible anticompetitive conduct that we need not make special exceptions to our proposal. We also seek comment on the relationship of this proposal to the requirement to unbundle network elements under the 1996 Act.

199. We also seek comment on whether we could deregulate new services. In the Third Report and Order, below, we eliminate the need for obtaining a waiver before an incumbent LEC introduces a new service, and instead require that it show that the new service is in the public interest. We now seek comment on whether we should eliminate all requirements that an incumbent LEC obtain any regulatory approval before a tariff introducing a new service can take effect. Many new services take advantage of new technical capabilities, and the delay entailed in obtaining regulatory approval may harm consumer welfare. Because the underlying core access service offerings, as well as unbundled network elements, would still be available, there may be little benefit from requiring an incumbent LEC to obtain regulatory approval before introducing a new service. We ask whether, if the new service is far superior to the existing service, the availability of the old service may not provide sufficient safeguards. The availability of the core service also raises the question of whether price regulation of new services is still needed or warranted. If not, these services could be removed from price cap regulation. Alternatively, if such services are not removed ***21441** from price cap regulation altogether, we seek comment on whether we should eliminate the new services test. We seek comment on these alternatives. Parties are invited to comment on whether relaxed regulation is more appropriate for some types of new services than it is for other new services.

200. Finally, we seek comment on whether, if we adopt the proposal in the preceding paragraph, we should also remove from price cap regulation some services that have required waivers in the past for their introduction. This would equate the treatment of existing services that were introduced following a waiver request to that for future new services. One example of such a service is 500 access service, which allows IXCs to offer their customers a service by which a call to one number is routed to a different telephone number at different times, or in different sequencing arrangements (a "follow-me" service). [260] This service offers specialized features for which continued regulation may not be necessary if competing carriers can develop substitute services to respond to customer needs. We seek comment on this example, and seek comment on whether other similar services exist for which continued price cap regulation may not be necessary. [261]

C. Phase 2 -- Actual Competition

201. In this subsection, we seek comment on the removal of additional regulatory constraints from incumbent price cap LECs upon the establishment of an actual competitive presence for an exchange access service in a relevant geographic area. A competitive presence short of substantial competition would help to ensure that the opening of the network has happened in fact, not just in theory, and would allow for further reforms under conditions short of the substantial competition necessary for full deregulation and detariffing. At Phase 2, we are seeking comment broadly on: (1) eliminating price cap service categories within baskets; (2) removing the ban on differential pricing for access among different classes of customers; (3) ending mandatory rate structure rules for transport and local switching; and (4) consolidating traffic-sensitive and trunking baskets. We are also seeking comment on whether and how to implement these reforms, or equivalent reforms, if the development of competition comes at significantly different rates for different switched access services in different areas. These reforms would appear appropriate because the competition present at Phase 2, together with the availability of unbundled network elements and the continuing price cap limits on price increases, should restrain incumbent LECs from overcharging their customers. We seek comment as well on how to define competitive presence for these purposes, including whether we should define the term differently for certain of the above reforms than for others. Finally, we seek comment on various alternatives -- including whether we should remove any ***21442** of these regulatory constraints at Phase 1; whether we should remove additional regulatory constraints at Phase 2; and whether we should wait until substantial competition has developed, as described above, before eliminating some or all these constraints.

1. Trigger and Relevant Markets

202. We invite comment on three possible factors for determining whether an incumbent LEC has met the trigger for Phase 2: (1) demonstrated presence of competition; (2) full implementation of competitively neutral universal service support mechanisms; and (3) credible and timely enforcement of pro-competitive rules. We also ask whether the proposals for deregulating new services we seek comment on in subsection V.B.2.d, above, would be better suited for Phase 2. We seek comment on whether

we should adopt any or all of these factors for the Phase 2 trigger point, and whether there are other competitive factors that we should consider.

203. First, we seek comment on how to determine when competition is sufficient to end mandatory rate structure rules for transport and local switching, remove the ban on differential pricing for access among different classes of customers, eliminate price cap service categories within baskets, and consolidate the traffic-sensitive and trunking baskets. We could measure market share as one factor, among others, in determining whether competition exists in a given market for purposes of removing the regulatory constraints we have identified. As we observed in the *Price Cap Second FNPRM,* we previously have used market share as one factor in measuring the presence of competition. [262] Nevertheless, there are drawbacks to using market share. An analysis of the level of competition for incumbent LEC services based solely on an incumbent LEC's market share at one time may not provide an adequate basis for us to conclude that a competitive presence truly exists. Further, we lack data on the relative market shares of incumbent LECs and their rivals, and thus would need to develop reasonable and nonburdensome ways to gather that information if we were to rely on it. [263] If the Commission considers the relative market shares of the incumbent LECs and their competitors as one factor in assessing the level of competition for incumbent LEC services, what data and information about incumbent LECs and their competitors would be necessary to assess their relative market shares? Also, we would have to determine the appropriate market to be measured and the unit of measurement, such as customer lines, revenues, or access minutes. We seek comment on whether using a market share trigger could affect how the market develops. We seek comment on whether, notwithstanding an absence of competitive entry, the incumbent could be adequately restrained from raising its prices such that it could ***21443** obtain Phase 2 treatment. If we were to adopt any new reporting requirements for purposes of calculating market share, we invite comment on what effect this requirement would have on incumbent LECs considered "small businesses" for purposes of the Regulatory Flexibility Act.

204. In addition to measuring market share as a percentage, we seek comment on the possible use of absolute measures of competitors' presence for services in an area. For instance, we ask parties to discuss whether a competitive presence should be measured in terms of an absolute number of customer lines, residential lines, or access minutes. Are there other factors that could be measured that could support a finding of competitive presence, *e.g.*, a specified number of competitive switches; or a certain number of customers receiving service from unbundled network elements or competitive facilities? What should be the relative importance of a measurement of competition in light of other factors that we propose to incorporate into our analysis and on any other factors that may be proposed? On one hand, a simple measurable test would be easier to administer than most other potential tests; on the other hand, the real significance of any particular competitive presence in the marketplace often only becomes clear after analyzing several different variables that measure competition.

205. We propose to apply any market-presence test we might adopt on a service-by-service basis. For example, we propose to allow an incumbent LEC to establish differential rates for transport when that incumbent LEC has satisfied the Phase 2 trigger for transport, even if there is no demonstrated presence of competitors for local switching. Such an approach would allow the incumbent LEC to respond to competitive alternatives for specific services, which should result in lower prices and more efficient utilization of the network, without permitting incumbent LECs to raise rates unreasonably for less competitive services. Also, this approach would be consistent with our proposal to remove services from price cap regulation when they are subject to substantial competition. [264] Certain Phase 2 proposals, such as elimination of service categories and consolidation of price cap baskets, may not be amenable to implementation on a service-by-service basis. We seek comment on how any such elements of Phase 2 regulatory relief should be implemented.

206. A second possible factor to consider in determining whether the Phase 2 trigger has been met is whether the universal service programs available to incumbent LECs and other eligible telecommunications carriers are competitively neutral. [265] The Universal Service Joint Board recommended that both the collection mechanism and the disbursement ***21444** mechanism for universal service programs be competitively neutral. [266] We ask whether some consumers will not see the benefits of competition if the state universal service programs are not competitively neutral. If in practice only incumbent LECs can receive universal service support, then the disbursement mechanism is not competitively neutral. Customers should be able to choose

their provider based on who best serves their needs, not on which provider specifically qualifies for a subsidy payment. We seek comment on this proposed factor.

207. We ask to what extent and how enforcement of pro-competitive rules should be a factor in determining whether Phase 2 has been achieved. Any state or federal rules or rights must be enforced vigorously and swiftly so that consumers enjoy the benefits of the promised competition. States and the FCC have a duty to create forums for fast, fair and efficient dispute resolution. We seek comment on whether enforcement should be used as a Phase 2 condition, and if so, on what the specific criteria should be for determining whether enforcement is adequate.

208. We also seek comment here on whether additional or different conditions should apply before implementing Phase 2 reforms. For instance, we seek comment on whether our definition of actual competitive presence should differ for implementing various of the reforms discussed here. Should we require greater competitive pressures on incumbent LEC access charges before we implement certain of the reforms discussed below? If so, which ones, and why? We also seek comment on the extent to which an actual competitive presence, from entrants purchasing unbundled elements, using their own constructed facilities, or a combination of the two as a substitute for current access service, would provide incumbent LECs incentives to reduce access charges. If it develops that carriers are competing for end-user customers primarily by providing bundles of local and long distance service, to what extent would incumbent LECs decide not to lower access charges charged to IXCs, but instead to raise them as high as possible as long as possible? If this occurs for certain groups of customers, or in certain areas, should this affect how we implement reforms at Phase 2, and, if so, how? To what extent is this competitive dynamic affected by the absence of a legal requirement under the 1996 Act that a requesting carrier provide local exchange service to an end user in order to purchase unbundled network elements and use them as a substitute for access service? To what extent would the continued constraints of price cap regulation for certain access services, perhaps as modified according to certain of the methods discussed in the prescriptive approach to access reform, provide sufficient protection during the transition to substantial competition?

209. We solicit comment on the procedures that an incumbent LEC should follow to demonstrate that it has met the Phase 2 triggers for one or more services. Petitioners should discuss whether an incumbent LEC should file a petition for waiver, a petition for declaratory ruling, or some other filing, and how the incumbent LEC should satisfy its burden of proof.

***21445** 210. We also seek comment on the relevant geographic area that should be considered in determining whether an incumbent LEC has met the Phase 2 competitive trigger. As discussed in Section II.D.1 above, there are several possible ways of specifying geographic areas. We tentatively conclude that any geographic area used in considering the presence of substantial competition would be appropriate for purposes of Phase 2. Moreover, by not requiring parties to maintain data on multiple geographic areas, such an approach would keep administrative burdens on all parties to a minimum. We seek comment on this tentative conclusion.

2. Reforms

a. Service Categories Within Baskets

211. The price cap service categories were developed both to protect ratepayers from precipitous changes in the prices for incumbent LEC services, and to prevent incumbent LECs from disadvantaging one class of ratepayers to the benefit of another class. [267] We tentatively conclude that, given competition in Phase 2, the current service categories in the trunking and traffic-sensitive baskets would no longer be necessary. We invite comment on how we should eliminate service categories, because doing so on a service-by-service basis appears infeasible. While the upper service band indices (SBIs) prevent incumbent LECs from offsetting price reductions in one service category with increases for less competitive services, the development of a competitive presence will provide IXCs with the alternatives of obtaining service from competitive LECs or using unbundled network elements instead. We seek comment on eliminating the current service categories at Phase 2. Parties should address whether there will be a need for any service categories at that point, to describe those categories, and to explain why it would be in the public interest to retain them.

b. Differential Pricing for Access to Different Classes of End-Users

212. While we generally have not considered differential pricing for access services to different classes of customers in prior proceedings (except for the Subscriber Line Charge), we seek comment on whether we should permit such flexibility at Phase 2. As used in this Notice, we define differential pricing as permitting incumbent LECs to charge different rates for access to different classes of customers. [268] There are at least three classes for which differential pricing may be appropriate: residential, single-line business, and multi-line ***21446** business. [269] We invite parties to suggest additional classes, and to analyze why rates for access to such classes should be afforded differential treatment. We seek comment on whether, for incumbent LECs that use differential pricing for their access rates, we should adopt some safeguards to protect the classes of customers not subject to competition, *e.g.*, residential and single-line business, and if so, what those safeguards should be.

213. Differential pricing for access could pose the same substantial risks to competition that accompany contract carriage and RFPs, [270] but, because differential pricing would enable an incumbent LEC to adjust all prices for access to a class of customers within a zone at the same time, the risks would be on a greater scale. We seek comment on whether we should permit incumbent LECs to offer differential pricing for access once the requirements of Phase 2 have been met.

c. Rate Structure Rules for Transport and Local Switching

214. We seek comment on eliminating the rate structure rules for the transport and local switching rate elements at Phase 2. We would also eliminate the mandatory rate structure modifications for transport and local switching that we propose in Section III, above. At Phase 2, if an incumbent LEC attempted to establish an inefficient rate structure, an IXC would be able to avoid paying above-cost rates by using cost-based unbundled network elements to originate and terminate toll traffic, or by acquiring access from a competitive provider. We will be able to rely on the presence of competitors to oblige the incumbent LECs to establish rate structures that reflect the manner in which costs are incurred. We do not propose to introduce this reform at Phase 1, even though unbundled network elements can act as an effective substitute for switched access at that point. We tentatively conclude that we should allow the Phase 1 reforms to take their effect prior to eliminating our mandatory rate structure rules, because it is not clear that the mere existence of efficient rate structure rules for unbundled network elements will cause incumbent LECs to adopt efficient access rate structures. For example, incumbent LECs may have an incentive to set per-minute access charges to raise the cost for interexchange resellers, who may have difficulty vertically integrating. This pricing would raise the marginal costs of those IXCs, distorting competition and raising prices and the profits of a LEC or its interexchange affiliate. We seek comment on this reform, and on when our mandatory rate structure rules should no longer apply. We ***21447** also seek comment on whether we should keep our rate structure rules for terminating access even after we have removed them for originating access. [271]

215. In conjunction with elimination of transport and switching rate structure rules, we also ask parties to comment on whether carriers satisfying Phase 2 requirements should be permitted to apportion access charges between carrier and end user according to marketplace pressures. In this regard, incumbent LECs would be treated in the same manner as competitive LECs, with neither a requirement nor a prohibition against adopting the most commercially appropriate rate structure. [272] Commenters should discuss whether we should permit LECs to collect charges from end users for originating access, terminating access, or both, and whether such charges should be imposed on the party placing a call or the party receiving the call. [273] Commenters should also address whether providing this flexibility might violate section 254(g), which prohibits interexchange rates in rural or high cost areas from exceeding rates in urban areas. [274] Alternatively, we seek comment on any steps we should take to ensure that an IXC can recover access charges from its customers in an efficient manner.

d. Consolidation of the Traffic-Sensitive and Trunking Baskets

216. When we created the price cap baskets for incumbent LECs, each with separate price cap indices and bands, we balanced two competing concerns. First, we limited the number of baskets to ensure that the company-wide productivity offset would be

appropriate for each basket. Second, we sought to limit the incumbent LECs' ability to subsidize price decreases for competitive services with price increases for services in a less competitive basket. [275] We expect that competition in trunking and switching will develop at approximately the same rate. Thus, the need to separate the traffic-sensitive and trunking baskets is reduced. We do not seek comment on consolidating the common line basket, because the common line possesses different bottleneck characteristics than do local switching and transport. These differences are likely to cause competition for common line services to develop differently than and probably generally lag somewhat behind competitive developments in the traffic-sensitive and trunking baskets. [276] We do not seek comment on ***21448** consolidating the interexchange basket because services within the interexchange basket are more competitive, and so are likely to be subject to substantial competition more quickly than traffic-sensitive or trunking services. [277] At this point, we invite comment on consolidating the traffic-sensitive and trunking baskets, enabling incumbent LECs to price their services more efficiently in response to the competitive market. Consolidating the traffic-sensitive and trunking baskets also reduces the administrative burdens placed on incumbent LECs.

217. We have considered modifying price cap baskets in the past, but declined to do so in the absence of information about the state of competition in the local telephone markets. [278] We suggest two possible points at which to remove this constraint: Phase 2 or in conjunction with the phase-out of the TIC, discussed below. [279] Our Phase 2 triggers should assess competition adequately for the purpose of determining whether incumbent LECs should be able to consolidate the traffic-sensitive and trunking baskets. Until the incumbent LEC reaches Phase 2 for each basket, it continues to face less competition for the services in one of the baskets relative to the services in the other. During this time, an incumbent LEC that can consolidate these baskets may still have an incentive and the ability to engage in anticompetitive behavior. We believe that in order to reduce this incentive, incumbent LECs would have to reach Phase 2 for each of the services within these baskets. Nevertheless, it may be better to permit consolidation of the traffic-sensitive and trunking baskets as part of the incumbent LECs' phasing out of the TIC. Removing this constraint at the time of the TIC phase-out would provide a method for incumbent LECs to reassign costs from the TIC. We seek comment on consolidating the traffic-sensitive and trunking baskets, particularly on when the consolidation should take place. We ask parties that favor consolidating the traffic-sensitive and trunking baskets as part of the incumbent LECs' phasing out of the TIC address what would ensure that incumbent LECs would not engage in anticompetitive behavior with respect to the services within these baskets.

VI. PRESCRIPTIVE APPROACH TO ACCESS REFORM

A. Introduction

218. In Section V above, we have set forth a framework under which we would reduce or eliminate, in phases tied to the potential for and growth of competition, access charge requirements that constrain rate structures and price levels. Some parties, such as ***21449** MCI, may contend that a market-based approach is inadequate to the task of reforming access. [280] Such parties might argue that, at best, competition will emerge unevenly among geographic areas, services, and customer classes, and argue that a second option for access reform, a prescriptive approach, should be followed. Although a prescriptive approach would move access rates to forward-looking economic costs in a more predictable and uniform manner than a market-based approach, such an approach would also require that the Commission play a greater role in the telecommunications marketplace. In Section IV.A above, we invite comment generally on whether a market-based approach, prescriptive approach, or some combination of the two approaches provides the best path for access reform.

219. In this Section, we seek comment on the specific requirements we should apply to incumbent LECs if we adopt an alternative, more prescriptive approach to access reform. First, we invite comment on the goal of a prescriptive approach. Next, we invite comment on a number of proposals, many of which have been suggested by industry participants, for specific requirements that could be incorporated into the prescriptive approach. Many proposals discussed below are designed to reduce access rates generally, because reducing access rates should in most, if not all, cases result in rates that are closer to cost. One of our proposals is to prescribe TSLRIC-based access rates, which would force rates to cost more effectively than our other proposals, but would also be more administratively burdensome. Finally, we address establishing phases for prescriptive access

reform, to avoid the market disruptions that might occur if we required incumbent LECs to move interstate access rates to cost on a "flash-cut" basis.

B. Goal of Prescriptive Access Reform

220. In both the prescriptive approach to access reform discussed in this Section and the market-based approach discussed in Section V, we seek to develop competition for interstate access services, which will ultimately result in the deregulation of these services. As we have emphasized elsewhere in this Notice and in other proceedings, the 1996 Act commands us to foster efficient competition in all telecommunications markets and to remove regulation when marketplace forces will drive competing providers to lower their costs and prices and offer services that are responsive to the demands of consumers. An intermediate goal of the market-based approach is to permit market forces to drive interstate access rates to economically efficient levels. We propose adopting a similar intermediate goal for prescriptive access reform; *i.e.*, we propose to adopt rules that would drive access rates to economically efficient levels. [281] MCI and AT&T have argued that interstate access rates, as well as prices for unbundled network elements offered pursuant to the 1996 Act, should be ***21450** based on the forward-looking economic costs of those services or elements. [282] Those IXCs have also submitted computer models designed to calculate forward-looking economic cost. [283] Specifically, in the case of access services, the model calculates "Total Service Long Run Incremental Cost" (TSLRIC) of the access service, and in the case of unbundled network elements, the model calculates the TSLRIC of network elements, also known as Total Element Long Run Incremental Cost (TELRIC).

221. An incumbent LEC's TSLRIC for a given service or facility, such as exchange access service, should include all incremental costs directly attributable, or dedicated, to the delivery of the service or facility in question. Carriers also should be allowed to recover a reasonable allocation of their forward-looking common costs, defined as those costs that are incurred in connection with the production of multiple products or services that remain unchanged as the relative proportion of those products or services varies. We note that when calculating the forward-looking economic cost of exchange access services, because these services share common network facilities with other incumbent LEC-provided services, such as local exchange service and intraLATA toll, fewer costs will be directly attributable or dedicated totally to exchange access services. Consequently, the incumbent LEC may need to recover significant common costs in addition to the TSLRIC of exchange access. These common costs should be recovered in a manner that is economically efficient and consistent with the pro-competitive goals of the 1996 Act. By contrast, the TELRIC of a specific facility, such the loop or the switch, would directly attribute to that facility all costs caused by that facility, regardless of the services provided by that facility. Consequently, the forward-looking common costs that the incumbent LEC must recover in addition to the TELRIC of that facility in order to recover forward-looking economic costs are lower than the forward-looking common costs that need to be recovered for a service. Additionally, the forward-looking costs of unbundled network elements should not include the costs of billing and marketing to end users, because unbundled network elements are intermediate products offered to competing carriers.

222. Under both TSLRIC and TELRIC-based pricing methodologies, prices should be based on forward-looking economic costs, including a reasonable allocation of forward-looking joint and common costs, and allow incumbent LECs to earn a fair, risk-adjusted rate of return on their investments. Such pricing should encourage efficient and effective entry ***21451** into the local telecommunications marketplace. Commission staff will soon be releasing for comment an analysis of the use of computer models in estimating forward-looking economic costs. In the event we determine that a market-based approach will not result in the development of efficient competition, we tentatively conclude that our goal for prescriptive access reform should focus on interstate access rates based on some form of a TSLRIC pricing method. We seek comment on this tentative conclusion. Below, we seek comment on several proposals for rules that would drive interstate access rates to TSLRIC levels.

C. Specific Regulatory Requirements

1. Readjustment of Rates to Economic Cost Levels

223. In the *LEC Price Cap Performance Review,* we required incumbent price cap LECs to adjust their price cap indices (PCIs) downward to reflect our decision to revise, in light of our past experience with price cap regulation, one of the economic studies on which we based the X-Factor in the *LEC Price Cap Order.* [284] In this Section, we seek comment on whether we should require a similar reinitialization in this proceeding. Specifically, we seek comment on the feasibility of readjusting the PCIs applicable to an incumbent LEC's baskets on the basis of a TSLRIC-based study. This would be one means of implementing the proposals of AT&T and MCI that access rates should be set at forward-looking economic costs. [285] Under this approach, we would determine the forward-looking incremental costs of providing all the access services in a price cap basket, and then add a suitable allocation of forward-looking common costs. Finally, we would require incumbent LECs to reduce their PCIs by an amount equivalent to the difference between their current PCIs and the TSLRIC revenues of providing the services in each basket. One benefit of requiring such a reinitialization is that it would enable us to avoid the administrative burdens associated with determining the proper allocation of common costs to each service within a basket. On the other hand, the reinitialization of PCIs we consider in this Section would simply lower rate levels. It would not guarantee that the incumbent LECs' rate structures would be reasonable. We seek comment on whether rate structure concerns should outweigh our concerns regarding the administrative burdens of allocating common costs. In Section VI.C.4 below, we seek comment on prescribing rate levels and rate structures based on TSLRIC studies, which would help ensure that incumbent LECs' rate structures are reasonable, but would also require us to determine how to allocate common costs.

***21452** 224. In order to reinitialize PCIs to levels that are consistent with the TSLRIC of incumbent LECs' access services, the Commission could evaluate incumbent LECs' TSLRIC studies for each price cap basket. This approach, however, could impose significant and potentially costly burdens on the FCC, incumbent LECs, and interested parties. Alternatively, state commissions might be better suited to evaluate TSLRIC-based studies because state commissions generally have more experience with cost studies. [286] Under this approach, which we could implement under section 410(a) of the Act, [287] we would rely on the state commissions' results to determine the difference between current interstate access rates and forward-looking economic cost-based access rates, and reinitialize interstate PCIs based on this difference. This approach ensures coordinated treatment between jurisdictions. We seek comment on this alternative and invite parties to comment on what, if any, federal guidelines should be established for the conduct of these state studies. Commenters should also suggest alternative proposals for reinitializing PCIs at forward-looking, economic cost, in the event we determine that a market-based approach will not result in economically efficient rates.

225. We seek comment on whether TSLRIC calculations for the services in some price cap baskets could be based in part on or derived from the TELRIC of certain unbundled network elements. TSLRIC and TELRIC are different versions of the same pricing methodology. To the extent that states reviewing arbitration agreements governing the prices of unbundled network elements rely on TELRIC studies, those studies might also provide data useful for determining TSLRIC rates for access prices. We seek comment generally on the feasibility of using prices derived from individual network element costs to establish prices for interstate access service. In particular, are there access services that employ dedicated facilities that are equivalent to an unbundled network element, and in those cases, would there be any difference between the TSLRIC of the access service and the TELRIC of the unbundled network element? For instance, it is not clear that the TSLRIC price of dedicated transport service, as opposed to tandem-switched transport service, should significantly differ from the TELRIC of a dedicated transport element. We also seek comment on what costs, if any, should be included in the price of interstate access that are not included in the price of unbundled elements. [288] For example, we ask commenters to address the nature of marketing and other customer operations costs that are involved with the provision of access services, and ask that they identify any costs that are incurred in the sale of access services that are not incurred in the sale of unbundled elements.

***21453** 226. In addition, we solicit comment on whether it is possible to reduce the administrative burdens associated with this approach by deriving estimates for TSLRIC-based prices in some study areas from TSLRIC or TELRIC studies conducted previously in other study areas. Is there a generic cost model that could be used to determine TSLRIC-based interstate access prices? [289]

227. Some parties that advocate readjusting access rates to the TSLRIC level maintain that TSLRIC rates would, in most cases, result in access rate reductions. In Section VII.A below, we seek comment on whether this is the case, the reasons therefore, and the magnitude of any differential. TSLRIC-based rates by definition would not be based on the level of embedded costs, regardless of whether embedded costs exceed TSLRIC-based rates or TSLRIC-based rates exceed embedded costs. We note that the presence of competitive LECs might increase incumbents' cost of capital, and might warrant increasing depreciation rates. [290] These effects might decrease to some extent any difference between TSLRIC-based rates and current rates. In Section VII.B, below, we seek comment on whether and to what extent incumbent LECs should be permitted an opportunity to recover any difference between TSLRIC-based rates and current rates.

2. Reinitialization of Rates on Some Other Basis

228. In the event we determine that a market-based approach to interstate access charge reform will not move rates closer to their economic cost, and reinitialization of PCIs based on TSLRIC studies or TELRIC cost models is not feasible, we could reinitialize PCIs on some other basis. For example, we could reduce PCIs to a level that would result in rates targeted to yield a rate of return of no more than 11.25 percent. A second basis for reinitialization could be to prescribe a new rate of return and then reinitialize access rates based on that rate of return as urged by MCI, AT&T, and GSA in the LEC Price Cap Performance Review proceeding. [291] Developing a new starting point for incumbent LEC PCIs under either of these two approaches might be reasonable for several reasons. First, to the extent that current price cap rates include a cost of capital greater than that necessary to enable carriers to attract investors, these rates may not represent the most reasonable balance between ratepayer and stockholder interests. Second, although we found in the *LEC Price Cap Performance Review Order* that there was not sufficient reason for reducing access rates ***21454** in the 1995-96 access period for changes in the cost of capital, [292] the incumbent LECs' cost of capital may now be less than 11.25 percent. Specifically, in the *Represcription Reform Order,* we found that the rate of return prescription may warrant revision if the monthly average on ten-year U.S. Treasury securities changes by more than 150 basis points, and the change continues for six months or more. [293] In February 1996, the Common Carrier Bureau invited comment on whether to initiate a proceeding to represcribe the authorized rate of return for incumbent LECs subject to rate-of-return regulation, pursuant to the trigger mechanism we established in the *Represcription Reform Order.* [294] If that proceeding reveals that the rate-of-return LECs' cost of capital has decreased since we prescribed the current authorized rate of return in 1990, then the price cap LECs' cost of capital may possibly be lower as well. On the other hand, incumbent LECs face potential competition as a result of the Act that they did not face previously. This potential competition could increase the risks facing the incumbent LECs, and thus increase their cost of capital, thus mitigating to some extent the factors suggesting that incumbent LECs' cost of capital has decreased since 1990. We also note that evolving competition may make it appropriate to assign different costs of capital to different services, reflecting differences in competition and higher risks in transport, switching, and loop services respectively.

229. We invite parties to discuss whether our prescriptive regulatory requirements should include reinitialization of price cap indices on any of the above-mentioned bases in this Section or Section VI.C.1. We seek comment on how, if we were to proceed with this approach, to reinitialize price cap indices. We also invite parties to provide estimates of what effect these reinitializations would have on the incumbent LECs' PCIs. In Section III.E above, we solicit comment on whether we should target the effects of any reinitialization to the TIC as a means of phasing out that rate element.

230. While reducing PCIs would clearly reduce access rates, reinitializing indices based on earnings could have a negative effect on the productivity incentives of the LEC price cap plan. [295] Represcribing a rate of return would also be administratively burdensome. We ***21455** invite commenters to discuss whether any such negative effects are likely to outweigh the benefits of moving rates closer to their economic cost, and whether this approach is consistent with the development of efficient competition.

3. Revision of LEC Price Cap Plan

231. In 1990, the Commission adopted mandatory price cap regulation for the BOCs and GTE. Other incumbent LECs may elect to be governed by price cap regulation. [296] In simple terms, price cap regulation permits rates to increase no more than a measure of inflation minus an "X-Factor," that largely reflects a reasonable productivity target. [297] Thus, the higher the X-Factor, the more downward pressure price cap regulation applies to access rates.

232. The X-Factor represents in large part the amount by which carrier productivity has historically exceeded productivity in the economy generally. [298] The X-Factor also includes a 0.5 percent consumer productivity dividend (CPD). The CPD was intended to serve the policy goal of assuring that the first benefits of the incumbent LECs' productivity growth induced by price cap regulation would flow to access customers in the form of reduced rates. [299] A policy-based mechanism similar to the CPD could be used to force price cap incumbent LECs to reduce their rates further. For example, if we can rely on TELRIC studies to estimate the economic costs of access services, as we discuss in Section VI.C.1 above, then we could set this policy-based mechanism at some fraction of the percentage difference between current access rates and rates based on economic costs. Therefore, in this example, setting the policy-based mechanism at 20 percent of the initial difference between current rates and economic cost-based rates should then cause the price cap formula to drive access rates to cost over a five-year period, assuming that costs do not change during that period. We invite comment on the use of such a policy-based mechanism, and on the derivation of such a mechanism.

***21456** 233. In 1995, we adopted the *Price Cap Fourth FNPRM,* in which we sought comment on various proposals for revising the productivity offset component of the X-Factor, [300] and for eliminating sharing obligations and the low end adjustment mechanism. [301] Subsequently, the Customers for Access Rate Equity (CARE) Coalition has filed several *ex parte* statements urging that we complete expeditiously the rulemaking proceeding initiated in the *Price Cap Fourth FNPRM* and adopt a higher X-Factor or set of X-Factor options. [302] AT&T and MCI have also urged us to adopt a higher X-Factor. [303] We solicit comment on whether there is any justification for increasing the productivity offset, either on the basis of the record developed pursuant to the *Price Cap Fourth FNPRM,* or on more recent economic studies. We specifically invite parties to discuss the effects of a forward-looking cost of capital and economic depreciation on TFP measurement. [304] Parties relying on more recent economic studies must comply with the "general criteria" we established for economic studies in the *Price Cap Fourth FNPRM.* [305]

***21457** 234. We also seek comment on whether we should change the rules governing justification of tariff filings that cause the API for a basket to exceed the PCI. The price cap plan does not prohibit above-cap rate filings, but does subject such filings to stringent review standards. [306] An incumbent LEC making an above-cap filing must submit an extensive cost showing that explains all cost allocations down to the lowest possible level of disaggregation. It must also give a detailed explanation of the reasons for the prices of all rate elements to which costs are not assigned. [307] We have stated that we will find such filings lawful only if the incumbent LEC can demonstrate that compliance with the price cap rules would have the effect of denying the LEC the opportunity to attract capital and continue to operate. [308] A LEC that is permitted to charge above-cap rates becomes subject to traditional rate-of-return regulation with respect to those rates. [309]

235. The cost showing contemplated by the price cap rules is, in essence, a traditional, embedded-cost rate case. [310] We seek comment on whether the rules should be changed to require that above-cap filings be justified based on the forward-looking economic cost of providing access service.

4. Rate Prescription

236. The proposals we discuss above, reinitializing price cap indices and increasing the X-Factor, are designed to reduce access rates. None of those proposals would necessarily compel price cap incumbent LECs to adopt efficient rate structures, nor ensure that price cap incumbent LECs allocate common costs in a reasonable manner. In Section III above, we invite comment on revisions to the rate structure rules to require price cap LECs to develop access rates that reasonably reflect the manner in which

they incur costs. Here, we seek comment on whether those rules are sufficient to ensure that access rates reflect costs in areas subject to prescriptive access reform. We also seek comment on prescribing forward-looking incremental cost-based access rates as part of our prescriptive approach to access reform.

***21458** 237. Basing the prices of discrete unbundled network elements, such as loops and switching, on a forward-looking economic cost methodology may be more economically rational than using the same methodology to price conventional services, such as interstate access. Separate services are typically provided over shared network facilities, the costs of which may be joint and common. For example, interstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long-distance services. Conversely, certain unbundled elements, such as loops and line cards, can be priced individually using a TELRIC methodology, and in those cases the allocation of common costs is less problematic than when pricing services.

238. We invite comment on whether, if we adopt a prescriptive approach to access reform, we should require incumbent LECs to conduct TSLRIC studies, and create new prices for individual interstate access services on the basis of those studies. [311] Under this proposal, we would reset access prices once, and then rely on price cap regulation to keep rates just and reasonable. We also seek comment on how to allocate common costs if we were to adopt this approach, and whether problems raised by allocating a large amount of common costs relative to direct costs outweigh the benefits of this approach.

D. Phases for Prescriptive Approach

239. We are unable at this time to quantify the magnitude of the difference, if any, between current interstate access rates and rates based on forward-looking economic costs. We seek comment on the amount of that difference in Section VII.B below, and the extent to which incumbent LECs should be permitted an opportunity to recover that amount. In this Section of the Notice, we observe only that there may be a substantial cost difference relative to interstate access revenues as a whole. If so, we tentatively conclude that we should include some sort of transition mechanism in the prescriptive access reform plan, comparable to the phases of the market-based access reform plan we discuss in Section V above.

240. One possible transition mechanism could be to establish phases for any reinitialization of price cap indices that we may adopt. In other words, we would implement the reduction in price cap indices through a series of reinitializations rather than a single reinitialization. A second option could be to adopt a policy-based increase to the X-Factor for a number of years, to reduce interstate access gradually, and then reinitialize price cap indices to TSLRIC levels as discussed in Section VI.C.1 above. We could also adopt a policy-based increase to the X-Factor for a number of years, and then prescribe TSLRIC-based access rates. Parties are invited to comment on all these options, and to make suggestions of their own.

*21459 VII. TRANSITION ISSUES

241. In this proceeding, we must address a variety of issues relating to the transition from the regulatory structure that existed before the passage of the 1996 Act to that which will exist after the three proceedings have been completed. In Section VII.A, below, we seek comment on the manner in which the universal service support amounts attributable to the interstate jurisdiction should reduce interstate access rates. [312] In Section VII.B., we address issues relating to the potential difference between the revenues that incumbent LECs generate from current interstate access charges and the revenues that revised access charges are likely to generate. We seek comment on both the estimated magnitude of that difference and the extent to which alternative methods of recovery of that difference should be permitted. [313]

A. Universal Service Joint Board Recommended Decision

242. The 1996 Act states that any federal universal service support provided to eligible carriers "should be explicit" [314] and recovered on an "equitable and nondiscriminatory basis" [315] from all telecommunications carriers providing interstate telecommunications service. In the *Joint Board Recommended Decision,* the Joint Board recommended that the Commission

establish a nationwide benchmark to use in calculating the amount of universal service support eligible telecommunications providers will receive. [316] Each eligible carrier would receive revenues from the federal universal service support mechanism based on the amount its forward-looking costs of serving a subscriber, as calculated using a proxy model, exceed the benchmark. The Joint Board advised that the benchmark be based on the nationwide average revenue-per-line, *i.e.*, the sum of the revenue generated by local, discretionary, [317] access services, and others as found appropriate, divided by the number of loops served. [318] Final determination of this issue, however, must also take into consideration ***21460** the revenue base for universal service contributions. [319] The Joint Board further advised the Commission to construct two benchmarks, one for residential service and a second for single line business service. [320] The Joint Board recommended that costs in excess of the benchmark be funded through an assessment based either on the interstate revenues of all interstate telecommunications carriers less interstate payments to other carriers, or interstate and intrastate revenues of all interstate telecommunications carriers less payments to other carriers. [321]

243. In its *Recommended Decision,* the Joint Board affirmed the Commission's tentative conclusion that LTS payments constitute a universal service support mechanism that serve to equalize LECs' access charges by raising some carriers' charges and lowering others. [322] The Joint Board concluded that the LTS mechanism is inconsistent with the 1996 Act's requirement that support be collected from all providers of interstate telecommunications services on a non-discriminatory basis. Accordingly, the Joint Board recommended that the LTS system no longer be supported via the access charge regime, and that rural incumbent LECs continue to receive payments comparable to LTS from the new universal service support mechanism. [323] In the event the Commission implements a rule assessing carriers' universal service support contributions based on both interstate and intrastate telecommunications revenues, the Joint Board recommended that there should be a downward adjustment in the residential and single-line business SLC cap and CCL charges to reflect the recovery of LTS from other sources. [324]

244. We recognize that, because of the role that access charges have played in funding and maintaining universal service, it is critical to implement changes in the access charge system together with complementary changes in the universal service system. Regardless of whether features of our access charge system, such as the per-minute CCL charge and geographically-averaged rates, contravene section 254 as discussed in Section III.B., above, we seek comment on whether retaining such features in light of the possible changes in universal service could, in essence, compensate incumbent LECs twice for providing universal service. We ask commenters addressing this issue to identify the circumstances, including assumed structure of the high-cost area support mechanisms, under ***21461** which any "double recovery" may exist. We further seek comment on how we could best address any potential double recovery.

245. We propose that a downward exogenous cost adjustment should be made for price cap incumbent LECs to reflect revenues received from any new universal service support mechanism. We note that the Commission, after receiving recommendation from a joint board, must determine the extent to which universal service support revenues are apportioned to the interstate jurisdiction. In the event the Commission, concludes that high cost universal service support should be allocated to the interstate jurisdiction, how should we adjust the price cap indices to reflect new explicit universal service support? Parties should also comment on whether a downward adjustment to the incumbent LECs' PCIs should be across-the-board, or targeted to a particular basket or service category, *e.g.*, the trunking basket or the TIC, or to the CCL charge or any new mechanism that may replace it. We seek comment on the manner in which we must adjust incumbent LECs' price cap indices to account for the removal of LTS from incumbent LECs' access charges. We tentatively conclude that a downward exogenous cost adjustment should be made to the CCL charge, or to any new mechanism that may replace it, to the extent that the recovery of LTS from other sources is not offset by a SLC cap reduction, and seek comment on this tentative conclusion. [325]

246. For rate-of-return incumbent LECs, interstate costs must be reduced to reflect revenues received from any new universal service support mechanism to the extent allocated to the interstate jurisdiction. We seek comment on how such reductions should be treated in Part 69 for non-price cap incumbent LECs. [326] Finally, we seek comment on how our proposed interstate

ratemaking treatment of the new universal service support mechanism affects small business entities, including small incumbent LECs and new entrants. [327]

B. Treatment of Any Remaining Embedded Costs Allocated to the Interstate Jurisdiction

247. A number of IXCs assert that a significant difference exists between the revenues generated by access charges based on embedded costs allocated to the interstate jurisdiction by Part 36, and the revenues that would be produced by access rates based on the forward- ***21462** looking economic cost of providing access services. For example, as of November 1996, AT&T estimated that total interstate access charges collected today from interexchange carriers exceed the forward-looking economic cost of providing access by about $11.0 billion, or nearly 70 percent of that total. [328] Similarly, in October 1996, AT&T asserted that it pays incumbent LECs an average (interstate/intrastate) per-minute access rate of 3.06 cents, and that this rate is more than 7.5 times greater than the TELRIC per-minute access rate of .40 cents. [329] AT&T labels $7.0 billion of the $11 billion as "pure uneconomic subsidy to monopoly incumbent local exchange carriers" caused by overallocation of costs to the interstate jurisdiction, the inclusion of retail and other costs unrelated to the provision of access, the understatement of incumbent LEC productivity, and other historical inefficiencies. [330] AT&T asserts that $4.0 billion of the current access revenues are universal service support amounts and should be recovered through mechanisms under section 254 and not through access charges. In March 1996, MCI estimated that approximately $46 billion (or more than 55 percent) out of $82 billion total network revenues for Tier 1 [331] local telephone companies is the difference between the accounting costs and the economic costs of providing those networks as network elements. [332] MCI attributed this gap largely to the inclusion of over-built plant ($17 billion), excess customer operations expenses ($15 billion), excess corporate operations expenses ($8.3 billion), and inefficiencies ($3.8 billion) in network charges. According to MCI, very little of the gap results from under-depreciation ($0.85 billion). [333]

248. Current interstate access service revenues permit recovery of the interstate portion of embedded costs, subject since 1991 to the constraints of price cap regulation. The revenues that would be generated if all access services were priced at forward-looking, economic cost may be much smaller. [334] We generally ask parties to discuss, in light of the ***21463** other reforms discussed in this proceeding and other developments pursuant to the 1996 Act, the following issues: the amount and make-up of the difference between these amounts, whether recovery of the remaining interstate-allocated costs should be permitted, the lawfulness of a denial of such recovery, and possible recovery mechanisms. [335] We also invite parties to comment on the impact of the following proposals on small business entities, including small incumbent LECs and new entrants. [336] In addition to seeking comment on the nature and magnitude of the difference, which could include a portion of the revenues that would remain in the TIC after the steps discussed in Section III.E. above, we seek comment on whether the identification and ratemaking treatment of remaining interstate-allocated costs should vary depending on whether an incumbent LEC is under a market-based or prescriptive approach to access reform.

1. Nature and Magnitude of Any Remaining Interstate-Allocated Costs

249. Some of the difference between the incumbent LECs' interstate-allocated embedded costs and forward-looking costs may be traced to past regulatory practices. For example, interstate access rates may exceed forward-looking economic cost, and thus produce some difference, because of misallocation of costs to the interstate jurisdiction. Historically, some separations rules were designed to shift some costs from the intrastate to the interstate jurisdiction, in order to further universal service goals. [337] For example, in 1987 the Commission agreed with a Federal-State Joint Board's recommendation to exclude interstate access revenues from the allocation factor used to apportion marketing expenses between the interstate and intrastate jurisdictions. [338] The Commission reconsidered its decision, however, and reinstated separations procedures that allocate marketing expenses in accordance with revenues in order to avoid shifting significant amounts of revenue requirement to the intrastate jurisdiction. [339] We note further that, to the extent that unbundled network element revenues are unseparated, a difference between the interstate-

allocated embedded and forward-looking ***21464** costs of providing access service may result when these revenues are removed from the interstate jurisdiction. [340]

250. Another possible regulatory cause of any difference between interstate-allocated embedded or accounting costs and forward-looking costs may be under-depreciation of incumbent LEC assets. Our depreciation procedures provide for incumbent LECs to depreciate the total investment in assets over the estimated useful life of the assets at rates we prescribe for each class of assets. [341] Under rate-of-return regulation, the incumbent LECs set rates for their access services that incorporated these depreciation charges; those rates were the foundation for the initial price cap rates. Many incumbent LECs contend that this Commission prescribed depreciation schedules based on relatively long asset lives in order to spread recovery of investment over an extended period and prevent large rate increases. [342] In a monopoly environment, there were no competitive providers that might prevent an incumbent LEC from eventually recovering its entire investment at the end of the prescribed period.

251. Under-depreciation of incumbent LEC capital assets can occur in two ways. First, facilities may be under-depreciated if the useful lives prescribed for regulated facilities exceed the economic lives of those facilities. This under-depreciation often occurs when new technologies are introduced that reduce the remaining economic lives of embedded plant. In that event, the existing depreciation rate will not produce an adequate depreciation charge to account for the shorter remaining lives of the old equipment. In other words, if a new technology shortens the economic life of existing incumbent LEC plant from 25 to 15 years, a prescribed depreciation schedule of 25 years for that plant will not enable the incumbent LEC to recover its investment during the useful economic life of the plant. However, under the remaining life techniques a LEC has the ability to request revised depreciation rates and recover its investment over the expected remaining life. [343]

***21465** 252. We note that, in response to the *Price Cap Fourth FNPRM,* MCI submitted a study analyzing the depreciation reserve deficiency. [344] The study concludes that changes in the Commission's depreciation practices during the 1980s reduced the reserve deficit from $21 billion in 1983 to only $3 billion in 1994. [345] Incumbent LECs, on the other hand, have claimed that unreasonably low depreciation rates (resulting from life estimates that are too long) have created a large overvaluation of their rate bases and a $40 billion depreciation reserve deficiency. [346] We note that traditional depreciation reserve studies, such as that employed by MCI, do not address the effects of a decline in replacement value during an asset's life, as discussed below.

253. Under-depreciation also can occur if the depreciation procedures do not recognize the decline in the economic value of plant already in service that occurs when the replacement cost is less than the cost of the older equipment. The annual charge to depreciation expense for incumbent LEC assets of different vintages or different technologies of comparable capacity will vary in an industry where the cost of assets is declining over time such as telecommunications. A price based on forward-looking economic cost would be based on the annual economic depreciation expense of the newer facility. Thus, a market characterized by developing competition may no longer support a price designed to recover depreciation expenses based on the Commission's currently prescribed depreciation rates for deployed equipment. In the emerging competitive marketplace that finds incumbent LECs facing competitors using newer, less expensive equipment, some portion of the deployed equipment is arguably under-depreciated by an amount equal to the difference between the current net book value and the forward-looking replacement cost of the depreciable plant.

254. We invite parties to explain in detail the magnitude of any difference between existing interstate-allocated embedded costs and interstate access revenues, on the one hand, and the revenues that would be generated if all interstate access services were offered at forward-looking, economic cost, on the other. We invite parties to submit data quantifying any difference, and explaining in detail to what extent the underlying difference between ***21466** embedded and forward-looking costs results from the Part 36 allocation rules, under-depreciation, or other factors. Parties should also specify the methodology used to calculate the amount, and define and show the calculation of economic lives, economic obsolescence, economic depreciation, and actual lives. We seek comment on what effect the significant under-utilization of equipment because of a transition to newer equipment, or because of reduced demand, should have on the calculation of any under-depreciation.

255. We also seek comment on whether the amount of any difference should be determined and fixed as of a date certain, such as the enactment of the 1996 Act. Under such an approach, some or all of unrecovered embedded costs incurred before that date might be eligible for special recovery mechanisms, but all costs incurred after that date would be regarded as incurred under the new competitive paradigm established by the Act and thus entitled to no special treatment. We invite comment as well on whether any special mechanisms would be necessary to ensure that the jurisdictional separations process does not allocate additional residual embedded costs to the interstate jurisdiction during any transitional recovery period. In addition, LECs may be permitted to recover some portion of the difference through explicit universal service support mechanisms adopted in the universal service proceeding. Accordingly, we ask parties, when identifying any difference between interstate-allocated embedded costs and the forward-looking economic costs of access, to take into account the amount of interstate costs that are likely to be recovered through such universal service support flows.

2. Recovery of Remaining Interstate-Allocated Embedded Costs

256. We invite parties to comment on whether, as a matter of law or equity, incumbent LECs are entitled, should be permitted an opportunity, or have already been permitted an opportunity, to recover some or all of the difference between interstate-allocated embedded costs and forward-looking economic costs that might be created by the access reform proposals discussed above in Sections V and VI. We specifically request that parties comment on whether the legal basis for permitting or denying such recovery varies depending on whether an incumbent LEC is under a market-based approach to access reform, as described in Section V, a prescriptive approach to access reform, as described in Section VI, or some combination of these approaches. NARUC has suggested that new sources of revenue from incumbent LEC in-region interLATA market entry may constitute a mitigating factor that should be reflected in the evaluation of any difference between embedded and forward-looking economic costs. [347] We seek comment on whether and how entry into the in-region, interLATA long-distance market or any other additional revenue flows should affect the amount of any remaining interstate-allocated embedded costs that incumbent LECs should have a special opportunity to recover.

***21467** 257. Some parties have suggested that we should limit recovery to those remaining embedded costs arising from certain sources, *e.g.*, under-depreciation, and deny recovery of remaining embedded costs resulting from over-investment and other inefficiencies. [348] We seek comment on this approach and ask commenting parties to specify those costs that incumbent LECs should be permitted an opportunity to recover and those that should be disallowed. Should incumbent LECs be required to demonstrate the specific costs they seek to recover and satisfy a burden or standard in order to recover some or all of such costs? Should we establish a rebuttable presumption that certain costs are recoverable? We invite parties to comment on this issue and specify any appropriate standard that should be applied and which party should bear the burden of proof. For example, should incumbent LECs seeking such recovery be required to show that their investment in telecommunications plant was prudent at the time it was made and does not reflect over-investment? Or should other parties bear the burden of showing that certain investments are no longer used and useful? If so, how should we determine whether any particular investment was prudent? Are there any legal constraints on where we place the burden? Parties should be specific in addressing these questions.

258. One option is to refer issues relating to the difference between revenues generated by rates based on embedded costs and revenues produced by rates based on forward-looking costs to state commissions to conduct the necessary rate cases and to make recommendations to the Commission on possible disallowances of imprudently incurred investments or excessive expenditures. Once the state commission reported back, we would determine the manner of recovery of the interstate portion of any difference. This approach, which we could implement under section 410(a) of the Act, [349] permits coordinated treatment between the federal and state jurisdictions and assigns the responsibility of conducting such rate cases to state commissions, which have substantial experience with the carriers operating in their respective states. This approach also conserves industry resources, because each state will have to address the issue of embedded cost recovery if it decides to set prices for intrastate services based on forward-looking costs or some basis other than embedded costs. We seek comment on this alternative and invite parties to comment on what, if any, federal guidelines should be established for the conduct of the prudence aspects of any rate cases referred to state commissions under section 410(a).

259. We also invite interested parties to comment on whether the incumbent LECs should be required to mitigate the magnitude of this potential problem by reducing their costs, and if so, how they might do so. We first discuss possible general mechanisms under the market-based and prescriptive approaches to access reform, and then address whether any recovery due to under-depreciation should be treated separately. Interested parties should also comment on how a decision to permit incumbent LECs to recover some or all of the ***21468** difference between embedded and forward-looking costs would affect small business entities, including small incumbent LECs and new entrants. [350]

3. Recovery Mechanisms

260. In the event we determine that incumbent LECs should be permitted a special opportunity to recover some or all of the difference between revenues generated by access charges based on embedded and forward-looking costs, we invite parties to comment on the various recovery mechanisms discussed below and to propose alternatives. We seek comment on the impact of any particular recovery mechanism on small business entities, including small incumbent LECs and new entrants. [351]

a. Market-Based Recovery

261. As new entrants succeed in attracting incumbent LEC customers, we expect competition gradually to drive access rates to more economically efficient levels. With a gradual transition, our removal of economic regulatory constraints may well give the incumbent LECs ample opportunity to recover any of the difference between embedded and forward-looking costs and therefore obviate any need for a formal recovery mechanism. Price cap incumbent LECs could use pricing and rate structure flexibility to reduce the revenue difference during a transitional period. Incumbent LECs would also have an opportunity, while competition is still developing, to reduce their costs of service to levels consistent with the revenues available to them in a competitive market. [352] We seek comment on this approach. Specifically, does the timing of the proposed stages and the flexibility proposed permit incumbent LECs a reasonable opportunity to recover any of the revenue differential and adjust to a competitive market? On the other hand, we ask parties to comment on whether, to the extent that our separations rules over-allocate costs to the interstate jurisdiction, this market-based approach may not give incumbent price cap LECs a reasonable opportunity to recover some portion of the difference between embedded and forward-looking costs and, if so, what measures would be appropriate.

b. Regulated Recovery

262. We seek comment on two situations under which it might be necessary to establish a separate regulatory mechanism for recovery of some portion of the interstate- ***21469** allocated embedded costs that might remain unrecovered if access service were priced based on forward-looking cost. First, in the event we determine that the market-based approach discussed above fails to provide incumbent LECs a fair opportunity to recover some or all remaining embedded costs, we invite parties to comment on whether we should implement a recovery mechanism to operate in lieu of, or in conjunction with, the market-based approach. Second, as we discussed in Section VI., above, a separate regulatory recovery mechanism may be necessary to the extent an incumbent price cap LEC is subject to prescriptive access reform. We seek comment on whether, and the degree to which, a separate recovery mechanism is required.

263. If we conclude that a recovery mechanism is necessary, we could design a mechanism to recover a specific, fixed, dollar amount of remaining embedded costs, over a fixed period. We seek comment on this proposal and invite parties to offer possible recovery mechanisms of limited duration. For example, one possible recovery mechanism might be to permit incumbent LECs to "amortize" their recovery of the difference, *i.e.*, to permit incumbent LECs to include in their rates a certain fraction of the difference each year for a certain number of years. The period could be designed to coincide with a gradual phase-out of the TIC, as discussed in Section III.E., above. We discuss issues raised by amortization of remaining embedded costs in more detail below, in conjunction with recovery of costs related to under-depreciation.

264. Another option would be to establish a competitively-neutral recovery mechanism that is separate and distinct from access charges. For example, should we permit incumbent LECs to impose a surcharge, either on all access customers, or on all providers or users of telecommunications services, in order to recover some portion of any remaining interstate-allocated costs? [353] This mechanism could be similar to the mechanism for collecting universal service funds, except that this recovery fund would not be permanent, nor would payments be portable to other eligible telecommunications carriers. We seek comment on when and how such a fund should be terminated. We seek comment on this option and our legal authority to adopt such an option. We ask parties to address, in particular, how to structure any such surcharge so that it is collected in a competitively-neutral manner, such as on the basis of telecommunications revenues, net of payments to other carriers, whether such surcharges should be levied on telecommunications carriers purchasing unbundled network elements, and, if so, how. Parties should also comment on how any surcharge imposed only on access customers could be structured so as not to burden unduly access customers and offer as little impediment as possible to our long-term goal of having access charges consistent with a competitive exchange access market. We invite parties to comment on the impact of this option on investment, innovation, and competition.

***21470** 265. In the event we adopt one of the special regulatory mechanisms described above or an alternative mechanism advocated by parties in this proceeding, as part of a transition to a competitive environment, we seek comment on whether some limitation on incumbent LECs' earnings is warranted. For example, we invite parties to comment on whether, if we set up a special mechanism that permitted incumbent LECs a reasonable opportunity to recover certain costs, it would be appropriate to limit to a certain prescribed rate of return the incumbent LEC earnings on the investment portion of the costs designated for recovery, or to increase the incumbent LEC's price cap sharing obligations, given the limited risk of nonrecovery under such a mechanism. Alternatively, we could permit incumbent LECs to select from two recovery options -- cost recovery through market-based prices to the extent they are able in a competitive market; or cost recovery through a regulatory mechanism, with a greater sharing obligation under the price cap plan. [354] In the event we determine that incumbent LECs should be permitted to select the manner of recovery, we seek comment on whether we should limit the ability to choose only to incumbent LECs that can make a competitive showing, as discussed in Section V., above. We invite parties to comment on this approach and other possible adjustments to the price cap plan that would be appropriate in the event we adopt a regulatory recovery mechanism.

c. Recovery of Difference Caused by Under-Depreciation

266. The portion of the difference between embedded costs and forward-looking costs that is attributable to under-depreciation may warrant separate treatment. Specifically, we must consider the appropriate balance between customer and shareholder risk as telecommunications markets become more competitive. In a competitive market, a firm's ability to raise its rates to recover higher depreciation costs is constrained by the pricing practices of other competitors, some of which may well have cost advantages through use of newer, more efficient equipment. A competitive firm is able to establish its depreciation charges and its prices free of any regulatory constraints, but its shareholders bear the risk of loss if the resulting prices are too high and, consequently, fail to generate revenues sufficient to cover the depreciation charges. The incumbent LEC's ability to recover its investment in a competitive market is dependent in part on depreciation practices that accurately reflect the decline in economic value of the LEC investment. The issue then is whether to permit incumbent LECs any relief with respect to the depreciation of equipment on their books at the time that the regulatory approach changes, whether the depreciation process should proceed unaffected by the shift in regulatory policies, or whether to modify our depreciation procedures. [355] If, for example, the Commission concluded that incumbent LECs have not ***21471** incurred significant depreciation reserve deficiencies to date, it could continue the current depreciation policies, or reflect small changes through increased depreciation rates in the future.

267. If, on the other hand, we conclude that the public interest would be served by adjusting the customer/shareholder risk levels because of regulatory changes, we could permit the incumbent LECs to adjust their accounts to establish an amortization of plant to reflect some or all of the change in economic value of the equipment installed under the earlier regulatory regime. We invite parties to comment on whether the local competition provisions of the 1996 Act and the competition expected to result from the implementation of those provisions constitute such an unexpected and dramatic regulatory shift that incumbent LECs should be permitted to adjust their accounts to reflect some or all of the change in economic value of their embedded

investment. Parties should also address the appropriate balance between customer and shareholder risk entailed in the shift to a more competitive regulatory policy.

268. If we permit incumbent LECs to adjust their accounts in such a way, the depreciation adjustment would presumably take the form of an amortization of these amounts over a prescribed period. An amortization plan would increase access rates in the short-term, but, all other things being equal, would lead to lower access rates after the amortization was completed. We invite parties to comment on the desirability of establishing an amortization plan, under which incumbent LECs could recover more rapidly some or all of any demonstrated under-depreciation costs resulting from economic obsolescence. We also ask whether any such amortization should be recovered in a competitively-neutral manner.

269. If we decide to take some action, we will need to determine the period over which to calculate the amount of the depreciation reserve deficiency. For example, we might measure under-depreciation for a period ending with the enactment of the 1996 Act. In addition, parties should comment on the period over which any amortization should take place. We invite any incumbent LEC, believing that it has facilities that are under-depreciated due to economic obsolescence, to submit a study demonstrating the extent of such under-depreciation and proposing the appropriate time period over which to amortize such amounts. Any incumbent LEC submitting such a study should provide complete details on original cost, salvage value, economic lives, and other relevant factors, for both old and new ***21472** technologies that are necessary to permit us to make an informed decision. We invite parties to address whether a different rate of economic obsolescence might occur in low-density areas than in high density areas.

270. Price cap incumbent LECs would account for this amortization through an upward exogenous adjustment to the price cap indices. Parties are also invited to suggest procedures for adjusting the PCIs, APIs, and SBIs to reflect the exogenous treatment of any amortization, if we permit incumbent LECs to adopt an amortization plan.

VIII. OTHER ISSUES

A. Regulation of Terminating Access

271. Some analysts have contended that an access provider's market power differs between originating and terminating access service. [356] With originating access, the calling party has the choice of service provider, the decision to place a call, and the ultimate obligation to pay for the call. The calling party is also the customer of the IXC that is purchasing the originating access service. As long as IXCs can influence the choice of the access provider, a LEC's ability to charge excessive originating access rates is limited, as IXCs will shift their traffic from that carrier to a competing access provider. This is particularly true for multi-line customers, who may select one carrier with lower access rates for their out-going interexchange calls and a different carrier with a lower flat monthly rate for local service. For terminating access, the choice of service provider is made by the called party. The decision to place the call and payment for the call lies, however, with the calling party. The calling party, or its long-distance service provider, has little or no ability to influence the called party's choice of service provider. [357] Thus, it appears that even with a competitive presence in the market, terminating access may remain a bottleneck controlled by whichever LEC provides access for a particular customer. As such, the presence of unbundled network elements or facilities-based competition may not affect terminating access charges.

***21473** 272. On the other hand, high terminating access rates may create an incentive for IXCs to win the local customer. It is true that winning the end user as customer will allow the IXC to save only a fraction of the total terminating access charges generated by the end user, because the IXC will carry only a fraction of the calls received by the end user. Nevertheless, serving the local customer using unbundled elements will also allow the IXC to collect terminating access charges on calls received by the end user. Thus, in this analysis, it would appear that high terminating access charges may give an IXC an incentive to win an end user as a local customer similar to the incentive created by high originating access rates. In this section, we seek comment on whether and to what extent we should regulate the terminating access services of price cap incumbent LECs and non-incumbent LECs and whether competition will have the same effect on terminating access rates as on originating access rates.

1. Price Cap Incumbent LECs

273. We seek comment on the implications of the above analysis for regulating the terminating access service of price cap LECs and ask parties to address the necessity of continued regulatory oversight of access prices for the termination of interstate calls by price cap LECs in markets where we find originating access services are subject to substantial competition.

274. One possible method of regulating price cap incumbent LECs' terminating access service is to establish a rate ceiling that prevents incumbent LECs from charging more for terminating access than the forward-looking, economic cost of providing the service. We seek comment on whether and how we should require incumbent price cap LECs to price terminating access service at forward-looking, economic costs. Whether an incumbent price cap LEC is offering terminating access at forward-looking economic cost could be measured by the prices in reciprocal compensation arrangements for the transport and termination charges of telecommunications pursuant to sections 251(b)(5) and 252(d)(2). Arbitrated reciprocal compensation rates may not include the NTS costs of either local switching or the subscriber line. Therefore, these NTS costs, which are now recovered in part from terminating access, would have to be recovered solely from originating access or a flat charge. Alternatively, we could ensure that terminating access is priced at its forward-looking economic cost by requiring such prices to be based on a TSLRIC study or other acceptable forward-looking, cost-based model. We invite parties to comment on these and alternative measures of forward-looking, economic costs to be used for terminating access rates.

275. Some observers have suggested that another possible method of regulating incumbent price cap LECs' terminating access service is to require the incumbent price cap LEC to charge the end user for the service. [358] If called parties paid for terminating access, the ***21474** individual who paid for the service would be the same individual who selected the provider. We seek comment on whether requiring called parties to pay for terminating access might encourage competition for terminating access. We note that wireless companies already charge the called parties for receiving calls. Would charging the called party for terminating access result in an increase of uncompleted calls, due to a reluctance by called parties to accept the charges? We invite parties to address how charging the customer receiving the call for terminating access could be accomplished, and whether this approach would be superior to using forward-looking economic cost. BellSouth argues that the availability of transport and termination under Section 251 for local traffic makes unnecessary any special regulation for terminating access that is different from originating access. [359] BellSouth argues that terminating interstate traffic would be disguised as terminating local traffic, resulting in less expensive terminating access. We seek comment on BellSouth's analysis.

276. Alternatively, we could require incumbent price cap LECs to charge nothing for terminating access service and permit them to recover all such costs from originating access charges. We invite parties to comment on the merits of this approach and whether incumbent price cap LECs should be permitted to choose between this approach and some other form of regulation of their terminating access services. Parties should also suggest other possible methods of regulating incumbent price cap LECs' terminating access service not discussed above. We seek comment on whether we should adopt different regulatory mechanisms for terminating access for those incumbent price cap LECs that are subject to the alternative regulatory regime discussed in Section VI, above. Finally, we invite parties to address whether we should keep our rate structure rules for terminating access for incumbent LECs even after we have eliminated such rate structure rules for originating access.

2. Non-Incumbent LECs

277. Between 1979 and 1985, the Commission conducted the *Competitive Carrier* proceeding, in which it examined how its regulations should be adapted to reflect and promote increasing competition in telecommunications markets. [360] In a series of orders, the ***21475** Commission distinguished between two kinds of carriers: those with market power (*i.e.*, the power to control prices) are deemed dominant carriers, and those without market power are deemed non-dominant carriers. [361] The Commission has regulated incumbent LECs as dominant carriers in their provision of interstate access service. [362] The Commission's policy since *Competitive Carrier* has consistently been that a carrier is non-dominant unless the Commission makes or has made a finding that it is dominant. [363]

278. Competitors have begun to provide exchange access services, aided in significant part by our expanded interconnection policies. [364] The pro-competitive policies of the 1996 Act are expected to result in increased entry into the exchange and exchange access markets. To date, the Commission has only applied the interstate access charge rules to incumbent LECs. New entrants into the exchange access market, such as competitive access providers (CAPs), [365] have been presumptively classified as non-dominant because they have been deemed not to have the ability to exercise market power in particular service areas. [366] NYNEX has suggested that there is a need for regulation of certain access services, particularly terminating access, offered by all LECs, including new entrants. [367] In this section, we consider and invite comment on whether, and the extent to which, we should establish any rules for the provision of access services by non-incumbent LECs, or competitive LECs, most particularly terminating access service. We note that we are extremely reluctant to impose ***21476** price regulation on non-dominant carrier services without a strong showing that such regulation is necessary.

279. The factors that warrant continued regulation of incumbent LECs' terminating access service appear to apply to all access providers, including competitive LECs, because these new entrants appear to possess market power over IXCs needing to terminate calls. As previously discussed, the recipient of a call, the called party, selects the carrier that provides the terminating access for the calls destined for that party. The decision to place the call, however, lies with the calling party, who currently pays for the call. In those cases, the calling party's long-distance service provider appears to have little or no influence on the called party's choice of service provider. [368] Because the paying parties do not choose the carrier that terminates their interstate calls, competitive LECs potentially could charge excessive prices for terminating access. [369] We therefore seek comment on whether there are some aspects of the competitive situation facing non-dominant LECs with respect to terminating access that distinguishes non-dominant from dominant carriers.

280. In the event we conclude that non-dominant carriers have market power with regard to terminating access charges or that market failure would preclude the marketplace from ensuring that terminating access rates are just and reasonable, we also invite parties to comment on whether competitive LECs' terminating access service should be subject to different limits than incumbent price cap LECs' terminating access service, or to similar limits on rate structure or rate level. Parties should address whether the incumbent LECs' terminating access charges should serve as a benchmark to evaluate competitive LECs' terminating rates. For example, we could find a competitive LEC's terminating access charge to be presumptively just and reasonable if the charge is less than or equal to the terminating access charge of the incumbent LEC with which the competitive LEC is competing. If, on the other hand, the competitive LEC's terminating access charge is greater than the incumbent LEC's charge, the competitive LEC could be required to provide cost support for its charge or it could collect the difference from its end users. We seek comment on these proposals, as well as on other less intrusive methods of ensuring a competitive LEC's terminating access charges are just and reasonable. We further invite parties to comment how small business entities, including small incumbent LECs and new entrants will be affected by this tentative conclusion and proposals to regulate terminating access. [370]

***21477 3. “Open End” Services**

281. In some instances, an IXC may not be able to influence the choice of the originating access provider, and, consequently, marketplace forces may be less effective in limiting a competing LEC's ability to charge higher originating access rates. For example, for “open end” originating minutes, [371] such as originating access for 800 service, it is the called party that pays for the call. Thus, while the calling party, who selects the local carrier/access provider, decides to place an individual call, that party pays nothing for the call. For these reasons, the Commission has long treated incumbent LECs' originating “open end” minutes as terminating minutes for access charge purposes. [372] We seek comment on whether this analysis should continue to apply to incumbent LECs' originating access for 800 service and other similar “open end” services for which terminating access rates serve as originating access rates, and whether such regulation should be extended to apply to competitive LECs.

B. Treatment of Interstate Information Services

282. Usage of interstate information services, and in particular the Internet and other interactive computer networks, has increased dramatically in recent years. [373] Such new services create significant benefits for the economy and the American people. [374] The 1996 Act states that it is the policy of the United States "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation," [375] and we have long sought to avoid unnecessary regulation of information services. As usage continues to grow, such services may have an increasingly significant effect on the public switched network.

***21478** 283. Therefore, as part of this comprehensive proceeding, we must consider how our rules can provide incentives for investment and innovation in the underlying networks that support the Internet and other information services. We consider in this section the narrow question of whether to permit incumbent LECs to assess interstate access charges on information service providers. We make no specific proposals, and we tentatively conclude that the existing pricing structure for information services should remain in place at this time. In Section X, we issue a Notice of Inquiry to examine various fundamental issues about the implications of usage of the public switched network by information service and Internet access providers.

284. Beginning with the *Computer II* proceeding in the 1970s, we have distinguished between basic and enhanced communications services. [376] The category of enhanced services, which includes access to the Internet and other interactive computer networks, as well as telemessaging, alarm monitoring, and other services, appears to be quite similar to the term "information services" in the 1996 Act. [377] In the 1983 *Access Charge Reconsideration Order,* we decided that, although enhanced service providers (ESPs) may use incumbent LEC facilities to originate and terminate interstate calls, ESPs should not be required to pay interstate access charges. [378]

285. As a result of these decisions, ESPs may purchase services from incumbent LECs under the same intrastate tariffs available to end users, by paying business line rates and the appropriate subscriber line charge, rather than interstate access rates. [379] Those business line rates are significantly lower than the equivalent interstate access charges, in part because of separations allocations and the access charge per-minute rate structure, and in part because the business lines that ESPs now purchase generally do not include usage-sensitive charges for ***21479** receiving local calls. [380] ESPs, consequently, typically pay incumbent LECs a flat monthly rate for their connections regardless of the amount of usage they generate. Pacific Bell estimates that calls to Internet-provided services could comprise up to 25 percent of its traffic by the end of the decade. [381] US West projects that 30 percent of all local exchange traffic will be for access to the Internet by the year 2000. [382] The Internet access market is also highly competitive and dynamic, with over 2,000 companies offering Internet access as of mid-1996. [383] It is extremely likely that, had per-minute interstate access rates applied to ESPs over the past 13 years, the Internet and other information services would not have developed to the extent they have today -- and indeed may not have developed commercially at all.

286. For some time, however, incumbent LECs and others have argued that ESPs impose costs on the network that are similar to those imposed by providers of interstate voice telephony, and that ESPs should therefore pay interstate access charges. [384] Several parties made this argument in their comments in response to a petition filed by America's Carriers Telecommunications Association (ACTA) earlier this year. [385] In addition, four BOCs have filed studies in recent months purporting to show that the current pricing structure for Internet access contributes to the congestion of incumbent LEC networks. [386] The BOCs claim that Internet users typically stay on the line far longer than voice users, but that the flat monthly rates Internet service providers pay to incumbent LECs do not cover the additional cost of network upgrades that are required to support such traffic.

287. In response, information service providers argue that the rates they pay to incumbent LECs, combined with the additional revenues from sources such as second lines ***21480** installed for Internet usage, more than cover the costs they impose on the network. [387] These parties also argue that the imposition of access charges would stifle growth, investment, and innovation in information services, causing detrimental effects for the economy and U.S. competitiveness. [388] The Network Reliability

and Interoperability Council (NRIC), an advisory committee of industry representatives organized to advise the FCC, is also looking into the effects of Internet usage on the public switched telephone network. [389]

288. We tentatively conclude that information service providers should not be required to pay interstate access charges as currently constituted. As we have explained throughout this Notice, the existing access charge system includes non-cost-based rates and inefficient rate structures. We see no reason to extend this regime to an additional class of users, especially given the potentially detrimental effects on the growth of the still-evolving information services industry. [390] Although our original decision in 1983 to treat ESPs as end users rather than carriers was explained as a temporary exemption, [391] we tentatively conclude that the current pricing structure should not be changed so long as the existing access charge system remains in place. The mere fact that providers of information services use incumbent LEC networks to receive calls from their customers does not mean that such providers should be subject to an interstate regulatory system designed for circuit-switched interexchange voice telephony. We seek comment on this tentative conclusion.

289. We recognize that this issue is of special interest to users of the Internet and online services. Therefore, we have established an electronic mailbox at <isp@fcc.gov> for submission of informal comments on the treatment of Internet and other information services. ***21481** Additional information on this issue is available through our World Wide Web site at <http:// www.fcc.gov/ isp.html>. We are inviting all parties that file formal paper comments in this proceeding to submit copies of their comments in electronic form, and we intend to make those electronic submissions available for review on the World Wide Web.

290. We invite interested parties to discuss the number of ESPs and Internet service providers, if any, that can be considered "small entities" within the meaning of the Regulatory Flexibility Act, and whether there is any reason to establish different requirements for small ESPs and information service providers.

C. Other Part 69 Revisions

1. Equal Access Network Reconfiguration Costs

291. The court in the *MFJ* required all Bell Operating Companies to provide access service that would enable subscribers to reach their interexchange carrier of choice without dialing additional digits, or in other words, "1 + dialing." [392] GTE was later required by court order to provide to all IXCs, upon bona fide request, exchange access that is equal in type and quality to that provided to AT&T. [393] The Commission later imposed similar "equal access" obligations on independent telephone companies other than GTE. [394]

292. In 1986, the Commission prohibited incumbent LECs from recovering all the costs incurred in converting their networks to equal access at the time they incurred those costs. Instead, LECs were required to amortize those costs over an eight-year period ending on December 31, 1993. [395] Prior to the termination of this amortization period, the Commission adopted price cap regulation for incumbent LECs, and based the initial price cap rates on the access rates in effect as of July 1, 1990, as adjusted for the represcription of the authorized rate of return we adopted in 1990. [396] In the *LEC Price Cap Reconsideration* ***21482** *Order,* the Commission declined to extent exogenous treatment to equal access reconfiguration costs because it might give incumbent LECs an artificial incentive to increase their investment in equal access facilities at a time when conversion to equal access was substantially complete. [397] In petitions to reject or suspend the price cap incumbent LECs' 1994 annual access tariffs, AT&T and MCI argued that the incumbent LECs' PCIs should be reduced to reflect the completion of the amortization of equal access costs. The Common Carrier Bureau did not suspend any tariffs for this reason, in part because the Commission decided not to require exogenous cost treatment in the *LEC Price Cap Reconsideration Order,* and in part because the completion of the equal access cost amortization is not listed in section 61.45(d)(1) of our rules as warranting exogenous cost treatment. [398] Later, in the *LEC Price Cap Performance Review,* the Commission considered requiring incumbent LECs to make an exogenous cost decrease to account for the completion of the equal access cost amortization, but found that the record was not adequate in that proceeding to require such an adjustment. [399]

293. We invite comment on whether to require incumbent price cap LECs to make an exogenous cost decrease to one or more of their PCIs to account for the completion of the amortization of equal access network reconfiguration costs on December 31, 1993. Parties supporting an exogenous cost reduction should explain in detail how such an adjustment should be calculated, and to which basket or baskets should the exogenous reduction apply. In addition, we invite interested parties to discuss whether it would be fair to require exogenous cost decreases to account for the completion of the amortization of equal access network reconfiguration costs in light of the fact that the Commission did not permit exogenous cost increases for equal access network reconfiguration costs. [400]

2. Part 69 Allocation Rules

294. We invite comment on relieving incumbent price cap LECs from the application of Part 69, Subparts D and E of our rules, in certain instances. Subparts D and E allocate incumbent LECs' investments and expenses to all the access rate elements. If we adopt a market-based approach to access reform as we discuss in Section V above, and decide to eliminate the rate structure rules, this would appear to eliminate the need for the Part 69 cost ***21483** allocation rules. Alternatively, if we adopt a more prescriptive approach to access reform as we discuss in Section VI above, and decide to base some or all their access rates on TSLRIC costs, then it may not be necessary to retain rules for fully distributing costs to different rate elements. We solicit comment on whether there might be any other reason to relieve any price cap LEC from the requirements of Subparts D and E, and if so, what the timing of that relief should be.

3. Other Proposed Part 69 Changes

295. Regardless of whether we adopt any of the proposals discussed in this Notice, we tentatively conclude that a number of provisions in Part 69 warrant revision. These revisions are necessary to conform Part 69 to the 1996 Act, or to update the rules for other reasons. We seek comment below on what these conforming or updating amendments should be. Also, over the years, several incumbent LECs have established access rate elements or subelements pursuant to waiver. We seek comment below on incorporating these rate elements into Part 69.

296. First, we discuss rule revisions necessary to conform Part 69 to the 1996 Act. Section 69.2(hh) of the Commission's rules defines “Telephone Company” in terms of section 3(r) of the 1934 Act. We propose to change this reference to “incumbent LEC” as it is defined in the 1996 Act. Sections 69.4(f) and 69.122, providing for a “contribution charge” that may be assessed on special access and expanded interconnection, appear to be inconsistent with the requirement in section 254 that such carrier contributions be equitable and nondiscriminatory. [401] Accordingly, we propose to delete these two rule sections. We also seek comment on what effect, if any, adoption of this proposal might have on small incumbent LECs or other small businesses. In addition, we invite parties to identify other rules which may be inconsistent with the Act.

297. Second, we seek comment on eliminating Part 69 rules that are no longer effective. For example, in the mid-1980s, we permitted incumbent LECs to recover their equal access conversion costs through a separate rate element. We also required carriers to eliminate any separate equal access charge by January 1, 1994. [402] Therefore, we propose deleting section 69.107, permitting carriers to establish an equal access element, and sections 69.308 and 69.410, which allocate costs to the equal access rate element. We also propose ***21484** removing section 69.4(d), [403] and in its place creating a new section 69.3(e)(12) to read as follows: “Such a tariff shall not contain any separate carrier's carrier tariff charges for an Equal Access element.” Finally, we would remove the reference to section 69.308 in section 69.309, and the reference to section 69.410 in section 69.411. Similarly, the transitions in section 69.205 have been completed, and so we propose deleting that section. We invite comment on whether there are any other similar rules in Part 69 that are no longer effective, or duplicate other rules, and so could be deleted without changing any current Part 69 requirements. Finally, we invite comment on our tentative conclusion that eliminating such rules would not affect any requirements currently placed on small telecommunications providers or any other small businesses.

298. Similarly, section 69.103 of our rules requires incumbent LECs to establish a separate rate element for costs associated with lines terminating at "limited pay telephones," which are pay telephones designed to provide access to only one interexchange carrier. [404] Section 276 of the Act provides statutory requirements governing pay telephones that we recently implemented. [405] In light of the new payphone compensation procedures, we seek comment on whether section 69.103 of our rules serves any ongoing purpose, or whether we should eliminate section 69.103, and the rules allocating costs to this rate element, [406] from our rules.

299. Lastly, several incumbent LECs provide service using rate elements created pursuant to waiver, and we seek comment on incorporating those waivers into Part 69. For example, in 1994, the Common Carrier Bureau granted several waivers of Part 69 to permit incumbent LECs to establish rate elements for 500 access service. [407] In 1990, the Bureau granted several incumbent LECs waivers of Part 69 to establish rate elements for electronic ***21485** white pages service. [408] Also, in 1985, the Bureau granted incumbent LECs waivers of section 69.109 to create a subelement within the Information rate element to recover costs they could show were not incurred in the provision of interstate directory assistance. [409] In this Notice, we seek comment on codifying these waivers as access rate elements or subelements in Part 69. We also seek comment on whether to incorporate any other rate elements created pursuant to waiver into the Commission's rules. Commenters supporting these rule revisions should also specify any revisions to Part 69, Subparts D and E, needed to allocate the proper costs to these rate elements.

IX. THIRD REPORT AND ORDER

300. We conclude that certain revisions to our rules should be made upon issuance of this Order. [410] These changes include eliminating the price caps lower service band indices, and substantially easing the requirements necessary for the introduction of new services. We make these adjustments in order to remove obstacles to lower access prices, and allow incumbent LECs to recover their costs in a manner consistent with the way that costs are incurred. Moreover, we believe that these changes will not adversely affect the development of a competitive marketplace. [411]

A. Lower Service Band Indices

1. Background

301. Our price cap rules divide incumbent LEC services among four baskets, with each basket being subject to a separate price cap index (PCI). Selected categories of services within the trunking and traffic-sensitive baskets are also subject to individual SBIs. Each tariff year the carrier must establish, for each such group of services, new upper and lower ***21486** bands that are set at specified percentages above and below the SBI. [412] Price changes are presumptively lawful if the API for the basket is at or below the PCI, and the prices for each category of services within the basket are within the established pricing bands. Most categories of services are currently subject to lower bands that limit the annual price reductions for those categories to ten percent, relative to the percentage change in the PCI for that basket, such as the service categories in the traffic-sensitive and trunking baskets other than the TIC. Where incumbent LECs are permitted to deaverage rates, as when an expanded interconnection cross-connect for special access or transport service has been taken in a LEC study area, annual price reductions within any zone of the service category are limited to fifteen percent, although price reductions for the service category as a whole cannot go down by more than 10 percent.

302. In the *Price Cap Second FNPRM,* we proposed eliminating the lower pricing bands for service categories to permit incumbent LECs to reduce prices to any level above average variable cost. We tentatively concluded that the price cap indices and upper service band limits would continue to inhibit predatory pricing effectively. [413]

2. Comments

303. Incumbent LECs commenting on this proposal were generally supportive, arguing that it would not harm customers (who would pay lower rates) and could result in more efficient pricing, with prices moving closer to the costs of providing access services. [414] These incumbent LECs also dismissed the idea that increased downward pricing flexibility could result in successful predatory pricing to eliminate actual or potential competitors in access markets, especially because the price cap basket and band caps limit an incumbent LEC's ability to raise other rates to compensate for below-cost pricing of particular services. [415] Incumbent LEC competitors or potential competitors opposed the proposals, contending, among other things, that increased downward pricing flexibility for incumbent price cap LECs is not in the public interest; would encourage predatory pricing; would result in anti-competitive cost-shifting; and may result in the incumbent LECs imposing a price ***21487** squeeze on new entrants. [416] Time Warner argued that " [e]limination of the lower band restrictions would be appropriate in only those few limited circumstances where LECs can and have demonstrated that true competition exists." [417]

304. In their comments, IXCs such as AT&T and MCI argued that we should not remove this regulatory constraint from incumbent LECs unless certain conditions were met. [418] MCI insisted that incumbent LECs first must be required to lower their access rates to economic costs. [419] AT&T supported that the proposal to eliminate the lower SBI limits, but contended that, without sufficient safeguards, elimination of lower SBI limits could result in cross-subsidization and predatory pricing. It therefore proposed that incumbent LECs be required to exclude any price reductions beyond the existing lower limits from its API calculation. According to AT&T, this would enable incumbent LECs to compensate for price reductions with price increases for other services in the same basket only up to the preexisting lower SBI limits of a band, but ensure that they cannot compensate for price decreases that are below the current SBI lower limits. [420] Second, it recommended that the Commission reduce the upper SBI limit from five percent to one percent for any service category or subcategory in which an incumbent LEC makes price reductions below the former SBI limit. [421]

3. Discussion

305. We find that removing the lower service band indices would be in the public interest, and we therefore eliminate them. As set forth in the *Price Cap Second FNPRM,* we find that this will lead to lower prices, particularly as competition emerges and puts pressure on incumbent LECs to charge rates that are related to the underlying costs of providing exchange access services. We believe that the current PCI and upper SBIs adequately control predatory pricing, and that we do not need AT&T's conditions for eliminating the lower SBIs to address predation. If an incumbent LEC lowers its prices in one year, the upper SBIs ***21488** prevent the incumbent LEC from immediately raising its rates back to its previous levels. [422] In addition, we remain skeptical that incumbent LECs in this context successfully could engage in predatory pricing (lowering prices to eliminate competitors and then raising prices to above-competitive levels). [423] The lower service band indices do not prohibit below-band tariff filings. Rather, they establish higher cost support requirements for below-band filings, [424] and a presumption that below-cap, within-band tariff filings are lawful. [425] Based on the comments submitted in response to the *Price Cap Second FNPRM*, and in light of the our continuing skepticism about the potential for an incumbent LEC to engage successfully in predatory pricing, we conclude that the presumption of lawfulness that we have applied to within-band tariff filings can now be extended to all rate decreases.

306. We also find that AT&T's suggested conditions are not necessary to limit the "headroom" an incumbent LEC might create by lowering certain access rates within a basket. [426] We are retaining the SBI upper bands. Those upper bands constrain the incumbent price cap LECs' ability to use headroom to increase rates for any particular access service beyond specified percentages. This decision is consistent with our current treatment of below-band filings, which are included in the calculation of an incumbent LEC's API. [427] In addition, in this Notice, we invite comment on two alternative approaches to access reform. Regardless of which approach we adopt, access reform should result in incumbent LECs' access rates moving closer to forward-looking economic cost, and so would limit the extent to which an incumbent LEC could take advantage of any headroom that may be created by lowering certain access rates.

B. Waiver Requirement for Introduction of New Services

1. Background

307. In the *Price Cap Second FNPRM,* we noted that many incumbent LECs have argued that new services and technologies often do not fit the existing Part 69 rate structure ***21489** requirements, and that obtaining a waiver to introduce a new rate element is costly, time-consuming, and poses a significant impediment to the introduction of new services. [428] Because we found that our rules may unnecessarily hinder the introduction of new services, we proposed to eliminate the current Part 69 requirement that incumbent price cap LECs seek a waiver each time they want to establish new rate elements for a new switched access service. [429] Specifically, we proposed to modify Part 69 to permit an incumbent price cap LEC to introduce a new service by filing a petition for the new service based on a public interest standard. We further proposed that after the first incumbent LEC had satisfied the public interest requirement for establishing new rate elements for a new switched access service, other incumbent price cap LECs could introduce identical new services, and their petitions would be reviewed in an expedited fashion (*i.e.,* within ten days).

2. Comments

308. Although incumbent LEC commenters generally supported these proposals, some argued that the proposals did not go far enough in removing undue restrictions on the introduction of new services. [430] NYNEX and SNET, for example, argued that the introduction of new service elements should be presumed lawful, and the introduction of new switched access rate elements should not be subject to any stricter review than is accorded special access elements. [431] Several other commenters, including IXCs and some incumbent LEC competitors, opposed the Commission's proposed revisions to the Part 69 waiver process. [432] MCI argued that the Commission should develop clear and precise guidelines for obtaining a ***21490** waiver, and that an incumbent LEC seeking to deviate from the established Part 69 tariff structure bears the burden of showing that its alternative better serves the public interest. [433]

3. Discussion

309. We conclude that the relaxed procedures for introducing new switched access services that we set forth in the *Price Cap Second FNPRM* will further the public interest, and we therefore adopt them. We find that requiring an incumbent LEC to file a waiver to introduce a new rate element imposes a costly, time-consuming, and unnecessary burden on incumbent LECs, and significantly impedes the introduction of new services. Also, we believe that delaying implementation would not assist in the development of a competitive marketplace. We therefore amend Part 69 so that an incumbent LEC may introduce a new service by filing a petition for the new service based on a public interest standard.

310. We also amend Part 69 so that after the first incumbent LEC has satisfied the public interest requirement for establishing new rate elements for a new switched access service, another incumbent price cap LEC can file a petition seeking authority to introduce identical rate elements for an identical new service, and its petition will be reviewed within ten days of the release of a Public Notice. Parties may file comments in response to such a petition within seven days of the Public Notice. The incumbent LEC shall have authority to introduce these new rate elements after expiration of the ten-day period, unless the Common Carrier Bureau has informed the LEC that the LEC has not demonstrated that its new service qualifies as a “me-too” service. The incumbent LEC may then file one subsequent new petition for “me-too” authorization for that service or may file a public interest petition seeking to introduce that service. An incumbent LEC may not seek expedited review based on our public interest authorization of a new service based on a competitive showing, such as was the case with the NYNEX USPP and Ameritech Customers First waivers. [434] In such cases, an incumbent LEC must file its own petition seeking approval for a new rate element.

X. NOTICE OF INQUIRY ON IMPLICATIONS OF INFORMATION SERVICE AND INTERNET USAGE

311. In Section VIII.B, above, we tentatively concluded that information service providers should not be subject to interstate access charges as currently constituted. However, the development of the Internet and other information services raise many critical ***21491** questions that go beyond the interstate access charge system that is the subject of this proceeding. Ultimately, these questions concern no less than the future of the public switched telephone network in a world of digitalization and growing importance of data technologies. Our existing rules have been designed for traditional circuit-switched voice networks, and thus may hinder the development of emerging packet-switched data networks. To avoid this result, we must identify what FCC policies would best facilitate the development of the high-bandwidth data networks of the future, while preserving efficient incentives for investment and innovation in the underlying voice network. In particular, better empirical data are needed before we can make informed judgments in this area.

312. We ask whether, after we complete reform of access charges as contemplated in this proceeding, we should consider any additional actions relating to interstate information services and the Internet. We therefore initiate this Notice of Inquiry, with a separate pleading cycle, to address these issues. Based on the record in response to this Notice of Inquiry, and the decisions we make in the Access Reform Report and Order, we will determine whether to make proposals in this area in a subsequent Notice of Proposed Rulemaking.

313. Many of the concerns now being raised about switch congestion caused by Internet usage arise because virtually all residential users today connect to the Internet -- a packet-switched data network -- through incumbent LEC switching facilities designed for circuit-switched voice calls. The end-to-end dedicated channels created by circuit switches are unnecessary and even inefficient when used to connect an end user to an ISP. We seek comment on how our rules can most effectively create incentives for the deployment of services and facilities to allow more efficient transport of data traffic to and from end users. We invite parties to identify means of addressing the congestion concerns raised by incumbent LECs, for example by deploying hardware to route data traffic around incumbent LEC switches, or by installing new high-bandwidth access technologies such as asymmetric digital subscriber line (ADSL) or wireless solutions.

314. We seek comment on what regulatory barriers -- at either the state or federal level -- might prevent provision of alternate network access arrangements for information service providers, or might create artificial disincentives against use of such arrangements when they become available. Should we consider using our forbearance or preemption authority to avoid results that would hamper the deployment of new technologies? We also seek comment on how the matters before us in our *Local Competition* and *Universal Service* proceedings affect information service providers and raise issues that we need to address in this proceeding.

315. We seek comment on the effects of the current system on network usage, incumbent LEC cost-recovery, and the development of the information services marketplace. We are disinclined to take actions that would stifle, rather than enhance, the development of ***21492** the Internet, or similar packet-switched networks. We encourage commenters to provide data on the characteristics of information service usage and its effects on the network. [435] We are also particularly interested in data on the incumbent LECs' costs directly related to ESPs' use of the PSTN, on incumbent LECs' revenues attributable to ESP traffic (including second phone line revenue), and in a comparison of what PSTN services ESPs desire, as opposed to what they currently have access to. We seek comment on administrative and technical issues that may arise either under continued operation of the current system or as modified by this proceeding. In particular, we seek comment on jurisdictional, metering, and billing questions, given the difficulty of applying jurisdictional divisions or time-sensitive rates to packet-switched networks such as the Internet. [436]

316. The current division in our rules between basic and enhanced services may not accurately capture the types of companies that provide information services today, and the manner in which these companies use incumbent LEC facilities. There are many kinds of information services, with different usage patterns and effects on the network. For example, arguments about network congestion caused by long hold-time calls would not seem to apply to information services such as telemessaging or credit card validation. We seek comment on whether we should distinguish between different categories of information or

enhanced services. In addition, several companies now provide software that allows a voice conversation to be conducted over the Internet. [437] Such "Internet telephony" allows what appears to be a basic service -- voice transmission -- to take place over a packet-switched interactive data network that we have traditionally considered to be an enhanced service. We seek comment on how new services such as Internet telephony, as well as real-time streaming audio and video services over the Internet, should affect our analysis. [438]

317. We seek comment as to whether the issues raised in this Notice of Inquiry should be addressed in any existing proceeding, or a new proceeding. As discussed in Section VIII, above, the Network Reliability and Interoperability Council (NRIC) is also currently evaluating the effects of Internet usage on the voice network. We do not intend for this proceeding to in any way supersede the NRIC's efforts, and we believe that the NRIC's recommendations will complement the record we develop here. Ultimately, a full and open debate about the relationship of information services to the public switched network will benefit all parties. We also strongly encourage interested parties among incumbent LECs and ***21493** ESPs to work together to identify which technological solutions hold the greatest promise in carrying Internet traffic most efficiently and with the least adverse price impact on consumers.

318. As discussed in Section VIII, above, we have established an electronic mailbox at <isp@fcc.gov> for submission of informal comments on the treatment of Internet and other information services, and we have made additional information available through our World Wide Web site at <http:// www.fcc.gov/isp.html>.

XI. PROCEDURAL ISSUES

A. *Ex Parte* Presentations

319. This is a non-restricted notice-and-comment rulemaking proceeding. *Ex parte* presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's rules. *See generally* 47 C.F.R. §§ 1.1202, 1.1203, 1.1206.

B. Paperwork Reduction Act

320. This NPRM contains either a proposed or modified information collection. As part of its continuing effort to reduce paperwork burdens, we invite the general public and the Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this NPRM, as required by the Paperwork Reduction Act of 1995, Pub. L. No. 104-13. Public and agency comments are due at the same time as other comments on this NPRM; OMB comments are due 60 days from date of publication of this NPRM in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

C. Initial Regulatory Flexibility Act Analysis

321. Pursuant to Section 603 of the Regulatory Flexibility Act, the Commission has prepared the following initial regulatory flexibility analysis (IRFA) of the expected impact of these proposed policies and rules on small entities. Written public comments are requested on the IRFA. These comments must be filed in accordance with the same filing deadlines as comments on the rest of the Notice, but they must have a separate and distinct heading designating them as responses to the regulatory flexibility analysis. The Secretary shall cause a copy of the Notice, including the initial regulatory flexibility analysis, to be sent to the ***21494** Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. Section 601 *et seq.* (1981).

322. Reason for action. The Telecommunications Act of 1996 requires incumbent LECs to offer interconnection and unbundled elements on an unbundled basis, and imposes a duty to establish reciprocal compensation arrangements for the transport and termination of calls. The Commission's access charge rules were adopted at a time when interstate access and local exchange services were offered on a monopoly basis, and in many cases are inconsistent with the competitive market envisioned by the 1996 Act.

323. Objectives. To revise the Commission's access charge rules to make them consistent with the Telecommunications Act of 1996.

324. Legal Basis. The proposed action is supported by Sections 4(i), 4(j), 201-205, 251, 252, 253, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201-205, 251, 252, 253, 403.

325. Description, potential impact and number of small entities affected. For purposes of this Notice, the Regulatory Flexibility Act defines a "small business" to be the same as a "small business concern" under the Small Business Act (SBA), 15 U.S.C. § 632, unless the Commission has developed one or more definitions that are appropriate to its activities. [439] Under the SBA, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the SBA. [440] The Small Business Administration has defined a small business for Standard Industrial Classification (SIC) category 4813 (Telephone Communications, Except Radiotelephone) to be small entities when they have fewer than 1500 employees. [441]

326. *Total Number of Telephone Companies Affected.* With the exceptions of the proposals under consideration in Sections III.D, III.E, VII.A, and VIII.C of this Notice, the proposals in this Notice, if adopted, would affect all LECs that are regulated by the Commission's price cap rules. Currently, 13 incumbent LECs are subject to price cap ***21495** regulation. We tentatively conclude that all price cap carriers have more than 1500 employees and therefore are not small entities.

327. The proposals under consideration in Sections III.B, III.D, III.E, VII.A., and VIII.C of this Notice, if adopted, would affect all incumbent LECs regulated by the Commission. The United States Bureau of the Census (Census Bureau) reports that, at the end of 1992, there were 3497 firms engaged in providing telephone service, as defined therein, for at least one year. [442] This number contains a variety of different categories of carriers, including incumbent LECs, IXCs, competitive access providers, cellular carriers, mobile service carriers, operator service providers, pay telephone operators, PCS providers, covered SMR providers, and resellers. It seems certain that some of those 3497 telephone service firms may not qualify as small entities or small incumbent LECs because they are not independently owned or operated. [443]

328. Because the small incumbent LECs that would be subject to these rules are either dominant in their field of operations or are not independently owned and operated, consistent with our prior practice, they are excluded from the definition of "small entity" and "small business concerns." [444] Accordingly, our use of the terms "small entities" and "small businesses" does not encompass small incumbent LECs. [445] Out of an abundance of caution, however, for regulatory flexibility analysis purposes, we will consider small incumbent LECs within this analysis and use the term "small incumbent LECs" to refer to any incumbent LECs that arguably might be defined by SBA as "small business concerns."

329. *Local Exchange Carriers.* Neither the Commission nor the Small Business Administration has developed a definition of small providers of local exchange service. The closest applicable definition under Small Business Administration rules is for telephone telecommunications companies other than radiotelephone (wireless) companies. [446] The most reliable source of information regarding the number of incumbent LECs nationwide appears to be the data that we collect annually in the provision of Telecommunications Relay Service (TRS). According to our most recent data, 1347 companies reported that they were engaged ***21496** in the provision of local exchange service. [447] Although it seems certain that some of these carriers are not independently owned or operated, or have fewer than 1500 employees, we are unable at this time to estimate with greater precision the number of incumbent LECs that would qualify as small business concerns under the Small Business

Administration's definition. Consequently, we estimate that there are fewer than 1347 small incumbent LECs that may be affected by the proposals in this Notice. We seek comment on this estimate.

330. Under the new competitive provisions of the 1996 Act, however, there could be a number of new LECs entering the local exchange market that would be considered small businesses. In Section VIII.A of this Notice, we seek comment on whether to apply certain of the regulations applicable to incumbent LECs to new entrant LECs. Thus, it is possible that new entrants will be affected by our actions in this proceeding.

331. *Enhanced Service Providers.* In Section VIII.B of this Notice, we seek comment on whether to continue to exempt enhanced service providers (ESPs) from any requirement to pay access charges. Because we are not contemplating imposing any new regulatory requirement on ESPs, we conclude that the Regulatory Flexibility Act does not require us to consider the effects of these proposed rules on ESPs that would fit the definition of small entity. If we modify the "ESP Exemption," we will consider the effect on small ESPs at that time. We seek comment on this tentative conclusion.

332. Reporting, record keeping and other compliance requirements. It is not clear whether, on balance, all proposals in this Notice would increase or decrease incumbent LECs' administrative burdens.

333. With respect to all incumbent LECs, we believe that the reforms to rate structure that we propose in Section III would require at least one, and possibly several additional filings, but otherwise should not affect their administrative burdens. We expect that the proposal we make in Section VII relating to the allocation of universal service support to the interstate revenue requirement could increase their administrative burdens. We expect that some of the Part 69 revisions that we propose in Section VIII would reduce, others increase, and the remainder have no effect on their administrative burdens.

334. With regard to incumbent price cap LECs, we expect the changes to the existing local switching rate structure that we propose in Section III would require an initial additional filing, but otherwise would have no effect on their administrative burdens. As to the proposals in Section V, to the extent that a carrier chooses to avail itself of the additional reforms, it will need to file a petition demonstrating that it has met the trigger, and make an initial tariff filing. Otherwise, most of the proposed reforms in Section V would reduce or ***21497** have no effect on its administrative burdens. We expect that some of our proposals in Section VI of this Notice, if adopted, would increase the administrative burdens placed on incumbent LECs. We expect that the other proposals in Section VI of this Notice would have no effect on their administrative burdens. We expect that the proposal to continue regulating terminating access charges in Section VIII would have no effect on the administrative burden placed on incumbent price cap LECs.

335. In Section II, we address the likelihood that many, if not all, new entrants would be considered "domestic nondominant carriers," whose tariff filings would be governed by Sections 61.20 through 61.23 of our rules, 47 C.F.R. §§ 61.20-23, unless they are exempted from some or all of those requirements. We are unable to estimate the number of times these incumbent LECs would file tariffs annually, but it could vary from none to 20 or more. Nor are we able to estimate how extensive each tariff filing, on average, would be. If these new entrants are not exempted from any tariff filing requirements, then we estimate that, on average, it would take approximately two hours per page for the incumbent LEC to prepare each tariff filing, at a cost of $80 per hour in professional level and support staff salaries. If these carriers are exempted from some or all the regulations applicable to incumbent LECs, then the administrative burdens imposed on such carriers would be less. In Section V, we ask whether a market share test to measure the level of competition may impose a reporting requirement on new entrants. We expect that the proposal in Section VIII to regulate terminating access charges for new entrants would increase the administrative burden placed on incumbent price cap LECs. Compliance with these requests may require the use of engineering, technical, operational, accounting, billing, and legal skills.

336. Federal rules which overlap, duplicate or conflict with this proposal. None.

337. Any significant alternatives minimizing impact on small entities and consistent with stated objectives. In Section II of this Notice, we seek comment on whether to exempt new entrant LECs from some or all of the regulations applicable to incumbent LECs. Thus, new entrants that may also be small entities may or may not become subject to any new requirements. In any case,

new entrants will become subject to no more requirements than those imposed on incumbent LECs. However, we recognize that new entrants may have different business or operational concerns compared to incumbent LECs. In Sections II.A, III.B, III.E, V.A, V.C, VII.A, and VII.B, we have sought comment on how a number of proposals would affect small entities. These proposals could have varying positive or negative impacts on small entities. We are unable to ascertain, at this time, what the significant economic impact would be on small entities as defined by the SBA. We seek comment on these proposals and urge that parties support their comments with specific evidence and analysis.

***21498 D. Notice of Proposed Rulemaking Comment Filing Dates**

338. Pursuant to applicable procedures set forth in Section 1.399 and 1.411 *et seq.* of the Commission's Rules, 47 C.F.R. Sections 1.399, 1.411 *et seq.,* interested parties may file comments with the Secretary, Federal Communications Commission, Washington D.C. 20554 no later than **January 27, 1997.** Interested parties my file replies no later than **February 13, 1997.** To file formally in this proceeding, participants must file an original and twelve copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus 16 copies must be filed. In addition, parties should file two copies of any such pleading with the Competitive Pricing Division, Common Carrier Bureau, Room 518, 1919 M Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington D.C. 20554.

339. Parties submitting diskettes should submit them along with their formal filings to the Office of the Secretary. Submissions should be on a 3.5 inch diskette formatted in an DOS PC compatible form. The document should be saved in to WordPerfect 5.1 for Windows format. The diskette should be submitted in “read only” mode. The diskette should be clearly labelled with the party's name, proceeding, type of pleading (comment or reply comment), Docket number, and date of submission.

340. You may also file informal comments electronically via e-mail <access @fcc.gov>. Only one copy of electronically-filed comments must be submitted. You must put the docket number of this proceeding in the subject line (see the caption at the beginning of this Notice, or in the body of the text if by Internet). You must note whether an electronic submission is an exact copy of formal comments on the subject line. You also must include your full name and Postal Service mailing address in your submission.

341. In order to facilitate review of comments and replies, by both parties and Commission staff, we require that comments be no longer than **100** pages, and that replies be no longer than **50** pages. Comments and replies must also comply with Section 1.49 and all other applicable sections of the Commission's Rules. We also direct all interested parties to include the name of the filing party and the date of the filing on each page of their comments and replies. Comments and replies must also clearly identify the specific portion of this Notice of Proposed Rulemaking to which a particular comment or set of comments is responsive. If a portion of a party's comments does not fall under a particular topic listed in the Table of Contents of this Notice, such comments must be included in a clearly labelled ***21499** section at the beginning or end of the filing. Parties may not file more than a total of **ten** pages of *ex parte* submissions, excluding cover letters. This **ten** page limit does not include the following: (1) written *ex parte* statements made solely to disclose an oral *ex parte contact*; (2) written material submitted at the time of an oral presentation that provides a brief outline of the presentation; (3) written material filed in response to direct requests from Commission staff; or (4) any proposed rule language. *Ex parte* filings in excess of this limit will not be considered part of the record in this proceeding.

342. Written comments by the public on the proposed and/or modified information collections are due **January 27, 1997.** Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before 60 days after date of publication in the Federal Register. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Dorothy Conway, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to dconway@fcc.gov and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725 - 17th Street, N.W., Washington, DC 20503 or via the Internet to fain_t@al.eop.gov.

E. Notice of Inquiry Comment Filing Dates

343. Pursuant to applicable procedures set forth in Section 1.399 and 1.411 *et seq.* of the Commission's Rules, 47 C.F.R. Sections 1.399, 1.411 *et seq.,* interested parties may file comments with the Secretary, Federal Communications Commission, Washington D.C. 20554 no later than **February 21, 1997.** Interested parties my file replies no later than **March 24, 1997.** Comments and replies must comply with Section 1.49 and all other applicable sections of the Commission's Rules. To file formally in this proceeding, participants must file an original and twelve copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus 16 copies must be filed. In addition, parties should file two copies of any such pleading with the Competitive Pricing Division, Common Carrier Bureau, Room 518, 1919 M Street, N.W., Washington, D.C. 20554. We also direct all interested parties to include the name of the filing party and the date of the filing on each page of their comments and replies. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington D.C. 20554.

344. Parties submitting diskettes should submit them along with their formal filings to the Office of the Secretary. Submissions should be on a 3.5 inch diskette formatted in an DOS PC compatible form. The document should be saved in to WordPerfect 5.1 for Windows format. The diskette should be submitted in "read only" mode. The diskette should be clearly labelled with the party's name, proceeding, type of pleading (comment or reply comment), Docket number, and date of submission.

***21500** 345. You may also file informal comments electronically via e-mail <isp @fcc.gov>, or via the World Wide Web. Information on how to file electronically is available at <http://www.fcc.gov/isp.html>. Only one copy of electronically-filed comments must be submitted. If you are using e-mail, you must put the docket number of this proceeding in the subject line (see the caption at the beginning of this Notice), and you also must note in the subject line if an electronic submission is an exact copy of formal comments. You also must include your full name and Postal Service mailing address in your submission.

F. Final Regulatory Flexibility Act Certification

346. In the *Price Cap Second FNPRM,* we certified that the Regulatory Flexibility Act did not apply to this rulemaking proceeding because none of the rule amendments under consideration would have a significant economic impact on a substantial number of small entities. [448] We concluded that the proposed rules would apply only to carriers subject to price cap regulation for local exchange access, and such carriers are generally large corporations or affiliates of such corporations. [449] No comments were received concerning the proposed certification. Since our initial certification, certain changes occurred. The Regulatory Flexibility Act was amended by the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"), [450] and Citizens elected price cap regulation. [451] Nonetheless, we certify that the rules adopted herein will not have a significant economic impact on a substantial number of small entities. [452]

347. The Regulatory Flexibility Act defines a "small business" to be the same as a "small business concern" under the Small Business Act. [453] Under the Small Business Act, a "small business concern" is one that: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) meets any additional criteria established by the ***21501** Small Business Administration. [454] Section 121.201 of the Small Business Administration regulations defines a small telecommunications entity in SIC code 4813 (Telephone Companies Except Radio Telephone) as any entity with 1,500 or fewer employees at the holding company level. [455] Entities directly subject to these rule changes are carriers subject to price cap regulation. [456] These entities, including the newest carrier subject to price cap regulation, Citizens, are generally large corporations that have more than 1,500 employees, or they are either dominant in their fields of operations or are not independently owned or operated. Thus, they are not "small entities" as defined by the Small Business Act. [457]

348. We therefore certify that the rules adopted herein will not have a significant economic impact on a substantial number of small entities. [458] The Commission shall provide a copy of this certification to the Chief Counsel for Advocacy of the Small Business Administration, and include it in the report to Congress pursuant to the SBREFA. [459] The certification will also be published in the Federal Register. [460]

XII. ORDERING CLAUSES

349. Accordingly, IT IS ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, 303(r), and 410(a) of the Communications Act of 1934, as amended, and Section 601 of the Telecommunications Act of 1996, 47 U.S.C. §§ 10, 151-154, 201-205, 224, 251, 254, 303(r) 410(a), and 601, that NOTICE IS HEREBY GIVEN OF the rulemaking described above and that COMMENT IS SOUGHT on these issues.

350. IT IS FURTHER ORDERED, pursuant to Sections 1-4, 10, 201-205, 251, 254, and 303(r) of the Communications Act of 1934, as amended, and Section 601 of the Telecommunications Act of 1996, 47 U.S.C. §§ 10, 151-154, 201-205, 224, 251, 254, 303(r) and 601, that NOTICE IS HEREBY GIVEN OF the inquiry described above and that COMMENT IS SOUGHT on these issues.

***21502** 351. IT IS FURTHER ORDERED that, pursuant to Sections 1-4, 201-205, and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 201-205, and 303(r) that the THIRD REPORT AND ORDER IS ADOPTED, effective 60 days after publication of a summary in the Federal Register. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

352. IT IS FURTHER ORDERED that Parts 61 and 69 of the Commission's rules, 47 C.F.R. Parts 61 and 69 ARE AMENDED as set forth in Appendix B.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

***21503** APPENDIX A

Parties Filing Pleadings

I. Pleadings in CC Docket No. 95-72 (*ISDN SLC NPRM*)

Comments

America Online Incorporated; CompuServe Incorporated; GE Information Services, Inc.;

Prodigy Services Company (America Online)

American Petroleum Institute

Ameritech

AT&T Corp. (AT&T)

Bell Atlantic Telephone Companies (Bell Atlantic)

BellSouth Telecommunications, Inc. (BellSouth)

Cable & Wireless, Inc. (Cable & Wireless)

California Bankers' Clearing House Association, MasterCard International Incorporated, the New York Clearing House Association, and Securities Industry Association (California Bankers' Clearing House)

Center for Democracy and Technology

Cincinnati Bell Telephone (Cincinnati Bell)

Commercial Internet eXchange Association (CIX)

Communications Managers Association (CMA)

Consumer Project on Technology

GTE Service Corporation (GTE)

Information Technology Industry Council (ITIC)

MCI Telecommunications Corporation (MCI)

Microsoft Corporation (Microsoft)

National Information Infrastructure Working Group

National Public Radio, Inc. (National Public Radio)

National Telephone Cooperative Association (NTCA)

Northern Arkansas Telephone Company, Inc. (Northern Arkansas Telephone Company)

NYNEX Telephone Companies (NYNEX)

Pacific Bell and Nevada Bell (Pacific Bell)

Public Utility Commission of Texas

Rochester Telephone Corp.

Roseville Telephone Company (Roseville)

Rural Telephone Coalition

Southwestern Bell Telephone Company (Southwestern Bell)

Sprint Corporation (Sprint)

Tele-Communications Association (TCA)

Tennessee Public Service Commission

***21504** Time Warner Communications Holdings, Inc. (Time Warner Communications)

United States Telephone Association (USTA)

U S WEST Communications, Inc. (US West)

West Virginia University

Replies

America Online

Ameritech

AT&T

Bell Atlantic

BellSouth

Cable & Wireless

Cincinnati Bell

CIX

CMA

GTE

ITIC

Information Technology Industry Council, United States Telephone Association, California

ISDN Users Group, Center for Democracy and Technology, Consumer Federation of

America, Information Industry Association, California Bankers' Clearing House Association, U. S. Chamber of Commerce, Independent Data Communications Manufacturers Association, Information Technology Association of America, Telecommunications Industry

Association (Joint Parties)

Interactive Services Association

MCI

Microsoft

Northern Telecom Inc. (Northern Telecom)

NYNEX

Pacific Bell

Roseville

Sprint

Southwestern Bell

3Com Corporation

USTA

***21505 Comments on Bell Operating Companies' Cost Data**

Comments

GTE Operating Company (GTE)

MCI Telecommunications Corporation (MCI)

Replies

America Online

NYNEX

Pacific Bell

Southwestern Bell

US West

II. Pleadings in CC Docket No. 94-1 (*Price Cap Second FNPRM*)

Comments

Ad Hoc Telecommunications Users Group (Ad Hoc)

Ameritech

ALTS

AT&T

Association for Local Telephone Services (ALTS)

Bell Atlantic

BellSouth

California Cable Television Association (CCTA)

Cincinnati Bell

Competitive Telecommmunicatiosn Association (CompTel)

Comcast Corp. (Comcast

Cox Enterprises, Inc. (Cox)

General Services Administration (GSA)

GTE

ICG Access Services, Inc. (ICG)

Information Industry Association (IIA)

LCI International, Inc. (LCI)

LDDS Worldcom (LDDS)

Lincoln Telephone and Telegraph Co. (Lincoln)

MCI

MFS

NCTA

NYNEX

***21506** Organization for the Protection and Advancement of Small Telephone Companies (Opastco)

Pacific Bell and Nevada Bell

Southern New England Telephone Co. (SNET)

Southwestern Bell

Sprint

Sprint Telecommunications Venture

TCA

Teleport

Telecommunciations Resellers Association

Time Warner Communications Holdings, Inc., (Time Warner)

USTA

US West

Replies

Ad Hoc

Ameritech

ALTS

AT&T

Bell Atlantic

BellSouth

Cincinnati Bell

Competitive Telecommmunicatiosn Association (CompTel)

Comcast

Cox

Frontier

GSA

GTE

LDDS

MCI

MFS

NCTA

NYNEX

Pacific Bell and Nevada Bell

Southwestern Bell

Sprint

Sprint Telecommunications Venture

Teleport

TRA

Time Warner

USTA

US West

***21507 APPENDIX B**

AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

PART 61 -- TARIFFS

1. The authority citation continues to read as follows:

Authority: Sec. 4, 48 Stat. 1066, as amended; 47 U.S.C. 154.

2. Section 61.47 is amended to remove Section 61.47(g)(6), and revised to read as follows:

§ 61.47 Adjustments to the SBI; pricing bands

*****

(e) Pricing bands shall be established each tariff year for each service category and subcategory within a basket. Except as provided in paragraphs (f), (g), and (h) of this section, each band shall limit the pricing flexibility of the service category or subcategory, as reflected in the SBI, to an annual increase of five percent, relative to the percentage change in the PCI for that basket, measured from the levels in effect on the last day of the preceding tariff year. For local exchange carriers subject to price caps as that term is defined in § 61.3(x), there shall be no lower pricing band for any service category or subcategory.

*****

(g) ***Local Exchange Carriers -- Service Categories and Subcategories.***

(1) Local exchange carriers subject to price cap regulation as that term is defined in § 61.3(x) shall use the methodology set forth in paragraphs (a) through (d) of this section to calculate two separate subindexes: One for the DS1 services offered by such carriers and the other for the DS3 services offered by such carriers. The annual pricing flexibility for each of these two subindexes shall be limited to an annual increase of five percent, relative to the percentage change in the PCI for the special access services basket, measured from the last day of the preceding tariff year. There shall be no lower pricing band for these two subindexes.

(2) The upper pricing band for the tandem-switched transport service category shall limit the annual upward pricing flexibility for this service category, as reflected in its SBI, to two percent, relative to the percentage change in the PCI for the trunking ***21508** basket, measured from the levels in effect on the last day of the preceding tariff year. There shall be no lower pricing band for the tandem-switched transport service category.

*****

(4) Local exchange carriers subject to price cap regulation as that term is defined in § 61.3(x) shall use the methodology set forth in paragraphs (a) through (d) of this section to calculate a separate subindex for the 800 data base vertical features offered by such carriers. The annual pricing flexibility for this subindex shall be limited to an annual increase of five percent, relative to the percentage change in the PCI for the traffic sensitive basket, measured from the last day of the preceding tariff year. There shall be no lower pricing band for this subindex.

*****

(h) ***

(2) The annual pricing flexibility for each of the subindexes specified in paragraph (h)(1) of this section shall be limited to an annual increase of five percent, relative to the percentage change in the PCI for the trunking basket, measured from the levels in effect on the last day of the preceding tariff year. There shall be no lower pricing band for these subindexes.

3. Section 61.49 is amended to remove Section 61.49(d).

PART 69 -- ACCESS CHARGES

4. The authority citation continues to read as follows:

Authority: Sec. 4, 201, 202, 203, 205, 218, 403, 48 Stat. 1066, 1070, 1077, 1094, as amended; 47 U.S.C. 154, 201, 202, 203, 205, 218, 403.

5. Section 69.4 is amended to read as follows:

§ 69.4 Charges to be Filed

*****

(g) (1) Local exchange carriers subject to price cap regulation as that term is defined in Section 61.3(x) of this chapter may establish one or more switched access rate ***21509** elements for a new service within the meaning of Section 61.42(g) of this chapter, upon approval of a petition demonstrating that:

(i) the establishment of the new rate element or elements would be in the public interest; or

(ii) another local exchange carrier has previously obtained permission to establish one or more rate elements identical to those proposed in the petition to offer the identical service; and the original petition did not rely upon a competitive showing as part of the public interest justification.

(2) The Chief, Common Carrier Bureau shall issue a Public Notice of the filing of a petition under subsection (g)(1)(ii). Parties may file comments in response to such a petition within seven days of the Public Notice. The local exchange carrier shall have authority to introduce new rate elements under subsection (g)(1)(ii) after the expiration of ten days from issuance of the Public Notice, unless the Chief, Common Carrier Bureau informs the LEC that the LEC has not demonstrated that its new service meets the standards of that subsection. The incumbent LEC may then file one subsequent petition for authorization of that service under subsectionHCA#**ERRATUM**

DA 97-212

Erratum Released: January 29, 1997

1. On December 24, 1996, the Commission released a Notice of Proposed Rulemaking seeking comment on several proposals for revising Part 69 of the Commission's Rules. [1] The first sentence of paragraph 338 is revised by deleting the period, and inserting the following language at the end of the sentence:

> , except that comments on the information collection requirements are due 30 days after publication of a summary of this Notice of Proposed Rulemaking in the Federal Register.

2. The second sentence of paragraph 338 is revised by deleting the period, and inserting the following language at the end of the sentence:

> , except that comments on the information collection requirements are due 60 days after publication of a summary of this Notice of Proposed Rulemaking in the Federal Register.

3. The first sentence of paragraph 342 is corrected to read as follows:

> 342. Written comments by the public on the proposed and/or modified information collections are due 30 days after publication of a summary of this Notice of Proposed Rulemaking in the Federal Register, and replies are due 60 days after publication of a summary of this Notice of Proposed Rulemaking in the Federal Register.

4. Paragraph 351 is corrected to read as follows:

> 351. IT IS FURTHER ORDERED that, pursuant to Sections 1-4, 201-205, and 303(r) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154, 201-205, and 303(r) that the THIRD REPORT AND ORDER IS ADOPTED, effective 150 days after publication of a summary in the Federal Register. The collections of information contained within are contingent upon approval by the Office of Management and Budget.

FEDERAL COMMUNICATIONS COMMISSION

Regina M. Keeney
Chief
Common Carrier Bureau

(g)(1)(ii).

Footnotes

a Averages may differ due to rounding.

1 Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, *to be codified at* 47 U.S.C. §§ 151 *et. seq* (1996 Act). Hereinafter, all citations to the 1996 Act will be to the 1996 Act as codified in the United States Code.

2 S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) (*Joint Explanatory Statement*).

3 Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) (*Local Competition Order*), Order on Reconsideration, CC Docket No. 96-98, 11 FCC Rcd 13042

(1996) (*Local Competition Reconsideration Order*), *petition for review pending and partial stay granted, sub nom.* Iowa Utilities Board et. al v. FCC, No. 96-3321 and consolidated cases (8th Cir., Oct. 15, 1996), *partial stay lifted in part*, Iowa Utilities Board et. al v. FCC, No. 96-3321 and consolidated cases (8th Cir. Nov. 1, 1996).

4 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 (rel. Nov. 8, 1996) (*Joint Board Recommended Decision*).

5 In providing interstate long-distance service, interexchange carriers use local telephone companies' facilities to originate and terminate calls. The use of local telephone company facilities to originate and terminate long-distance calls is referred to as access service. Local exchange carriers receive access charges for providing interexchange carriers with access to the local exchange carrier's customers.

6 47 U.S.C. § 253.

7 *See* 47 U.S.C. § 251(a).

8 47 U.S.C. §§ 251(b)(5), (c)(2), and (c)(3).

9 47 U.S.C. § 252(d)(2).

10 47 U.S.C. §§ 251(b)(2) and (b)(3).

11 47 U.S.C. § 251(c)(4).

12 47 U.S.C. § 254.

13 47 U.S.C. § 214(e). We note that, while section 214(e) requires a state commission to designate additional eligible telecommunications carriers upon request and consistent with the public interest, in the case of an area served by a rural telephone company, section 214(e) permits a state commission to designate additional eligible telecommunications carriers only if the state commission finds that the designation is in the public interest. 47 U.S.C. § 214(e)(2).

14 Section 3(21) of the 1996 Act defines interLATA services as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21).

15 United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982) (*MFJ*).

16 47 U.S.C. § 271.

17 Part 36 of the Commission's Rules; 47 C.F.R. §§ 36.1 *et seq.*

18 The NYNEX Telephone Companies Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, Memorandum Opinion and Order, 10 FCC Rcd 7445 (1995); Ameritech Operating Companies, Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Order, FCC 96-58 (rel. Feb. 15, 1996).

19 Letter from Bruce K. Cox, Government Affairs Director, AT&T, to William F. Caton, Acting Secretary, FCC, October 9, 1996, filed in CC Docket No. 96-45; Letter from R. Gerard Salemme, Vice President, Government Affairs, AT&T, to Regina Keeney, Chief, Common Carrier Bureau, Nov. 22, 1996 (*AT&T November 22 Letter*).

20 *See, e.g., AT&T November 22 Letter.*

21 Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858 (1995) (soliciting comments on proposed and other possible changes to the price cap plan to reflect emerging competition in telecommunications services) (*Price Cap Second FNPRM*).

22 *See* MCI Telecommunications Corporation, Docket No. 20640, Decision, 60 FCC 2d 25 (1976); MCI v. FCC, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978); MCI v. FCC, 580 F.2d 590 (D.C. Cir. 1978), *cert. denied*, 439 U.S. 980 (1978).

23 For additional background on the ENFIA agreement, *see, e.g.,* Investigation of Access and Divestiture-Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part 1, FCC 85-100, 57 Rad.Reg.2d 1229, 1241 (rel. March 8, 1985).

24 MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase 1, 93 FCC 2d 241 (*Access Charge Order*), *recon.,* 97 FCC 2d 682 (1983), *second recon.,* 97 FCC 2d 834 (1984).

25 *See* 47 C.F.R. Part 32.

26 *See* 47 C.F.R. Part 36. The fundamental principles of jurisdictional separations were described by the Supreme Court in Smith v. Illinois Bell Telephone Co., 282 U.S. 133 (1930). Our Part 36 rules address this jurisdictional distinction.

27 *See, e.g.*, Proposal for Universal Service and Access Reform: Post 96-98 Interconnection Order, NYNEX, Nov. 5, 1996 (*NYNEX November 5 Proposal*), at 13.

28 *See* Halprin, Albert, "Separations' Legacy of Subsidy", Exhibit 7 to the The NYNEX Telephone Companies Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, Dec. 15, 1993; *AT&T November 22 Letter* at 12.

29 Dedicated facilities or "circuits" come in varying degrees of capacity, from a single voice-grade circuit, with sufficient bandwidth to carry a single voice conversation, to fiber optic circuits capable of carrying thousands of conversations simultaneously.

30 *See* Investigation of Access and Divestiture Related Tariffs, CC Docket No. 83-1145, Phase I and Phase II, Part 1, FCC 85-70, 57 Rad.Reg.2d 1459, 1465 (Com. Car. Bur. 1985).

31 *See Access Charge Order*, 93 FCC 2d at 315; *see also* 47 C.F.R. § 69.114.

32 *See Access Charge Order*, 93 FCC 2d at 253, 268. Part 69 also prescribes cost allocations for each switched access service element. Under the price cap rules discussed below, however, the cost allocation sections of Part 69 no longer play a role in setting the actual price levels for the access element charges of price cap carriers.

33 *See* 47 C.F.R. §§ 69.110, 69.112.

34 Such shared circuits, as well as tandem switches, may also be used to carry intrastate toll and local calls.

35 *See* 47 C.F.R. § 69.111.

36 *See* 47 C.F.R. § 69.106.

37 *See* 47 C.F.R. § 69.124. We note that our rules do not constrain an incumbent LEC's downward pricing flexibility for the TIC. 47 C.F.R. § 61.47(g)(3).

38 *See* 47 C.F.R. § 69.104.

39 *See* 47 C.F.R. § 69.105.

40 *See* 47 C.F.R. §§ 69.116, 69.117.

41 *See generally* 47 C.F.R. §§ 69.101-129.

42 Class A companies are those having annual revenues from regulated telecommunications operations of $100 million or more. 47 C.F.R. § 32.11(a)(1). In 1996, the Class A companies included all price cap LECs.

43 Source: ARMIS Data compiled by Industry Analysis Division, Common Carrier Bureau. Totals reflect rounding to the nearest hundred million.

44 ARMIS does not identify TIC revenues. The TIC revenue is derived by using the ratio of TIC to total transport revenue (73 percent) reported in the annual access tariff filings.

45 Miscellaneous includes billing and collection, and interexchange services.

46 Totals do not reflect incumbent LECs' revenues derived from Lifeline ($.2 billion) or Universal Service Fund ($0.3 billion).

47 “Other Intrastate Services” include toll, private line, vertical features, payphones, etc.

48 The Commission required price cap regulation for the BOCs and GTE, and permitted other LECs to adopt price cap regulation voluntarily, provided that all their affiliates also convert to price cap regulation, and that they withdraw from the NECA pools. Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786, 6818-20 (1990) (*LEC Price Cap Order*). Currently, the price cap LECs serve more than 92 percent of the total access lines, based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission, and account for almost 91 percent of the total interstate revenues for access services, *see* Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

49 *See, e.g.*, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961 (1995).

50 *Price Cap Second FNPRM*, 11 FCC Rcd at 862.

51 The price cap rules create a fourth basket for interexchange services.

52 47 C.F.R. §§ 61.45, 61.47.

53 *See* 47 U.S.C. § 271.

54 47 U.S.C. § 160. The Commission must forbear if the Commission determines: (1) that enforcement of the regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or service are just and reasonable and are not unjustly or unreasonably discriminatory; (2) that enforcement is not necessary for the protection of consumers; and (3) that forbearance consistent with the public interest. 47 U.S.C. § 160(a). The forbearance authority applies to all provisions of the Communications Act, except the provisions added by the 1996 Act relating to interconnection and BOC entry into long-distance services. 47 U.S.C. § 160(d).

55 47 U.S.C. § 251(a).

56 47 U.S.C. § 251(b).

57 47 U.S.C. § 251(c).

58 47 U.S.C. §§ 251(c)(2) and (c)(3).

59 47 U.S.C. § 253(a). Section 253 also authorizes the Commission to preempt any law or regulation that is violative of this section. 47 U.S.C. § 253(d).

60 47 U.S.C. § 252(a)(1).

61 *Local Competition Order* at para. 366.

62 47 U.S.C. § 254.

63 Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, FCC 96-93 (rel. Mar. 8, 1996) (*Universal Service NPRM*).

64 47 U.S.C. § 254(c).

65 47 U.S.C. § 254(e), (k).

66 47 U.S.C. §§ 254(e), 214(e); *see also Joint Board Recommended Decision* at paras. 155-62; *Joint Explanatory Statement* at 131 (1996) ("The conferees intend that only eligible telecommunications carriers should receive support from specific Federal universal service support mechanisms ....").

67 47 U.S.C. 254(e).

68 *Joint Explanatory Statement* at 131 ("In keeping with the conferees' intent that universal service support should be clearly identified, [section 254(e)] states that such support should be made explicit ....").

69 47 U.S.C. § 254(d).

70 47 C.F.R. §§ 36.601 *et seq.*

71 47 C.F.R. § 36.125(b).

72 47 C.F.R. §§ 69.105, 69.502, 69.603(e), 69.612.

73 *Joint Board Recommended Decision* at paras. 268-82.

74 *See* Section VII.A, *infra.*

75 *Universal Service NPRM* at paras. 113-14.

76 *Joint Board Recommended Decision* at paras. 775-76.

77 *See generally, e.g., AT&T November 22 Letter* at 1-4; *NYNEX November 5 Proposal* at 16-17.

78 *See generally, e.g., AT&T November 22 Letter* at 2; *NYNEX November 5 Proposal* at 8.

79 *See, e.g., AT&T November 22 Letter* at 2.

80 *See e.g., AT&T November 22 Letter* at 3.

81 *See Local Competition Reconsideration Order* at para. 13 (stating that a requesting carrier that purchases an unbundled local switching element for an end user may not use that switching element to provide interexchange service to end users for whom that requesting carrier does not also provide local exchange service).

82 We consider in Section VIII.A., *infra,* whether to establish access charge rules for non-incumbent LECs, or competitive LECs, to the extent they provide terminating access service.

83 These incumbent LECs are the seven Regional Bell Operating Companies (Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Bell, SBC, US West), Citizens, Frontier, GTE, Aliant (formerly Lincoln), SNET, and United/Central.

84 Universal Service Fund Data Collection, CC Docket No. 80-286, Universal Service Fund 1996 Submission of 1995 Study Results by NECA, Oct. 1, 1996.

85 Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

86 Data based on LECs' 1995 and 1996 Annual Access Tariffs filed with the Commission.

87 *See, e.g.,* Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, 8 FCC Rcd 4545 (1993), *recon. pending.*

88 For example, section 251(f)(1) exempts rural telephone companies from the requirements of section 251(c)(2) until the rural telephone company has received a bona fide request for interconnection, services, or network elements, and the state commission determines that the exemption should be terminated. In addition, section 251(f)(2) permits LECs with fewer than two percent of the nation's subscriber lines to petition a state commission for a suspension or modification of any requirements of sections 251(b) and (c).

89 *See, e.g.,* USTA Holding Company Report, 1996.

90 Although several incumbent price cap LECs may be eligible to request suspension or modification under section 251(f)(2) (*e.g.,* Citizens, Frontier, Aliant, and SNET), we note that these LECs may not receive state approval of any such petition for suspension or modification. For example, the Connecticut Department of Public Utility Control recently rejected a SNET request pursuant to section 251(f)(2) for limited suspension of the application of section 251(c)(4)(A). Connecticut Department of Public Utility Control, Docket No. 96-03-19, Petition of the Southern New England Telephone Company for Suspension of Section 251(c)(4) of the Telecommunications Act of 1996, May 17, 1996.

91 47 C.F.R. Part 69, Subparts D and E.

92 Competitive Telecommunications Association v. FCC, 87 F.3d 522 (D.C. Cir. 1996) (*CompTel v. FCC*).

93 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

94 In the *Local Competition Order,* we determined that section 251 allows entrants to use unbundled network facilities to provide access services to customers they win from incumbent LECs, without having to pay access charges. *Local Competition Order* at para. 717. We also established a temporary transition mechanism that would permit incumbent LECs to recover a certain portion of access charges

from purchasers of unbundled network elements based on usage of the unbundled local switching element. *Local Competition Order* at paras. 716-25. These provisions are among those that have been stayed by the Eight Circuit. *Iowa Utilities Board et. al v. FCC.*

95 *Local Competition Order* at para. 356; *Local Competition Reconsideration Order*, 11 FCC Rcd at 13048-49.

96 47 U.S.C. § 252(d)(1)(A).

97 *Local Competition Order* at para. 1034.

98 *See, e.g.*, Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786, 6793 (1990) (*LEC Price Cap Order*); Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990); *modified on recon.*, 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*); *aff'd sub nom.* National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

99 *See* 47 C.F.R § 69.104.

100 *See* 47 C.F.R § 69.105.

101 *Access Charge Order*, 93 FCC 2d at 279.

102 *Access Charge Order*, 93 FCC 2d at 284.

103 *Joint Board Recommended Decision* at para. 776.

104 *Joint Board Recommended Decision* at para. 776.

105 *Joint Board Recommended Decision* at para. 775.

106 *Joint Board Recommended Decision* at para. 775, n.2480.

107 *Joint Board Recommended Decision* at para. 776.

108 *Joint Board Recommended Decision* at para. 776.

109 Ideas for Access Charge Reform, prepared by the Competition Policy Institute, Dec. 5, 1996, at 3-4.

110 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

111 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

112 47 U.S.C. § 254(g). *See also* Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as Amended, CC Docket No. 96-61, Report and Order, 11 FCC Rcd 9564 (1996).

113 *Joint Board Recommended Decision* at paras. 90-91.

114 *Joint Board Recommended Decision* at paras. 89-92.

115 *Joint Board Recommended Decision* at para. 769. We note that the Joint Board recommended that, in the event the Commission assesses carriers' universal service contributions based on all telecommunications revenues regardless of jurisdictional classification, the SLC cap for primary residential and single-line-business local exchange subscribers, as well as the CCL charge, should be reduced after removal of LTS and pay telephone costs from the CCL rate element. *Id.* at para. 773.

116 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

117 In Section V, *infra,* we also invite comment on whether we should permit incumbent LECs to deaverage SLCs, and other access charges, as part of any market-based approach to access reform that we may adopt.

118 In order for a LEC to provide ISDN, it must have a digital switch in the central office serving the customer, and substitute an ISDN line or trunk card for the standard cards that would otherwise be used in the central office with the loop facilities serving the customer. The customer also must use special ISDN-capable customer premises equipment.

119 The two voice-grade-equivalent channels, which are called bearer or B channels, can be used for voice local exchange service or for data transmission at speeds up to 64 kbps. The third channel is a 16 kbps data channel, called the delta or D channel, which is used for signalling and packet data services. The Bell Atlantic Telephone Companies Petition for Waiver of Section 69.104 of the Commission's Rules in Connection with ISDN Services (filed Feb. 10, 1995) at 4 n.8 (*Bell Atlantic Waiver Petition*).

120 In the case of PRI ISDN, the 23 B channels and the D channel can transmit voice or data at speeds up to 64 kbps. When a customer has more than one PRI connection at a given location, all of the B channels can share a single D channel, permitting the customer to obtain 24 voice-grade-equivalent channels for each PRI connection after the first one. *Bell Atlantic Waiver Petition* at 4, n.8

121 For example, NYNEX Telephone Companies (NYNEX) uses derived channel technology to provide FLEXPATH service, which provides a customer with 24 digital voice-grade-equivalent trunk channels over a T-1 facility between a suitably equipped central office and a digital PBX. PBX Conversion Service, another NYNEX offering, provides digital trunking capability, with up to 24 trunk access lines, between a customer's digital PBX and an analog-to-digital interface located at the central office switch. NYNEX's Data Over Voice service provides customers with a voice-grade channel and a data channel over a single copper pair. Memorandum Opinion and Order, NYNEX Telephone Companies Revisions to Tariff F.C.C. No. 1, 7 FCC Rcd 7938 n.11 (Com. Car. Bur. 1992), *aff'd on recon.*, 10 FCC Rcd 2247 (1995). Several other LECs provide similar services using derived channel technology. *See, e.g.*, Cincinnati Bell Comments at 6.

122 End User Common Line Charges, CC Docket No. 95-72, Notice of Proposed Rulemaking, 10 FCC Rcd 8565 (1995) (*ISDN SLC NPRM*).

123 We incorporate by reference in this proceeding all pleadings filed in response to the *ISDN SLC NPRM,* as listed in Appendix A. Citations to "Comments" or "Replies" in this Section of the Notice therefore refer to pleadings filed in response to the *ISDN SLC NPRM.* Parties may attach their *ISDN SLC NPRM* comments as appendices and incorporate them by reference.

124 *Compare* AT&T Comments at 3-4 *with, e.g.,* America Online Comments at 8-10 (*citing* U.S. Industrial Outlook 1994, U.S. Department of Commerce at 25-1, January 1994, and citing *Bell Atlantic Waiver Petition* at 7-8, which estimates that requiring a SLC per derived channel would reduce demand for BRI service by about 60 percent and demand for PRI service by about 35 percent); Cable & Wireless Comments at 3-4; Microsoft Comments at 4; TCA Comments at 4; ITIC Reply at 3; Roseville Reply at 4; Northern Telecom Reply at 5; Bell Atlantic Reply at 3.

125 *See, e.g.,* Roseville Comments at 2; TCA Comments at 1; Tennessee Public Service Commission Comments at 2-3.

126 *See, e.g.,* Ameritech Comments at 2; BellSouth Comments at 4-5; Cincinnati Bell Comments at 3, 6; NTCA Comments at 1-2; NYNEX Comments at 16; Southwestern Bell Comments at 3; USTA Comments at 2; 3Com Reply at 6.

127 The California Bankers' Clearing House Comments at 4; US West Comments at 4; AT&T Comments at 5; AT&T Reply at 5.

128 In their responses, three of the BOCs, BellSouth, NYNEX, and Southwestern Bell, asked for confidential treatment of portions of the information submitted. NYNEX publicly filed the information we requested, but submitted as confidential additional information that contained more detailed cost data. The confidential data were not necessary to perform our analysis, and the following tables only include data that was filed on the public record. We have returned to the respective companies data for which confidential treatment was sought.

129 *See* 47 C.F.R. § 69.106.

130 *See* Letter from Anthony Alessi, Federal Relations Director, Ameritech, to William F. Caton, Acting Secretary, FCC, Dec. 6, 1996 (*Ameritech December 6 Letter*), at 8.

131 We sought comment on this approach in the *Local Competition NPRM,* noting that the Illinois Commerce Commission was considering a "local switching platform" approach for local switching prices at the time we adopted that Notice. *Local Competition NPRM* at paras. 100, 153. We concluded that a state could reasonably find that capacity-based flat rates reasonably reflect the costs of shared facilities. *Local Competition Order* at para. 757.

132 *Local Competition Order* at para. 799.

133 Access Reform Recommendation, Ameritech, Oct. 9, 1996, at Attachment. For 5ESS switches, however, Ameritech asserts that only three percent of local switching costs are not traffic-sensitive. *Id.*

134 It is possible that some SS7 call-setup costs are currently recovered through the TIC.

135 Bell Atlantic Telephone Companies, Petition for Waiver of Sections 69.106 and 69.205 of the Commission's Rules to Permit a Call Setup Charge, Memorandum Opinion and Order, 4 FCC Rcd 7210 (Com. Car. Bur. 1989); US West Communications, Inc., Petition for Waiver of Part 69 of the Commission's Rules, Order, 7 FCC Rcd 4043 (Com. Car. Bur. 1992). Pacific Bell filed a similar petition on June 30, 1994.

136 *See generally,* Engineering and Operations in the Bell System (2nd ed., 1983).

137 Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, Notice of Proposed Rulemaking, 11 FCC Rcd 5020, 5042 (1996).

138 *See Local Competition Order* at para. 756.

139 *See Local Competition Order* at para. 756.

140 *See Local Competition Order* at para. 757.

141 In 1986, the Commission concluded that peak and off-peak pricing might better reflect the manner in which incumbent LECs incur costs in providing traffic-sensitive access services. Nevertheless, because of the potential difficulties in determining the peak period, and other issues discussed in this section, the Commission did not require carriers to develop peak-sensitive access rate structures. Instead, the Commission stated that it would consider granting waivers of its Part 69 rules to permit incumbent LECs to develop voluntarily peak and off-peak pricing for traffic-sensitive access services, and would permit incumbent LECs to submit tariffs establishing such a rate structure at the same time they filed their petition for waiver. WATS-Related and Other Amendments of Part 69 of the Commission's Rules, CC Docket No. 86-1, Report and Order, FCC 86-115 (rel. Mar. 21, 1986), at paras. 35-37.

142 *See* 47 C.F.R. §§ 69.110, 69.111, 69.112, 69.124.

143 Transport Rate Structure and Pricing, CC Docket No. 91-213, 7 FCC Rcd 7006 (1992) (*First Transport Order*); *recon.* 8 FCC Rcd 5370 (1993) (*First Transport Reconsideration Order*); *further recon.* 8 FCC Rcd 6233 (1993) (*Second Transport Reconsideration Order*); *further recon.* 10 FCC Rcd 3030 (1994) (*Third Transport Reconsideration Order*); *further recon.* 10 FCC Rcd 12979 (1995) (*Fourth Transport Reconsideration Order*).

144 *See MFJ,* 552 F.Supp. at 233-34.

145 *First Transport Order,* 7 FCC Rcd at 7009-10.

146 *First Transport Order,* 7 FCC Rcd at 7010.

147 *First Transport Order,* 7 FCC Rcd at 7034-35.

148 *First Transport Order,* 7 FCC Rcd at 7036-37.

149 *First Transport Order,* 7 FCC Rcd at 7037-38.

150 *First Transport Order,* 7 FCC Rcd at 7038. The TIC is a non-facilities-based, usage-sensitive charge that currently accounts for some 70 percent of incumbent LEC transport revenues. In *CompTel v. FCC,* the court has directed the Commission to eliminate the TIC, or to provide a reasoned explanation for retention of this non-cost-based rate element. 87 F.3d at 532. The TIC is sometimes referred to as the Residual Interconnection Charge (RIC) or Residual Charge, because it was initially priced on a residual basis.

151 *First Transport Reconsideration Order,* 8 FCC Rcd at 5372. *See also Third Transport Reconsideration Order,* 10 FCC Rcd at 3036 and 3037, Figure 2; 47 C.F.R. §§ 69.111, 69.112; *Transport Order,* 7 FCC Rcd at 7009 n.7, and 7077, Diagram 3.

152 *First Transport Order,* 7 FCC Rcd at 7016-19.

153 *CompTel v. FCC,* 87 F.3d at 532-33.

154 *CompTel v. FCC,* 87 F.3d at 529-31.

155 *CompTel v. FCC,* 87 F.3d at 531-32.

156 *CompTel v. FCC,* 87 F.3d at 532-33.

157 A channel facility assignment is the actual designation of the routing that a circuit takes within the LEC network.

158 *See, e.g.,* Ameritech Operating Companies Petition for Waiver of Part 69.112 of the Commission's Rules to Provide Bulk Capacity Transport (filed April 14, 1993); Bell Atlantic Telephone Companies Petition for Waiver of Part 69.112(b) and (c) of the Commission's Rules To Offer Facilities Management Service (filed April 4, 1994).

159 *First Transport Reconsideration Order,* 8 FCC Rcd at 5372. *See also* Local Exchange Carrier Switched Local Transport Restructure Tariffs, Petitions for Waiver or Clarification, Memorandum Opinion and Order, 11 FCC Rcd 14328 (Com. Car. Bur. 1996).

160 *Access Charge Order,* 93 FCC 2d at 313.

161 *See* Section III.C.1, *supra.*

162 *CompTel v. FCC,* 87 F.3d at 531-32.

163 *First Transport Order,* 7 FCC Rcd at 7017-19.

164 *First Transport Order,* 7 FCC Rcd at 7019.

165 *CompTel v. FCC,* 87 F.3d at 533.

166 *First Transport Order,* 7 FCC Rcd at 7036-37.

167 *First Transport Order,* 7 FCC Rcd 7006.

168 *First Transport Order,* 7 FCC Rcd at 7038-40.

169 *First Transport Order,* 7 FCC Rcd at 7038-39.

170 *First Transport Order,* 7 FCC Rcd at 7038-39.

171 Letter from Frank McKennedy, Director, Legal and Regulatory Affairs, USTA, to James Schlichting, Chief, Competitive Pricing Division, October 10, 1996, Attachment at 3 (*USTA October 10 Letter*).

172 *Ameritech December 6 Letter* at 9.

173 *USTA October 10 Letter,* Attachment at 10-11.

174 *USTA October 10 Letter,* Attachment at 10-11.

175 *USTA October 10 Letter,* Attachment at 10.

176 *USTA October 10 Letter,* Attachment at 10.

177 *USTA October 10 Letter,* Attachment at 10.

178 *USTA October 10 Letter,* Attachment at 10.

179 *USTA October 10 Letter,* Attachment at 9.

180 *USTA October 10 Letter,* Attachment at 12-13.

181 *See* Southwestern Bell Comments in CC Docket No. 91-213, filed Feb. 1, 1993, at 39-45.

182 For example, if investment was identical for each category, but the expenses were $25, $45, and $20, the separations rules would allocate $30 to each category rather than the actual expense amounts.

183 *USTA October 10 Letter,* Attachment at 12-13.

184 *See, e.g., USTA October 10 Letter,* Attachment at 14.

185 *Ameritech December 6 Letter*; Proposal for Universal Service and Access Reform: Post 96-98 Interconnection Order, NYNEX, Nov. 5, 1996.

186 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

187 "Common channel" refers to the capability of one channel to carry the signalling for many calls simultaneously. Several different terms are used to describe the information that passes over CCS networks; in this Notice we will use the terms "signalling," "messages," and "queries" relatively interchangeably.

188 *See, e.g.,* Intelligent Networks, CC Docket No. 91-346, Notice of Inquiry, 6 FCC Rcd 7256 (1991).

189 47 C.F.R. § 69.125.

190 *See, e.g.,* 47 C.F.R. § 69.120 (defining the LIDB per-query charge).

191 47 C.F.R. § 69.129. In the *Expanded Interconnection* proceeding, the Commission required Tier 1 incumbent LECs (excluding members of the National Exchange Carrier Association (NECA)) to provide to interested third parties signaling information necessary to provide tandem switching. Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 94-141, Transport Phase II, Third Report and Order, 9 FCC Rcd 2718 (1994). This requirement was intended to permit competitive access providers (CAPs), IXCs, and end users with the ability to offer competitive tandem-switching services.

192 Ameritech Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Establish Unbundled Rate Elements for SS7 Signalling, Order, 11 FCC Rcd 3839 (Com. Car. Bur. 1996) (*Ameritech SS7 Waiver Order*).

193 47 C.F.R. § 69.125(b).

194 *See* 47 C.F.R. § 61.42(d)(3).

195 "Per-query" here is used to refer to a charge for each SS7 message passing through a particular point. Although the term "per-message" is used in some contexts with this meaning, this term is also used in some contexts to refer to charges that vary based on the number of calls, rather than on the number of signalling queries, and so we will avoid it here in the interest of clarity.

196 The designation "ISDN User Part" refers only to an official protocol that supports ISDN connections, and does not mean that only calls using ISDN can be set up using these messages.

197 *Ameritech SS7 Waiver Order,* 11 FCC Rcd at 3856-57.

198 Ameritech, for example, stated that it currently is capable of metering SS7 traffic only at STPs. Because Ameritech's STPs were not capable of distinguishing direct-routed and tandem-switched calls, and tandem-switched calls require additional use of the signalling network, Ameritech proposed an additional "signal tandem switching" rate element to recover the signal switching and signal transport costs involved with providing signalling for a tandem-switched call.

199 *See* 47 C.F.R. § 61.45(d)(1)(vi).

200 Provision of Access for 800 Service, CC Docket No. 86-10, Second Report and Order, 8 FCC Rcd 907, 911 (1993).

201 *See* Letter from Kenneth McClure, Chairman, NARUC Communications Committee, to Reed Hundt, Chairman, FCC, dated Oct. 23, 1996 (*NARUC October 23 Letter*) at 55.

202 SONET uses a synchronized digital fiber optic hierarchy to transport special access services at operating speeds from 1.5 Mbps to 2.4 Gbps, with circuit performance monitoring and advanced network alarming and management. *See, e.g.,* Pacific Bell Tariff F.C.C. No. 128, Transmittal No. 1790, Order, 10 FCC Rcd 7362 (Com. Car. Bur. 1995); US West Communications Revisions to Tariff F.C.C. No. 1, Transmittal No. 80, Order, 5 FCC Rcd 5546 (Com. Car. Bur. 1990); Petitions for Waiver of Part 69 of the Commission's Rules to Establish Switched Access Rate Elements for SONET-based Service, Memorandum Opinion and Order, DA 96-2004 (Com. Car. Bur., rel. Dec. 2, 1996). SONET may be deployed in the traditional star configuration, or in a fiber ring arrangement. In the star configuration, SONET provides wider transmission band widths (or higher speeds) than non-SONET "asynchronous" digital networking technologies. It also provides an easier means of adjusting band widths at nodes within the network, because it allows information to be easily added to, and dropped off, a high-speed fiber optic circuit without the need to demultiplex the entire signal down to its component lower-speed channels and then multiplex the signal back to its original speed.

203 ATM is a packet switching protocol in which all information transmitted over the network -- whether voice, video, or data -- is split into small fixed-length cells. *See generally* Sharon Watson, *Have ATM, Will Travel,* Telephony, Apr. 24, 1995, at 32. ATM networks are especially well-suited for broadband multimedia transmission, because they allow extremely high-speed transmission and switching of different types of information.

204 AIN is a telecommunications network in which call processing and routing, and network management are provided by means of centralized databases, rather than from a comparable database at every switching system. *See Ameritech SS7 Waiver Order,* 11 FCC Rcd at 3868.

205 *See, e.g.,* "MCI Urges FCC to Fold Price cap Proceeding Into Access Charge Reform," Communications Daily, Vol. 16, No. 239, Dec. 11, 1996, at 2.

206 *See, e.g.,* Regulatory and Policy Problems Presented by the Interdependence of Computer and Communications Services and Facilities, Docket No. 16979, Final Decision and Order, 28 FCC 2d 267, 270 (1971).

207 *See, e.g.,* Amendment of Section 64.702 of the Commission's Rules and Regulations, CC Docket No. 85-229, Phase I, Report and Order, 104 FCC 2d 958 (1986); *recon.* 2 FCC Rcd 3035 (1987); *further recon.* 3 FCC Rcd 1135 (1988); *second further recon.* 4 FCC Rcd 5927 (1989); *vacated in part sub nom.* People of the State of California v. FCC, 905 F.2d 1217 (9th Cir. 1990).

208 *LEC Price Cap Order,* 5 FCC Rcd at 6819-20. The "all or nothing" rule requires all LECs adopting price cap regulation to convert all its subsidiaries to price cap regulation, and to convert any LECs it may acquire in the future to price cap regulation.

209 *See* Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880 (1991) (*Interexchange Order*); Revisions to Price Cap Rules for AT&T Corp., CC Docket No. 93-197, Report and Order, 10 FCC Rcd 3009 (1995).

210 47 U.S.C. § 160(a).

211 Such an approach appears to be favored by incumbent LECs; we have received several petitions in which incumbent LECs seek exemption from price cap regulation for particular services in certain geographic markets. *See* Petition to Regulate Bell Atlantic as a Nondominant Provider of Interstate InterLATA Corridor Service (filed July 7, 1995); Ameritech Communications, Inc. Petition for Nondominant Status (filed July 21, 1995).

212 *See* n. 211, *supra*; *see also Ameritech Dec. 6 Letter* at Appendix A at 12.

213 *See, e.g.,* New York Telephone Company and New England Telephone and Telegraph Company, Memorandum Opinion and Order, 10 FCC Rcd 5070 (Com. Car. Bur. 1995).

214 The Joint Board concluded that the 1996 Act explicitly delegated authority to the state commissions to designate the area throughout which a carrier must provide the defined core services in order to be eligible for universal service support. The Joint Board also recommended that this Commission urge states to designate service areas for non-rural telephone company areas that are of sufficiently small geographic scope to permit efficient targeting of high cost support and to facilitate entry by competing carriers. *Universal Service Recommended Decision* at paras. 175-78.

215 Demand responsiveness measures the sensitivity of the quantity demanded to price changes. Demand responsiveness is typically measured by the elasticity of demand, which is the percentage change in the quantity demanded for a particular product will be following a one percent change in the price of that product. Robert S. Pindyck and Daniel L. Rubinfeld, Microeconomics 29 (1992).

216 Supply responsiveness is typically measured using the elasticity of supply, a concept parallel to that used for demand elasticity. Supply elasticity measures the percentage change in the quantity supplied that results from a one percent change in the price of a product. *Id.* at 32. A high supply elasticity indicates that entry is relatively easy and that any attempt by an incumbent to raise prices will result in new entry. Conversely, a low supply elasticity is indicative of market power.

217 The incumbent LEC's elasticity of demand is affected by new entrants' elasticity of supply. It can be shown that the incumbent LEC's demand becomes more responsive to changes in price as the new entrants' supply becomes more elastic and their market share increases. These results indicate that as new entrants become capable of supplying access services to more customers, an increase in access prices by the incumbent LEC results in a larger decrease in the quantity of access services purchased from the incumbent LEC and an increase in the amount supplied by the new entrants. *See* Carleton and Perloff, Modern Industrial Organization 158-69, 172-74 (1993).

218 *Price Cap Second FNPRM,* 11 FCC Rcd at 922 (*citing Interexchange Order,* 6 FCC Rcd at 5890; Revisions to Price Cap Rules for AT&T Corp., CC Docket No. 93-197, Report and Order, 10 FCC Rcd 3009, 3015 (1995)).

219 *Interexchange Order,* 6 FCC Rcd at 5887.

220 *See* Section IX, *infra.*

221 In the *Price Cap Second FNPRM,* we mentioned three significant phases at which it may be appropriate to remove regulatory constraints: (1) the removal of certain barriers to competitive entry; (2) the point where a particular service is subject to substantial competition; and (3) the point where a carrier no longer can exercise market power in the provision of that service. *Price Cap Second FNPRM,* 11 FCC Rcd at 861-62, 905-08, 915-23, 927-30.

222 For example, new carriers may be unlikely to enter a high-cost area in the absence of a competitively neutral universal service mechanism.

223 Parties may attach their *Price Cap Second FNPRM* comments as appendices and incorporate them by reference.

224 *See* Regulatory Flexibility Act, 5 U.S.C. § 601 *et seq.*

225 *See* Regulatory Flexibility Act, 5 U.S.C. § 603(b).

226 *See also* Section XI, *infra.*

227 The Commission does permit some geographic deaveraging and some volume and term discounts, in limited circumstances in conjunction with expanded interconnection offerings. *See, e.g.,* Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order and Notice of Proposed Rulemaking, 7 FCC Rcd 7369, 7454-56 (1992) (*Special Access Expanded Interconnection Order*) (geographic deaveraging); Transport Phase 1, Second Report and Order and Third Notice of

Proposed Rulemaking, 8 FCC Rcd 7374, 7433-36 (1993) (*Switched Transport Expanded Interconnection Order*) (volume and term discounts).

228 *Ameritech December 6 Letter* at 10-11.

229 47 U.S.C. §§ 251(c)(4) and 252(d)(3).

230 *See* Sections V.C, *infra,* and IV.B, *supra.*

231 47 C.F.R. § 69.3(e)(7). A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Carriers perform jurisdictional separations at the study area level. For jurisdictional separations purposes, the Commission adopted a rule freezing study area boundaries effective November 15, 1984. Part 36 of the Commission's Rules, 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area." *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985).

232 47 C.F.R. § 69.123. *See also Special Access Expanded Interconnection Order,* 7 FCC Rcd at 7454-56.

233 In the *Universal Service Recommended Decision,* the Joint Board also recommended that there be a reduction in the SLC as applied to first residential lines and single-line business lines, if the Commission bases universal service contributions on all telecommunications revenues. *Universal Service Recommended Decision* at paras. 769-73.

234 *E.g.,* Pacific Bell Comments at 27.

235 AT&T Reply at 57-60.

236 *See* Section II.B, *supra.*

237 *Special Transport Expanded Interconnection Order,* 7 FCC Rcd at 7454-55; *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7426 n.230. An interconnector will be deemed to have taken the cross-connect element when it has ordered the cross-connect and the LEC has provided this service.

238 For example, different geographic zones may work for these purposes so long as the results are not widely disparate in any particular location.

239 47 U.S.C. § 254(g).

240 *See Special Access Expanded Interconnection Order,* 7 FCC Rcd at 7458-65.

241 *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7433-34.

242 *See, e.g.,* Expanded Interconnection with Local Telephone Company Facilities, Memorandum Opinion and Order, CC Docket No. 91-141, 9 FCC Rcd 5154, 5202 (1994) (*Virtual Collocation Order*).

243 *Special Access Expanded Interconnection Order,* 7 FCC Rcd at 7463.

244 *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7434-35. In affirming our decision to permit volume and term discounts for transport, we specified that this threshold must be attained under the virtual collocation system adopted on July 14, 1994. *See Virtual Collocation Order,* 9 FCC Rcd at 5204.

245 *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7434-35.

246 *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7435.

247 *Switched Transport Expanded Interconnection Order,* 8 FCC Rcd at 7435.

248 NYNEX Comments at 25; Pacific Bell and Nevada Bell Comments at 25-28; Southwestern Bell Comments at 35.

249 NYNEX Comments at 25-26.

250 AT&T Comments at 29-30.

251 For example, if a buyer purchased $100 of services for a given three-month period, the seller's offer of a five percent discount on the buyer's purchase for the next three-month period if the buyer committed to purchasing $120 of services during that time would be considered a growth discount.

252 Ameritech Update Reply Comments at 24-25.

253 *Interexchange Order,* 6 FCC Rcd at 5897. In that context, streamlined regulation meant relieving AT&T of price cap requirements for specific services, and permitting AT&T to develop contract tariff rates for those services. *Id.*

254 *Interexchange Order,* 6 FCC Rcd at 5897.

255 *E.g.,* Ameritech Comments at 40-42; AT&T Reply at 49-51; BellSouth Comments at 57-58; GSA Comments at 18-19; MCI Comments at 34-35.

256 CompTel Comments at 40; *see also* Sprint Reply at 3-4.

257 GTE Comments at 18-19; USTA Comments at 26-27; U S West Comments at 20-21.

258 *See* Pacific Bell Comments at 45; *see also* Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873, 3033-34 (1989) (excluding Tariff 12 and Tariff 15 services from price cap regulation).

259 We note that the D.C. Circuit recently reversed and remanded a Commission Order rejecting Southwestern Bell tariff provisions that would have permitted Southwestern Bell to respond to a customer's request for proposal to provide access services in a competitive bid situation. *Southwestern Bell Telephone Company v. FCC,* No. 95-1592 (D.C. Cir. Nov. 26, 1996).

260 Ameritech Operating Companies et al., Petitions for Waiver of Sections 69.4(b) and 69.106 of the Commission's Rules, Order, 9 FCC Rcd 7873 (Com. Car. Bur. 1994).

261 *See also* Section VIII.C, *infra.*

262 *Price Cap Second FNPRM,* 11 FCC Rcd at 921.

263 In the interexchange market, the Commission has required AT&T to report quarterly data concerning its share of interstate calling. *See* Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd 3271, 3357 (1995).

264 *See* Section II.D, *supra.*

265 The Joint Board has recommended permitting competitive LECs to be eligible for universal service support only if they meet the criteria specified in Section 214(e)(1) of the 1996 Act. *See Joint Board Recommended Decision* at para. 155.

266 *Joint Board Recommended Decision* at para. 23.

267 *LEC Price Cap Order,* 5 FCC Rcd at 6811-12.

268 *NYNEX November 5 Proposal* at 11.

269 We have previously distinguished among these classes in determining how to assess the SLC. *See, e.g.,* 47 C.F.R. §§ 69.104, 69.105, 69.203; MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, Decision and Order, CC Dockets No. 78-72 and 80-286 (rel. Dec. 28, 1984), 50 Fed. Reg. 939 (Jan. 8, 1985).

270 *See* Section V.B.2.c, *supra.*

271 *See* Section VIII.A, *infra.*

272 We discuss issues relating to the common line in Section III.A, *supra.*

273 End User Billing of Originating Access, BellSouth, Oct. 30, 1996.

274 47 U.S.C. § 254(g).

275 *LEC Price Cap Order,* 5 FCC Rcd at 6811-12.

276 *See* Section VIII.A, *infra.*

277 Petition to Regulate Bell Atlantic as a Nondominant Provider of Interstate InterLATA Corridor Service (filed July 7, 1995).

278 *LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9142.

279 *See* Section III.E, *supra.*

280 *See, e.g.,* "MCI Urges FCC to Fold Price cap Proceeding Into Access Charge Reform," Communications Daily, Vol. 16, No. 239, Dec. 11, 1996, at 2.

281 NARUC suggested seeking comment on the goals of access reform. *See NARUC October 23 Letter* at 3.

282 *See, e.g., AT&T November 22 Letter* at 4.

283 *See* The Cost of Basic Network Elements: Theory, Modeling and Policy Implications (Hatfield Associates, Inc. March 1996), submitted by MCI on March 29, 1996 (*Hatfield Model*). MCI basis its estimate on 1993 data. *Hatfield Model* at 34-35. We note that this model has since been revised. *See* Hatfield Model, Version 2.2, Release 1, (Hatfield Associates, Inc., March 1996), submitted by AT&T and MCI on May 16, 1996 (*Hatfield 2.2*); *see also* AT&T Reply in CC Docket No. 96-98 at Appendix D (Update of the Hatfield Model Version 2.2, Release 1); *AT&T November 22 Letter* at Appendix A (further update of the Hatfield Model, Version 2.2, Release 2).

284 *LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9069-73. For a discussion of the economic study at issue in the *LEC Price Cap Performance Review, see* Appendix C of the *LEC Price Cap Order,* 5 FCC Rcd at 6885-6928.

285 *AT&T November 22 Letter* at 4.

286 In Section VII.B, *infra,* we solicit comment on adopting this approach to determine the prudency of residual costs.

287 47 U.S.C. § 410(a).

288 *See NARUC October 23 Letter* at 3.

289 *See AT&T November 22 Letter* at Appendix A.

290 We discuss the relation between depreciation and residual costs in Section VII.B, *supra.* Issues related to our depreciation rate prescriptions, or our methods for prescribing depreciation rates, are beyond the scope of this proceeding.

291 *LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9064-65.

292 *LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9063.

293 Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes, 10 FCC Rcd 6788, 6802-03 (1995) (*Represcription Reform Order*).

294 Common Carrier Bureau Sets Pleading Schedule in Preliminary Rate of Return Inquiry, Public Notice, 11 FCC Rcd 3651 (Com. Car. Bur. 1996).

295 For example, in its comments preceding the *LEC Price Cap Performance Review Order,* AT&T suggested setting the X-Factor equal to the amount necessary to equate the price cap LECs' average rate of return with 11.25 percent. We found that this method might not create adequate incentives for increasing productivity. *See* Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, 10 FCC Rcd 13659, 13672 (1995) (*Price Cap Fourth FNPRM*). *See also LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9034 (tying productivity measure to actual rate of return was a "possible disadvantage" of AT&T's method). In its comments filed in response to the *Price Cap Fourth FNPRM,* AT&T proposed an X-Factor calculation method based on total factor productivity (TFP) instead of the rate-of-return based method it proposed previously.

296 *LEC Price Cap Order,* 5 FCC Rcd 6786. To date, Citizens, Frontier, Lincoln, SNET, and United have elected price caps.

297 *LEC Price Cap Order,* 5 FCC Rcd at 6792. For a complete summary of the original price cap plan, *id.* at 6787-89.

298 *LEC Price Cap Order,* 5 FCC Rcd at 6796.

299 *LEC Price Cap Order,* 5 FCC Rcd at 6799.

300 In particular, we sought comment on basing the X-Factor on some measure of total factor productivity (TFP). TFP is the ratio of an index of total outputs to an index of total inputs. *LEC Price Cap Performance Review Order,* 10 FCC Rcd at 9008-09. This output index represents the quantities of goods or services consumed, and the input index represents the quantities of goods or services produced. If an incumbent LEC can increase its outputs without increasing its inputs, it has become more productive. In order to develop these quantity indices, it is also necessary to develop output and input price indices. The input quantity and price indices are composites of indices of capital, labor, and materials. The development of each of these indices raises important issues. In addition to these TFP calculation issues, there are other issues raised by calculation of the X-Factor. Two of the most important of these issues are whether to make an X-Factor adjustment for the difference between incumbent LEC input prices and input prices for the economy as a whole, and whether to make an adjustment for a perceived difference between interstate and intrastate productivity growth. *See Price Cap Fourth FNPRM,* 10 FCC Rcd at 13663-71.

301 We noted that, although sharing tends to blunt the efficiency incentives otherwise created by the price cap plan, it also serves beneficial functions. We sought comment on eliminating sharing and establishing other mechanisms to serve those functions. *See Price Cap Fourth FNPRM,* 10 FCC Rcd at 13676-80.

302 *See, e.g.,* Presentation of CARE Coalition in CC Docket No. 94-1, filed April 16, 1996. CARE includes purchasers of interstate access providers and others: the National Association of State Utility Consumer Advocates, the Telecommunications Resellers Association; Ad Hoc Telecommunications Users Committee; MCI Telecommunications Corp.; Consumer Federation of America, LDDS Worldcom; AT&T Corp.; American Petroleum Institute; International Communications Association; and CompTel.

303 *AT&T November 22 Letter* at 6. *See generally* AT&T Comments in CC Docket No. 94-1, filed Jan. 11, 1996; MCI Comments in CC Docket No. 94-1, filed Jan. 11, 1996.

304 We stated that the TELRIC-based rates of unbundled network elements should be based on the forward-looking cost of capital. *Local Competition Order* at para. 691. We discuss economic depreciation rates below.

305 *Price Cap Fourth FNPRM,* 10 FCC Rcd at 13662-63.

306 *LEC Price Cap Order,* 5 FCC Rcd at 6823.

307 47 C.F.R. §61.49(e).

308 *LEC Price Cap Order,* 5 FCC Rcd at 6823.

309 *See LEC Price Cap Order,* 5 FCC Rcd at 6836 ("if a LEC has been permitted to charge above-cap rates, the sharing mechanisms no longer apply, and the LEC's rates would be subject to complaint on the basis that they are unjust and unreasonable in light of the current rate of return prescription.")

310 *See LEC Price Cap Order,* 5 FCC Rcd at 6323 ("A LEC may request an above-cap rate increase by filing a tariff transmittal that complies with specific rules for such filings, a showing that includes but is not limited to the cost support information normally required in annual access tariff filings for LECs subject to rate of return regulation, and other information necessary to establish that the increase is needed if the LEC is to have an opportunity to attract capital.")

311 AT&T has explained how it would derive access prices from the Hatfield Model. *AT&T November 22 Letter* at Appendix A.

312 We sought comment on the Joint Board's suggestions for the common line rate structure in Section III.B, *supra.*

313 In Section III.E, we explored possible explanations for the sums recovered through the TIC, and on different approaches to phasing out the TIC.

314 47 U.S.C. § 254(e).

315 47 U.S.C. § 254(d).

316 *Joint Board Recommended Decision* at para. 309.

317 Discretionary services include services that are added on to basic local service, *e.g.,* call waiting, call forwarding, or caller ID.

318 *Joint Board Recommended Decision* at para. 310.

319 *Joint Board Recommended Decision* at para. 314.

320 *Joint Board Recommended Decision* at para. 312.

321 *Joint Board Recommended Decision* at paras. 817-23.

322 *Joint Board Recommended Decision* at para. 767.

323 *Joint Board Recommended Decision* at para. 768.

324 *Joint Board Recommended Decision* at para. 773.

325 Whether, as discussed above, the SLC cap for single-line business and the primary residential connections should be lowered to reflect part of the recovery of LTS support will be addressed in the universal service proceeding.

326 As for price cap LECs, whether the SLC cap for single-line business and the primary residential connection should be lowered to reflect part of the recovery of LTS support by non-price cap LECs will be addressed in the universal service proceeding.

327 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

328 *AT&T November 22 Letter* at 1-2.

329 Letter from Bruce K. Cox, Government Affairs Director, AT&T, to William F. Caton, Acting Secretary, FCC, October 9, 1996, filed in CC Docket No. 96-45.

330 *AT&T November 22 Letter* at 1-2.

331 For tariff review purposes, the term "Tier 1 LEC" has traditionally referred to a company having annual revenues from regulated operations of $100 million or more. For accounting purposes, the Commission uses the terms Class A and B companies as defined in Section 32.11(a)(1) and (2) of the Commission's rules to differentiate large and small carriers. 47 C.F.R. § 32.11(a)(1), (2).

332 *See Hatfield Model.* MCI based its estimate on 1993 data. *Hatfield Model* at 34-35.

333 *Hatfield Model* at 34-44.

334 *See AT&T November 22 Letter* at 5; *NARUC October 23 Letter* at 3, 4 (suggesting that we seek comment on this issue).

335 We note that certain parties have referred to those costs to which they assert they are entitled as "residual" or "legacy" costs. *See, e.g., NARUC October 23 Letter* at 3-4.

336 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

337 *See, e.g.,* 47 C.F.R. § 36.125(f) (requiring triple dial equipment minute (DEM) weighting for carriers with fewer than 10,000 access lines).

338 Amendment of Part 67 (New Part 36) of the Commission's Rules and Establishment of a Federal-State Joint Board, CC Docket No. 86-297, Recommended Decision and Order, 2 FCC Rcd 2582 (1987).

339 MTS and WATS Market Structure, CC Dockets No. 78-72, 80-286, and 86-297, Memorandum Opinion and Order on Reconsideration and Supplemental Notice of Proposed Rule Making, 2 FCC Rcd 5349 (1987).

340 We intend, in the near future, to initiate a proceeding to address the separations issues raised by incumbent LEC provision of unbundled network elements.

341 We plan to initiate a separate proceeding to undertake comprehensive review of our depreciation rules.

342 *See, e.g.,* Ameritech Reply in CC Docket No. 94-1, filed March 1, 1996, at 3-4; U S West Reply USTA Reply in CC Docket No. 94-1, filed March 1, 1996, at 24-25.

343 Remaining life depreciation techniques allow a company to increase depreciation expense when it is determined that an asset's economic life is shorter than originally anticipated. By contrast, whole life depreciation techniques do not automatically correct for past underdepreciation. The Commission in the early 1980's began using a remaining life depreciation methodology instead of whole life methods. *See* Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies), 83 FCC 2d 267 (1980), *recon.* 87 FCC 2d 916 (1981), Supplemental Opinion and Order, 87 FCC 2d 1112 (1981).

344 Depreciation reserve deficiencies occur when actual plant retirements occur sooner than the accounting system anticipates. In that event, the reserve deficiency represents the difference between the amount of depreciation expense that a LEC should have charged, based on the actual plant life, and the amount of depreciation charges that the LEC naturally recorded. These deficiencies can result from imperfections inherent in a depreciation method, or by disparities between useful life projections prescribed by a regulatory commission and those used by the regulated carriers. *See* Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to

Provide for Nonregulated Activities and to Provide for Transaction between Telephone Companies and their Affiliates, CC Docket No. 86-111, 2 FCC Rcd 1298, 1325 n.331 (1987).

345 *See* MCI Comments in CC Docket No. 94-1, filed Jan. 11, 1996, at Attachment A at 2.

346 *See, e.g.,* USTA Reply in CC Docket No. 94-1, filed March 1, 1996, at 17.

347 *NARUC October 23 Letter* at 4.

348 *See Hatfield 2.2*; *AT&T November 22 Letter* at Appendix A.

349 47 U.S.C. § 410(a).

350 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

351 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

352 We note that, as discussed in Section III.E, *supra,* several LECs have proposed similar market-based approaches for treatment of the TIC.

353 *See, e.g.,* Paul L. Joskow, *Does Stranded Cost Recovery Distort Competition?,* The Electricity Journal (April 1996) (supporting a surcharge to recover residual costs in the electricity industry).

354 *See* Access Reform Presentation, Ad Hoc Telecommunications Users Committee, Oct. 31, 1996.

355 Our current depreciation prescription procedures were developed in the 1940s, when there was less technological innovation and no competition in the telecommunications industry. As a result, it was necessary to scrutinize supporting data for depreciation rates carefully, to help ensure that ratepayers were charged just and reasonable tariffed rates. *See* Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order, 8 FCC Rcd 8025, 8031 (1993). As competition grows, it will exert greater downward pressure on the rates LECs charge for telecommunications services, and it will become less important for us to prescribe depreciation rates. The 1996 Act amended Section 220(b) of the Communications Act, so that we are no longer required to prescribe depreciation rates for the LECs. The issue of whether or under what conditions we will discontinue our prescription of depreciation rates is beyond the scope of this Notice. We plan, however, to initiate a separate proceeding to undertake comprehensive review of our depreciation rules.

356 *See, e.g.,* Joseph Gillan & Peter Rohrbach, The Potential Impact of Local Competition on Telecommunications Market Structure: Diversity or Reconcentration, 1994; Robert W. Crandall and Leonard Waverman, Talk Is Cheap: The Promise of Regulatory Reform in North American Telecommunications, 1995, at 265-66 (*Talk Is Cheap*).

357 Section 254(g) requires IXCs to integrate and average the rates they charge for service. 47 U.S.C. § 254(g). *See also* Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended, CC Docket No. 96-61, Report and Order, 11 FCC Rcd 9564 (1996) (*Section 254(g) Order*). Consequently, not only does the call originator not choose the terminating LEC, but because of Section 254(g), the cost of high terminating access rates is spread among all end users.

358 *See Talk Is Cheap* at 265-66.

359 End User Billing of Originating Access, BellSouth, Oct. 30, 1996.

360 Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking, 77 FCC 2d 308 (1979); First Report and Order, 85 FCC 2d 1 (1980) (*Competitive Carrier First Report and Order*); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, FCC 82-187, 47 Fed.Reg. 17,308 (1982); Second Report and Order, 91 FCC 2d 59 (1982); Order on Reconsideration, 93 FCC 2d 54 (1983); Third Further Notice of Proposed Rulemaking, 48 Fed.Reg. 28, 292 (1983); Third Report and Order, 48 Fed.Reg. 46,791 (1983); Fourth Report and Order, 95 FCC 2d 554 (1983), *vacated, AT&T v. FCC,* 978 F.2d 727 (D.C. Cir. 1992), *cert. denied, MCI Telecommunications Corp. v. AT&T,* -- U.S. --, 113 S.Ct. 3020 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 1191 (1984); Fifth Report and Order, 98 FCC 2d 1191 (1984); Sixth Report and Order, 99 FCC 2d 1020 (1985), *vacated MCI Telecommunications Corp. v. FCC,* 765 F.2d 1186 (D.C. Cir. 1985) (collectively referred to as *Competitive Carrier*).

361 *See, e.g., Competitive Carrier First Report and Order,* 85 FCC 2d at 20-22; *see also* 47 C.F.R. §61.3(o).

362 *Competitive Carrier First Report and Order,* 85 FCC 2d at 23-24.

363 *See, e.g., Competitive Carrier First Report and Order,* 85 FCC 2d at 10-11; 47 C.F.R. 61.3(u).

364 *See, e.g., Special Access Expanded Interconnection Order*; *Switched Transport Expanded Interconnection Order*. *See also* The NYNEX Tel. Cos. Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, Memorandum Opinion and Order, 10 FCC Rcd 7445 (1995), *recon. pending*; Ameritech Operating Companies Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Order, FCC 96-58 (rel. Feb. 15, 1996).

365 CAPs compete with incumbent LECs in the provision of access and local transport services. Competitive LECs provide local exchange service, in addition to access or transport services, in competition with incumbent LECs.

366 *See* Tariff Filing Requirements for Nondominant Common Carriers, CC Docket No. 93-36, Memorandum Opinion and Order, 8 FCC Rcd 6752, 6754 (CAPs are nondominant carriers because they have not been previously declared dominant); *vacated in part,* Southwestern Bell Corp. v. FCC, 43 F.3d 1515 (D.C. Cir. 1995); Order, 10 FCC Rcd 13653 (1995).

367 Access Reform, NYNEX, Sept. 25, 1996 at 5.

368 Section 254(g) requires IXCs to integrate and average the rates they charge for service. 47 U.S.C. § 254(g). *See also Section 254(g) Order*. Consequently, not only does the call originator not choose the terminating LEC, but because of section 254(g), the call originator also does not pay the egregiously high terminating access charge.

369 *See, e.g.,* Joseph Gillan & Peter Rohrbach, The Potential Impact of Local Competition on Telecommunications Market Structure: Diversity or Reconcentration, 1994; *Talk Is Cheap* at 264-65.

370 *See* Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq.*

371 According to Section 69.105(b)(1)(ii): "The term *open end* of a call describes the origination or termination of a call that utilizes exchange carrier common line plant (a call can have no, one, or two open ends)." 47 C.F.R. § 69.105(b)(1)(ii).

372 WATS-Related and Other Amendments of Part 69 of the Commission's Rules, CC Docket No. 86-1, Report and Order, FCC 86-115 (rel. Mar. 21, 1986) at para. 53 (concluding that "open end" minutes are less subject to uneconomic bypass than originating MTS and MTS-like minutes, and therefore must be treated as terminating access minutes); 47 C.F.R. § 69.105(b)(1)(iii).

373 According to a study by Find/SVP and Jupiter Communications, the number of U.S. households with Internet access more than doubled in the past year to 14.7 million, and roughly 38.7 million Americans over the age of 18 have accessed the Internet at least once. Jared Sandberg, "U.S. Households with Internet Access Doubled to 14.7 Million in Past Year," *Wall Street Journal,* October 21, 1996 at B11.

374 *See, e.g.,* Takuma Amano and Robert Blohm, "The Internet Economy" (op ed), *Wall Street Journal,* October 17, 1996, at A22.

375 47 U.S.C. § 230(b)(2).

376 *See* Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Docket No. 20828, Final Decision, 77 FCC 2d 384, 417 (*Computer II*).

377 "Enhanced services" are defined in § 64.702(a) of our rules: "For the purposes of this subpart, the term *enhanced services* shall refer to services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol, or similar aspects of the subscriber's transmitted information; provide the subscriber additional different, or restructured information; or involve subscriber interaction with stored information." The 1996 Act defines "information services" as offering the capability for "generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications." 47 U.S.C. § 153(20).

378 MTS and WATS Market Structure, Memorandum Opinion and Order, Docket No. 78-72, 97 FCC 2d 682, 711-22 (*Access Charge Reconsideration Order*). *See also* Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers, CC Docket No. 87-215, Order, 3 FCC Rcd 2631 (1988) (*ESP Exemption Order*).

379 *ESP Exemption Order,* 3 FCC Rcd at 2631 nn.8, 53. Most information service providers have deployed points of presence to maximize the number of subscribers that can reach them through a local call.

380 Business line rates often include per-minute usage charges for outgoing calls, but Internet service providers tend to exclusively receive calls from their subscribers.

381 Pacific Bell Comments in RM 8775 at 11.

382 US West Comments in RM 8775 at 2-3.

383 Internet Service Providers Quarterly Directory Summary 1996.

384 *See, e.g., ESP Exemption Order,* 3 FCC Rcd at 2631.

385 America's Carriers Telecommunication Association, Provision of Interstate and International Interexchange Telecommunications Service via the "Internet" by Non-Tariffed, Uncertified Entities, Petition for Declaratory Ruling, Special Relief, and Institution of a Rulemaking, RM-8775 (filed Mar. 4, 1996) (*ACTA Petition*). We address other issues raised in ACTA's petition in a separate Order.

386 Letter from Joseph J. Mulieri, Bell Atlantic, to James D. Schlichting, FCC, June 28, 1996; letter from Kenneth Rust, NYNEX, to James Schlichting, FCC, July 10, 1996; Letter from Glenn Brown, US West, to James Schlichting, FCC, June 28, 1996; Letter from Alan Ciamporcero, Pacific Telesis, to James Schlichting, FCC, July 2, 1996.

387 *See, e.g.,* Letter from Steve Case, Chief Executive Officer, America Online, Inc., *et al.* to Reed Hundt, Chairman, FCC, Nov. 15, 1996 (*ISP November 15 Letter*), at 2; Letter from Barbara A. Dooley, Executive Director, Commercial Internet eXchange Association, to Reed Hundt, Chairman, FCC, Dec. 19, 1996.

388 *See, e.g.,* Letter from Gilbert F. Amelio, Chief Executive Officer, Apple, *et al.* to Reed Hundt, Chairman, FCC, Oct. 30, 1996 (*CSPP Letter*).

389 *See* News Release, "Hundt Asks Network Reliability and Interoperability Council to Monitor Impact of Internet Growth on Public Networks," November 1, 1996. As discussed in Section X, below, our consideration of congestion issues in this proceeding in no way precludes or supersedes the efforts underway by the NRIC.

390 We also do not address in this proceeding questions about whether some Internet-based services could conceivably be considered "telecommunications" under the 1996 Act. 47 U.S.C. § 153(43).

391 *Access Charge Reconsideration Order,* 97 FCC 2d at 715. We have, however, decided to leave the current pricing structure in place on multiple occasions. *See, e.g., ESP Exemption Order,* 3 FCC Rcd at 2633; Amendments of Section 64.702 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, CC Dockets No. 89-79 and 87-313, Report and Order & Order on Further Consideration & Supplemental Notice of Proposed Rulemaking, 6 FCC Rcd 4524, 4535 (1991) (*Part 69 ONA Order*).

392 *MFJ*, 552 F.Supp. at 232-33.

393 United States v. GTE Corporation, 603 F. Supp. 730, 744 (D.D.C. 1984).

394 MTS and WATS Market Structure, CC Docket No. 78-72, Phase III, 100 FCC 2d 860 (1985), *recon. denied* FCC 86-4, 59 Rad. Reg. 2d 1410 (released Jan. 4, 1986).

395 *See* Petitions for Recovery of Equal Access and Network Reconfiguration Costs, Memorandum Opinion and Order, 1 FCC Rcd 434, 437 (1986). Later, the Commission permitted incumbent LECs to establish a separate rate element to recover equal access reconfiguration costs. MTS and WATS Market Structure, Amendment of Part 69 of the Commission's Rules for Recovery of Equal Access Costs, CC Docket No. 78-72, Report and Order, 4 FCC Rcd 2104 (1989).

396 *LEC Price Cap Order,* 5 FCC Rcd at 6816-17.

397 *LEC Price Cap Reconsideration Order,* 6 FCC Rcd at 2666-67.

398 1994 Annual Access Tariff Filings, CC Docket No. 94-65, 9 FCC Rcd 3519, 3535-36 (Com. Car. Bur. 1994) (suspending 1994 annual access tariffs filed by Pacific Bell, Nevada Bell, Rochester, and Vista); 1994 Annual Access Tariff Filings, CC Docket No. 94-65, 9 FCC Rcd 3705, 3730-31 (Com. Car. Bur. 1994) (suspending other 1994 annual access tariffs).

399 *LEC Price Cap Performance Review,* 10 FCC Rcd at 9094.

400 *LEC Price Cap Performance Review,* 10 FCC Rcd at 9094.

401 47 U.S.C. § 254(b)(4).

402 47 C.F.R. § 69.4(d).

403 Section 69.4(d) provides as follows: "For the period June 1, 1988 through December 31, 1993, all telephone companies may implement a separate carrier's carrier tariff charge for an Equal Access element. Effective January 1, 1994, all telephone companies shall eliminate separate carrier's carrier tariff charges for an Equal Access element."

404 47 C.F.R. § 69.103.

405 Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388 (rel. Sep. 20, 1996), *recon.,* FCC 96-439 (rel. Nov. 8, 1996).

406 *See, e.g.,* 47 C.F.R. §§ 69.303(a), 69.304(c), 69.307(c), 69.406(a)(9).

407 Ameritech Operating Companies, *et al.,* Petitions for Waiver of Sections 69.4(b) and 69.106 of Part 69 of the Commission's Rules, 9 FCC Rcd 7873 (Com. Car. Bur. 1994).

408 *See, e.g.,* Ameritech, Petition for Waiver for Electronic Directory Assistance, 5 FCC Rcd 7120 (Com. Car. Bur. 1990); BellSouth, Petition for Waiver for Electronic Directory Assistance, 5 FCC Rcd 7121 (Com. Car. Bur. 1990); NYNEX, Petition for Waiver for Electronic Directory Assistance, 5 FCC Rcd 7122 (Com. Car. Bur. 1990); US West Communications, Inc., Petition for Waiver of Part 69 of the Commission's Rules To Provide Electronic White Pages Service, 5 FCC Rcd 5526 (Com. Car. Bur. 1990).

409 Petitions for Waiver Concerning 1985 Annual Access Tariff Filings, Mimeo No. 5007 (Com. Car. Bur., rel. June 7, 1985) at paras. 72-77.

410 Additional rate structure proposals to be implemented at this time are discussed in Section III, *supra.*

411 In this Section, the terms "Comments" and Replies" refer to comment and replies filed in response to the *Price Cap Second FNPRM,* as listed in Appendix A.

412 There are no upper or lower service band limits imposed on services in the common line and interexchange price cap baskets.

413 *Price Cap Second FNPRM,* 11 FCC Rcd at 893-97.

414 *See, e.g.,* Ameritech Comments at 20-21; BellSouth Comments at 29-30; Cincinnati Bell Comments at 10; USTA Comments at 31-32.

415 USTA Comments at 5-6.

416 *See, e.g.,* Time Warner Comments at 21-22; Association for Local Telecommunications Services Comments at 7-12; Sprint Telecommunications Venture Comments at 6-8.

417 Time Warner Comments at 22.

418 *See, e.g.*, AT&T Comments at 38-45; MCI Comments at 20-21.

419 MCI Comments at 21.

420 Ad Hoc also favors this approach. Ad Hoc Comments at 18-19.

421 AT&T Comments at 38-45.

422 NYNEX Telephone Companies Annual Access Tariff Filings, Requests for Waiver, Memorandum Opinion and Order, 11 FCC Rcd 5448, 5454 (Com. Car. Bur. 1995).

423 *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 589 (1986).

424 *LEC Price Cap Order*, 5 FCC Rcd at 6824.

425 *LEC Price Cap Order*, 5 FCC Rcd at 6822.

426 "Headroom" refers to the difference between the PCI and API for any particular price cap basket. *See Price Cap Second FNPRM*, 11 FCC Rcd at 885.

427 47 C.F.R. § 61.46.

428 *Price Cap Second FNPRM*, 11 FCC Rcd at 891 (citing *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9135, and pleadings cited therein).

429 The waiver request must specify the exact rate elements intended for the service and must show that "good cause" exists for grant of the waiver *See* 47 C.F.R. § 1.3. To show "good cause," a petitioner must demonstrate that "special circumstances warrant a deviation from the general rule and such deviation will serve the public interest." *See* Northeast Cellular Telephone Co. v. FCC, 897 F.2d 1164, 1166 (D.C. Cir. 1990); WAIT Radio v. FCC, 418 F.2d 1153 (D.C. Cir. 1969).

430 *E.g.*, Ad Hoc Comments at 17 (agrees with the Commission's proposal to allow LECs seeking to offer new switched access services to bypass the Part 69 waiver process and instead file a petition showing that the new service would serve the public interest); Ameritech Comments at 2 (states that no separate waiver or finding should be required for the introduction of new switched access rate elements); Cincinnati Bell Comments at 8-9; Pacific Bell and Nevada Bell Comments at 10, 18 (argues that no waivers of the rules should be required with respect to new services).

431 NYNEX Comments at 17; SNET Comments at 9-11.

432 *E.g.*, Comcast Comments at 28; MCI Comments at 15-18; MFS Reply at 4; Teleport Reply at 18-20.

433 MCI Comments at 15-18; MCI Reply at 2-4.

434 The NYNEX Telephone Companies Petition for Waiver, Transition Plan to Preserve Universal Service in a Competitive Environment, Memorandum Opinion and Order, 10 FCC Rcd 7445 (1995); Ameritech Operating Companies, Petition for a Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region, Order, FCC 96-58 (rel. Feb. 15, 1996).

435 *See NARUC October 23 Letter* at 4.

436 *See ISP November 15 Letter* at 2.

437 *ACTA Petition* at 3.

438 We plan to address the legal questions about Internet telephony raised in the *ACTA Petition*, and broader issues about the continued viability of our basic/enhanced dichotomy, in separate proceedings.

439 *See* 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in 15 U.S.C. § 632).

440 15 U.S.C. § 632. *See, e.g.*, Brown Transport Truckload, Inc., v. Southern Wipers, Inc., 176 B.R. 82 (N.D. Ga. 1994).

441 13 C.F.R. § 121.201.

442 United States Department of Commerce, Bureau of the Census, *1992 Census of Transportation, Communications, and Utilities, Establishment and Firm Size*, at Firm Size 1-123 (1995) (*1992 Census*).

443 15 U.S.C. § 632(a)(1).

444 *See Local Competition Order* at paras. 1328-1330, 1342.

445 *See id.* para. 1342.

446 Standard Industrial Classification (SIC) Code 4813.

447 Federal Communications Commission, Common Carrier Bureau, Industry Analysis Division, *Telecommunications Industry Revenue: TRS Fund Worksheet Data*, Table 21 (Feb. 1996).

448 *See* 5 U.S.C. § 605(b).

449 *Price Cap Second FNPRM*, 11 FCC Rcd at 936.

450 5 U.S.C. §§ 601-611. SBREFA was enacted as Subtitle II of the Contract With America Advancement Act of 1996 ("CWAAA"), Pub. L. No. 104-121, 110 Stat. 847 (1996).

451 Citizens Telecommunications Companies, Transmittal No. 30, filed April 2, 1996. Citizens is the only incumbent LEC that has changed from rate-of-return regulation to price cap regulation since the *Price Cap Second FNPRM*.

452 5 U.S.C. § 605(b).
453 *Id.* at § 601(6), adopting 15 U.S.C. § 632(a)(1).
454 15 U.S.C. § 632. *See, e.g.*, Brown Transport Truckload, Inc. v. Southern Wipers, Inc., 176 B.R. 82 (N.D. Ga. 1994).
455 13 C.F.R. § 121.201.
456 *See* n. 83, *supra.*
457 15 U.S.C. § 632(a)(1).
458 5 U.S.C. § 605(b).
459 5 U.S.C. § 801(a)(1)(A).
460 5 U.S.C. § 605(b).
1 Access Charge Reform, Notice of Proposed Rulemaking, CC Docket No. 96-262, FCC 96-488 (rel. Dec. 24, 1996).

11 F.C.C.R. 21354, 11 FCC Rcd. 21354 (F.C.C.), 5 Communications Reg. (P&F) 604 (F.C.C.), 1996 WL 733469 (F.C.C.)

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