BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Access Charge Reform	)	**CC Docket No. 96-262**
	)	
Price Cap Performance Review for	)	**CC Docket No. 94-1**
Local Exchange Carriers	)	
	)	
Low Volume Long Distance Users	)	**CC Docket No. 99-249**
	)	
Federal-State Joint Board	)	**CC Docket No. 96-45**
On Universal Service	)	

COMMENTS OF
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CONSUMERS UNION
(JOINT CONSUMER COMMENTORS)

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EXECUTIVE SUMMARY

THE CONSUMER IMPACT OF BOTTOM OF THE BILL CHARGES

In January of 1996, just before the Telecommunications Act of 1996 was passed, residential consumers paid a Federal charge (called the Subscriber Line Charge) of $3.50 per line. Its purpose is to help recover the fixed costs of the telephone network that are used by long distance companies (Interexchange Carriers or IXCs) to provide service.

By January 2000, the recovery of costs had been radically changed by a combination of Federal Communications Commission policy and industry pricing practices.

- The subscriber line charge had been joined by another fixed charge at the bottom of the bill called a Primary Interexchange Carrier Charge (PICC). This charge of $1.50 constituted the first increase in federal fixed charges on the bottom of the bill in over a decade.

- Moreover, the subscriber line charge, which had been uniform in the residential sector, was sharply increased for residential second lines. Instead of paying $3.50, customers of residential second lines are now charged $6.07. This increase of $2.57 was in addition to the PICC.

- As a result of these increases, the average consumer is paying about $2.00 per month more in fixed federal charges. In total, this increase has already cost consumers about $2.50 billion per year.

This dramatic increase in fixed charges and cost recovery from low and average volume residential customers took place in spite of the fact that the cost of providing service was declining dramatically. It took place in spite of the fact that the LECs consistently earned excess profits on the costs they were recovering in the federal jurisdiction.

AN IMMEDIATE AND PERMANENT REDUCTION IN COST RECOVERY IS JUSTIFIED ON THE BASIS OF THE RECORD

The economic evidence before the Commission shows that the current recovery of costs is excessive.

- If the Commission implements its decision to utilize forward-looking economic costs (as embodied in the Synthesis Proxy Cost Model) and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased but decreased.

- The Commission has required that the rates for unbundled network elements (UNEs) be set on the basis of forward looking economic costs. Examining the

outcome of the application of that principle at the state level reinforces our conclusion that there is an over recovery of costs in the Federal jurisdiction.

- The conclusion that current cost recovery in the Federal jurisdiction is excessive is also supported by the results of ongoing proceedings at the Commission. Year-after-year, when the local exchange companies report their earnings in the Federal jurisdiction, they are far above the targeted level.

As demonstrated in several proceedings at the FCC, this over-recovery arises because the Commission has not established sufficient productivity goals or held the local company books up to rigorous scrutiny. Excess profits alone account for the $2.5 billion of increased costs imposed on consumers

There is no justifiable basis for delaying the appropriate costing and pricing of the loop. The economic analysis already demonstrates that there is an over-recovery of loop costs by the LECs. The Commission has a duty to consumers to ensure that cost recovery is just and reasonable. Perpetuation of a system that results in over-recovery and cost-shifting violates this duty to customers. We urge the Commission to write an Order that allows for fair recovery of loop costs while allowing cost-justified savings to flow through to customers.

THE THRUST OF THE CALLS PROPOSALS

Against this background of dramatic increases in bills and continuous over-earnings by the LECs, a coalition of the largest local and long distance telephone companies (CALLS) proposed to not only institutionalize these bottom of the bill charges, but to increase them and to increase the total cost recovery in the federal jurisdiction by almost $4 billion. The IXCs went along because they would receive yet another $2 billion reduction in their costs, with no mechanism for ensuring whether, or how, these costs would be passed through to the public.

Consumer groups, small telephone companies, and many state Commissions responded negatively to this proposal, to say the least. Over the past five months, the FCC has sought to reconcile the difference between the CALLS group and consumer groups. No such reconciliation was possible. What has emerged is the offer of a one-sided truce in a long war with a date certain for resumption of hostilities.

- The CALLS proposal now on the table would almost double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about $1.25 per month.

- In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers.

- The proposal would also eliminate the Carrier Common Line Charge (CCL).

- It would institutionalize new and unsubstantiated universal service fund payments as a line item on the bottom of the bill.

- The proposal would reconcile a huge discrepancy between the Wall Street books of the local companies and their regulated books. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal simply wipes the slate clean.

The modified CALLS proposal does not eliminate the philosophical or legal infirmities of the CALLS plan, or address the fact that current cost recovery in the Federal jurisdiction is too high. However if the Commission designs the cost proceeding properly, it at least gives consumers a fighting chance at a date certain in the future, of preventing further unjustified price increases and creates the opportunity to challenge the unfair price increases consumers have experienced since 1996.

CALLS DOES NOT RESOLVE ANY OF THE OUTSTANDING ISSUES

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and transformation of, the universal service fund into a line item are illegal, arbitrary and capricious, uneconomic and unfair.

The Commission has required the states to use forward looking economic costs to set their rates for unbundled network elements and recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet the CALLS proposal does not set recovery of loop costs at forward looking economic levels. It is arbitrary and capricious to lower switching costs to reflect forward looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996.

The CALLS proposals contemplate the deaveraging of rates for the new combined SLC/PICC. The Commission has not discussed to what extent differential SLCs are in conflict with the requirement that rates be reasonably comparable between rural and urban areas. Deaveraged rates must be found to be reasonably comparable.

RECONCILING REGULATORY AND FINANCIAL BOOKS

The LECs propose to amortize the difference between the asset accounts on their regulatory books and the asset accounts on their financial books. The LECs commit to not seeking rate increases as a result of the charges against income that they will take over a five year period. We believe that there is no legitimate claim to recovery of these costs, which have long been written off of their financial books. In our view, the excessive rate of return earned by the LECs has more than compensated them for the occasional write-off of assets that all companies take. We have consistently argued this in the earlier rounds of the docketed proceeding. We believe that consumer should be given rate reductions as a result of the reconciliation of these books and that is precisely what we intend to argue in the rate proceeding that must inevitably take place after the CALLS plan expires.

In the mean time, it is critical for the Commission to ensure that the bizarre treatment of these costs have no impact on access charges, UNE rates or USF distribution.

PROMISES ABOUT PRICE REDUCTIONS LINKED TO THE CALLS PROPOSAL

The FCC has also been given a series of promises dealing with costs and pricing policies that are not part of the current proceeding and are not enforceable by the FCC. AT&T has agreed to eliminate its minimum usage charges – although these charges never involved costs that the FCC regulated and were not subject to FCC price regulation. AT&T has also promised to change its practice of collecting the universal service charge on a per line basis and begin collecting it as a percentage of the bill. Both of these changes are good for consumers, but in no manner should they be considered a *quid pro quo* for access charge reform.

While AT&T claims to link changes in corporate pricing policies that were solely at its discretion to a reduction in its regulated cost of business, these policy changes also reflect negative consumer reaction, Bell Company offers not to charge a monthly fee, and extremely bad publicity. Thus, these "offers" by the some IXCs are merely the recognition by these entities of practices that are no longer sustainable in a competitive marketplace. In addition, the IC pledge to flow through access charge reductions to business and residential customers "over the life of the plan" could be meaningless unless the Commission devises a monitoring mechanism and makes "flow-though" mandatory on a proportion of usage/revenue basis. We believe that any promise worthy of consideration as public policy must carry the same accountability and enforceability as Commission regulatory decisions.

I. INTRODUCTION

A. JOINT COMMENTORS

The Texas Office of Public Utility Counsel (Texas OPC) is the state consumer agency designated by law to represent residential and small business consumer interests of Texas. The agency represents over 8 million residential customers and advocates consumer interests before Texas and Federal regulatory agencies as well as State and Federal courts.

The Consumer Federation of America (CFA) is the nation's largest consumer advocacy group, founded in 1968. Composed of over 250 state and local affiliates representing consumer, senior citizen, low-income, labor, farm, public power, and cooperative organizations, CFA's purpose is to represent consumer interests before the Congress and the federal agencies and to assist its state and local members in their activities in their local jurisdictions.

Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumer's Union's income is solely derived from sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees.

B. THE CALLS COALITION PROPOSALS ARE NOT THE BASIS FOR A COMPREHENSIVE SETTLEMENT

These three organizations (hereafter, Joint Consumer Commentors) have participated in each of the dockets cited in the caption to this Notice of Proposed Rulemaking.[1] The notice is in response to the modified proposal from a coalition (Coalition for Affordable Local and Long Distance Service, "CALLS") made up entirely of telecommunications companies. The CALLS proposal would radically alter the Commission's approach to access charges and harm the majority of residential consumers.[2]

Previously, CALLS filed its original proposal which was thoroughly discredited in a earlier round of comments. It has now subsequently filed a memorandum and attachments detailing modifications to its original proposal (hereafter CALLSII).[3] CALLSII had such obvious shortcomings that it has been followed by yet further modifications (CALLS III).[4] The filing asserts that the modified proposal represents a comprehensive settlement and that, because it is

[1] Federal Communications Commission, Notice of Proposed Rulemaking, Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for local Exchange Carriers, CC Docket No. 94-1, Low Volume Long Distance Users, CC Docket No. 99-249 In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 (September 15, 1999).

[2] *Universal Service and Access Reform Proposal*, Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself as the Proposal. We refer to the justification offered as CALLS.

[3] The second proposal is composed of a series of documents and *ex parte* filings including the following, Memorandum in Support of the Revised Plan of The Coalition for Affordable Local and Long Distance Service ("CALLS*")*, (hereafter CALLSII Memorandum); Modified Universal Service and Access Reform Proposal (Hereafter Modified Proposal); (*Ex parte* of LECs) (*Ex parte* of AT&T), and (*Ex parte* of Sprint) *In the Matter of Price Cap Performance Review of Local Exchange Carriers, Federal and State Joint Board on Universal Service, Low-Volume Long Distance Users, Access Charge Reform*, CC Docket Nos. 94-1, 96-45, 99-249, 96-262, March 8, 2000.

[4] *Ex Parte of Kathy Wallman*, March 29, 2000; *Ex Parte of AT&T*, March 30, 2000.

a settlement, should be accepted by the courts.[5] Nothing could be farther from the truth.

A broad range of consumer groups has participated in each of the proceedings captioned in this Docket throughout their history as well as in the most recent round of comments. A number of these groups jointly made specific and concrete proposals to settle all of the outstanding issues immediately (see Attachment 1). The other parties to this proceeding never discussed or addressed this comprehensive settlement offer with the consumer groups who made it. Their modified filing clearly rejects the comprehensive consumer settlement offer. Instead, they have filed a modified proposal of their own which violates all of the principles that the consumer groups articulated in their proposal.

The CALLS proposal would almost double the cap on the subscriber line charge (SLC) for primary lines. The industry estimates that the net increase in bottom of the bill charges would be about $1.25 per month. In addition to the net increase, the proposal would shift the Primary Interexchange Carrier Charge (PICC) from the carriers to consumers. The proposal would also eliminate the Carrier Common Line Charge (CCL). It would institutionalize new and unsubstantiated universal service fund payments as a line item on the bottom of the bill.

The proposal would reconcile a huge discrepancy between the Wall Street books of the local companies and their regulated books. Unfortunately for consumers, the proposal would not impose any penalties or lower rates to reflect phantom assets that are still embedded in the prices charged to consumers, or even set the rates at lower levels to reflect the overcharges. The CALLS proposal simply wipes the slate clean.

[5] CALLSII, p. 10.

The recommended increases in the subscriber line charge, the elimination of the PICC and CCL and the increase in, and transformation of, the universal service fund into a line item are illegal, arbitrary and capricious, uneconomic and unfair.

- The Commission has required the states to use forward looking economic costs to set their rates for unbundled network elements and recently used forward-looking economic costs to establish the high cost payments for large LECs. Yet, the CALLS proposal does not set recovery of loop costs at forward looking economic levels. In fact, it increases rates even farther above the forward looking economic levels as determined by the very same model used to estimate switching costs and high cost loop costs. It is arbitrary and capricious to lower switching costs to reflect forward looking economic costs but raise loop rates, when the very same model indicates they should be reduced.

- The uncompensated use of facilities violates section 254 (k) of the Telecommunications Act of 1996 by allowing IXCs to use shared facilities without paying for them. It is contrary to the long standing interpretation of the requirements for reasonable recovery of shared costs which stretches back 70 years to Smith v. Illinois.

- The proposal removes the obligation of telecommunications carriers to contribute to universal service, which contradicts the plain language of the Telecommunications Act of 1996.

The proposal would institutionalize federal charges for access that are far in excess of the economic cost of providing access as estimated by the Commission's own forward looking cost model and thereby insulate the charges from competitive pressures. The CALLS proposal insulates other charges from competitive pressures. Although CALLS defenders claim that the proposal is pro-competitive, because it lowers the per minute costs of usage, joint consumer commentors believe it will have the opposite effect because its main thrust is to shift costs out of the most competitive rate elements and into the least competitive area. As a result, a huge set of costs will be shielded from competitive market forces. It is noteworthy that several

commentors point out that one way to expose costs to greater competitive pressures is to remove them from the bill as governmentally mandated line items. This would throw them into the market.

Loop plant is a cost of doing business for telecommunications companies. It is no different than any other cost of doing business. It is illogical for the Commission to continue to allow an antiquated and anti-competitive method of cost recovery for loop plant based on a now defunct notion of monopoly regulation. Congress has ordered the FCC to implement pro-competitive policies and encourage competition. Segregation of certain costs into non-bypassable surcharges inappropriately insulates these costs from competitive pressures thereby defeating the objectives of the Telecommunications Act of 1996. If there ever was a reasonable rationale for these charges, it has certainly gone the way of switchboard operators and party line service. The FCC must stand down and allow carriers to compete for customers on the basis of price, without manipulating cost recovery in a manner contrary to or insulated from market forces.

The conclusion we draw from the legal, conceptual and empirical analysis is straightforward – the CALLS proposal should be rejected. Economic analysis demonstrates that the subscriber line charge is too high; public policy dictates that it should be reduced. In a world of efficient, multi-product telecommunications companies, claims that current fixed charges do not cover the federal share of loop costs are contradicted by the FCC's own cost analysis. Increases in unavoidable end-user charges, mandated by FCC action and tolerated by FCC inaction, run directly contrary to the congressional intention that basic service should bear no more than a reasonable share of joint and common costs.

CALLS II is not the basis for a comprehensive settlement. It resolves some issues

partially; delays final consideration of many others; and actually raises a number of new concerns. CALLS II makes much more progress on issues that were not being litigated in these dockets than it does on issues properly before the Commission. The ultimate day of reckoning on many critical issues has simply been delayed. Therefore, the Commission must be diligent in writing an order that preserves the fundamental principles that consumers have shown are embodied in the Telecommunications Act of 1996.

The Commission has recognized the importance of a number of critical issues to consumers and the CALLS members now at least accept the fact that these principles are important to consumers, albeit without accepting the principles themselves. First and foremost, the Commission should ensure that loop charges are based on economically valid loop costs. In particular, the Commission must guarantee that the "interim cost review" contemplated by CALLS II is based on forward looking costs for all loops; that subscriber line charges for all residential lines are adjusted to reflect the forward looking costs (consistent with the CALLS II caps) as determined in this cost review; and that any reductions in subscriber line charges, or increases in SLCs that are lower than the caps contemplated in CALLS II, would not result a shifting of the "shortfalls" below the CALLS II caps into any other ratepayer charges. In addition, we believe the cost review should include a reassessment, based on the forward looking costs identified in that study, of the need for the $650 million universal service fund for local exchange carriers in the CALLS II plan. Any universal service charge should be based on a percentage of the overall monthly bill, rather than a flat fee, to ensure that low volume users do not pay a disproportionate share of these costs.

The CALLS III modifications do not eliminate the philosophical or legal infirmities of the

CALLS plan, or address the fact that current cost recovery in the Federal jurisdiction is too high. However, if the Commission designs the cost proceeding properly, they do at least give consumers a fighting chance at a date certain in the future, of preventing further unjustified price increases and create the opportunity to challenge the unfair price increases consumers have experienced since 1996.

The comprehensive consumer settlement offered a post transition structure that would have presumed rates were just and reasonable, while giving petitioners the opportunity to demonstrate that the market is not working and regulated costs dictate a change in prices. The proposed consumer settlement was willing to make that concession because it moved rates much closer to cost (it cut out the excess profits and inefficiencies). CALLS II does not even come close to accomplishing that objective and threatens to move them above costs. Therefore, the FCC must demonstrate that rates are just and reasonable at the expiration of the CALLS plan.

C. KEEPING CALLS I, II, AND III IN CONTEXT

In January of 1996, just before the Telecommunications Act of 1996 was passed, residential consumers paid a Federal charge (called the Subscriber Line Charge) of $3.50 per line to help recover the fixed costs of the telephone network that are used by long distance companies (Interexchange Carriers or IXCs) to provide service. Since the local exchange companies (LECs) incur those network costs, the SLC was paid directly by consumers to the LECs.

Additional costs of the network were paid by IXCs to the LECs in the form of carrier common line charges (CCL). The expression carrier common line charges is appropriate, since it reflect that fact that the telephone line (called a “loop”) is used in common by local and long

distance services. In essence, the IXCs were paying for the use of the common line in the form of a carrier common line charge. The IXCs paid these charges to the LECs on the basis of the amount of usage of the network and then recovered these costs in the marketplace (to the extent they could) in the usage charges paid by consumers.

By January 2000, the recovery of costs had been radically changed by a combination of Federal Communications Commission policy and industry pricing practices. The subscriber line charge had been joined by another fixed charge at the bottom of the bill called a Primary Interexchange Carrier Charge (PICC). This charge of $1.50 constituted the first increase in federal fixed charges on the bottom of the bill in over a decade. Moreover, the subscriber line charge, which had been uniform in the residential sector, was sharply increased for residential second lines. Instead of paying $3.50, customers of residential second lines are now charged $6.07. This increase of $2.57 was in addition to the PICC.

As a result of these increases, the average consumer is paying about $2.00 per month more in fixed federal charges. In total, this increase has already cost consumers about $2.50 billion per year.

Over the same period, long distance companies have received about $4 billion in reduced charges that they pay to LECs for the use of the network. Because the FCC has essentially deregulated long distance rates, it could not ensure that these cost reductions were passed through to the public in any systematic way. As a result, IXCs offered discount plans for high volume residential users and negotiated deals with large business users. Thus, the vast majority of consumers suffered a substantial net increase in their bills.

This dramatic increase in fixed charges and cost recovery from low and average volume

residential customers took place in spite of the fact that the cost of providing service was declining dramatically. It took place in spite of the fact that the LECs consistently earned excess profits on the costs they were recovering in the federal jurisdiction.

Against this background of dramatic increases in bills and continuous over-earnings by the LECs, a coalition of the largest local and long distance telephone companies (CALLS) proposed to not only institutionalize these bottom of the bill charges, but to increase them and to increase the total cost recovery in the federal jurisdiction by almost $4 billion. The IXCs went along because they would receive yet another $2 billion reduction in their costs, with no mechanism for ensuring whether, or how, these costs would be passed through to the public.

Consumer groups, small telephone companies, and many state Commissions responded negatively to this proposal, to say the least. Over the past five months, the FCC has sought to reconcile the difference between the CALLS group and consumer groups. No such reconciliation was possible. What has emerged, is the offer of a one-sided truce in a long war with a date certain for resumption of hostilities.

According to the most recent version of the CALLS proposal, hostilities will recommence on July 1, 2001, in the form of a cost proceeding. In the mean time, single line customers will receive a very small, one year reduction in the line items on their bills of approximately $.29. This reduction will be eliminated in the second year and a small increase of $.36 above today's charges will result. At that point, a cost proceeding will be conducted to ascertain whether any further changes (up or down) in fixed cost recovery are justified, with the intention of the LECs to recoup lost revenues through some other mechanism.

This is hardly a great deal for consumers. There is very little near term cost reduction for

consumers, with a definite escalation in loop cost recover. Add to that, the LEC's desire to recover lost revenues and the plan actually places consumers in a worse position than they are today. Additionally, the plan attempts to establish the principle (in contravention of existing case law) that all fixed costs of the network should be recovered directly from consumers, while IXCs get a free ride. This type of cost-shifting and cross-subsidization should be flatly rejected by the Commission.

On the other hand, it is also true that the FCC's earlier decisions that opened the door to the sharp increases in bottom of the bill charges are at least opened for further debate. Things could have gotten much worse if the FCC's misguided decisions adopted soon after the 1996 Act was passed were allowed to run their course. Under the CALLS proposal, there is the possibility that the FCC will apply its concept of forward looking economic costs to the recovery of loop costs in the federal jurisdiction and this could substantially lower the total cost recovery, but only if there are no make whole provisions.

The FCC has also been given a series of promises dealing with costs and pricing policies that are not part of the current proceeding are not enforceable by the FCC. AT&T has agreed to eliminate its minimum usage charges – although these charges never involved costs that the FCC regulated and were not subject to FCC price regulation. AT&T has also promised to change its practice of collecting the universal service charge on a per line basis and begin collecting it as a percentage of the bill. Both of these changes are good for consumers, but in no manner should they be considered a *quid pro quo* for access charge reform. While AT&T claims to link changes in corporate pricing policies that were solely at its discretion to a reduction in its regulated cost of business, these policy changes also reflect negative consumer reaction, Bell Company offers

not to charge a monthly fee, and extremely bad publicity. Thus, these "offers" by the some IXCs are merely the recognition by these entities of practices that are no longer sustainable in a competitive marketplace.

There is no justifiable basis for delaying the appropriate costing and pricing of the loop. The economic analysis already demonstrates that there is an over-recovery of loop costs by the LECs. The Commission has a duty to consumers to ensure that cost recovery is just and reasonable. Perpetuation of a system that results in over-recovery and cost-shifting violates this duty to customers. We urge the Commission to write an Order that allows for fair recovery of loop costs while allowing cost-justified savings to flow through to customers.

D. OUTLINE OF THE COMMENTS

Section II of these comments discusses the analysis of costs in the federal jurisdiction. It argues that forward looking economic costs, which have been the cornerstone of Federal cost analysis since the passage of the Telecommunications Act of 1996, must be applied to access costs, the loop in particular. It demonstrates that all lines, in all zones and all universal service funds must be included in the analysis. To arrive at rates that are just and reasonable, cost recovery must be reduced, if the analysis indicates an over recovery.

Section III demonstrates that forward looking economic costs as estimated by the Commission's Synthesis Proxy Cost Model and the states in their pricing of Unbundled Network Elements are far below the embedded costs claimed by the local exchange companies.
This indicates an over recovery of costs, which is reaffirmed by ongoing cost proceedings at the FCC. Consequently, an immediate and permanent reduction in cost recovery is necessary.

Section IV demonstrates that the loop is a cost shared by many services, including long distance. Under the 1996 Act, such costs must be shared among services and basic service can bear no more than a reasonable share of these costs. This is consistent with the case law, which reaches back to 1930 in *Smith v. Illinois*, the practices of the states in cost allocation, and the FCC in a series of decisions since the passage of the 1996 Act. The CALLS proposal contradicts this clear legal requirement by proposing to allow IXCs to use the loop with paying for that use.

Section V reviews other elements of the CALLS proposal which contradict the 1996 and raise concerns. Specific concerns are raised about how companies will meet their obligation to contribute to universal service under section 254 (b) (4) of the Act and how the Commission must ensure that rural and urban rates remain reasonably comparable under section 254 (b)(3) of the Act. It also urges the Commission to write an order that backs up promises to eliminate minimum charges and pass access charge reductions through to consumers with the force of a regulatory requirement.

II. ANALYSIS OF COSTS

A. FORWARD LOOKING ECONOMIC COST MUST BE THE BASIS OF COST RECOVERY IN THE FEDERAL JURISDICTION

In the three and one-half years since the passage of the Telecommunications Act of 1996 the Commission has articulated a paradigm for the estimation, allocation and recovery of costs that faithfully balances the complex goals of the Act. Through a long series of orders in the universal service, local competition, and access charge reform dockets the Commission's paradigm has identified the following essential principles (in order of their magnitude of importance measured by their impact on rates or the size of the universal service fund):

- Forward-looking economic costs must be the basis for establishing prices and universal service support.[6]
- The loop is a shared cost – shared by all of the services that utilize it.[7]
- Actual competition is the trigger for action, not theory.[8]

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[6] Joint FNPRM

> We agree with the Joint Board that we should use forward-looking costs as a starting point in determining support amounts. We believe that basing support levels on forward-looking costs will send the correct signals for investment, competitive entry and innovation, and that a single national cost model will be the most efficient way to estimate forward-looking cost levels (¶ 11).
>
> We adopt the Joint Board's recommendation that forward-looking economic costs should be used to estimate the costs of providing supported services (¶ 48).

[7] The most explicit statement can be found at Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237

> 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 service

[8] Joint FNPRM.

With the development of the Synthesis Proxy Cost Model (SPCM) and a Supreme Court ruling upholding the concept of forward-looking economic costs, the end is in sight. Now is the time to implement the above principles.

The FCC has received substantial evidence that rates should be declining because productivity has exceeded the rate of inflation by a substantial margin for the past decade. The most extensive studies of local costs commissioned by Public Counsels across the country show even higher productivity increases than the Commission found in the interstate jurisdiction.[9] The Commission should consider reductions in the SLC and the universal service package, rather than rate increases.

> Support based on forward-looking models will ensure that support payments remain specific, predictable, and sufficient, as required by section 254, particularly as competition develops. To achieve universal service in a competitive market, support should be based on costs that drive market decisions, and those costs are forward-looking costs. (¶ 50)
>
> The model currently suggests that, using this methodology, a cost benchmark level near the center of the range recommended by the Joint Board would provide support levels that are sufficient to enable reasonably comparable rates, in light of current levels of competition to preserve and advance the Commission's universal service goals. (¶ 99)
>
> We also seek comment on whether we should calculate costs at the study area level. In recommending that the federal support mechanism calculate costs at the study area level, the Joint Board suggested that the level of competition today has not eroded implicit support flows to an extent as to threaten universal service. (¶ 105).

[9] "Rebuttal Testimony of Dr. Marvin Kahn, on Behalf of the Office of the Attorney General," Before the State Corporation Commission of Virginia, In the Matter of Evaluating Investigating the Telephone Regulatory Case No. PUC930036 Methods Pursuant to Virginia Code S. 56-235.5, Cause No. PUC930036, March 15, 1994 and "Prefiled Testimony of David Gable on Behalf of the Indiana Office of Utility Consumer Counselor," Before the Indiana Utility Regulatory Commission, In the Matter of Petition of Indiana Bell Telephone Company, Incorporated for the Commission to Decline to Exercise in Part Its Jurisdiction Over Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, to Utilize alternative Regulatory Procedures for Petitioner's Provision of Basic Local Exchange Service and Carrier Access Service, and to Decline to Exercise in Whole Its Jurisdiction Over all other Aspects of Petitioner and Its Provision of All Other Telecommunications Service and Equipment, Pursuant to IC 8-1-2.6, Cause Number 39705, January 1994, estimate the productivity offset in the rate of 7 percent per year in the late 1980s and early 1990s.

Now is the time for the subscriber line charge to be eliminated so that the playing field can be leveled for competition. In this way, loop costs would be recovered from two entities, local and long distance companies, who are soon to be competing with one another. Recovering these input costs from suppliers will also place local and long distance companies on an equal footing with other potential providers of loop services. New entrants who provide loop cannot charge consumers a subscriber line charge. Eliminating the subscriber line charge eliminates the wedge between the cost of loop and the costs incurred by the traditional service providers (ILECs and IXCs) who use it.

B. THE MODIFIED COST PROCEEDING

One of the modifications that CALLSII introduced into its proposal was a cost proceeding during the period the caps for the subscriber line charge are increasing. Unfortunately, the proceeding it defined bears no relationship to a legitimate forward looking economic cost proceeding.

The Commission must apply consistent cost principles. UNE rates, high cost support, and federal fixed cost recovery must be calculated using the same principles. CALLSII does not accept this principle. CALLSII reserves the right to litigate the concept of forward looking costs.[10] The Commission must, of course, use the most recent data, for the purposes of that cost proceeding, but the CALLSII proposal, as worded will unleash a firestorm of controversy over

[10] CALLSII, page 8, footnote, 7.

how forward looking costs should be calculated.[11] CALLSII would allow the Local Exchange Carriers (LECs) to use data other than forward looking economic costs. This point has been litigated and decided. The Commission should simply update the existing model, which is solely based on forward looking economic costs.

Treatment of cost zones and second lines is crucial in the cost analysis.. CALLSII handled second lines and cost zones very poorly and this flaw has been recognized in CALLS III.

CALLSII explicitly excluded the consideration of second lines from the cost analysis, which is absurd as an analytic proposition.[12] Because first and second lines share many costs, and the prevalence of second lines is increasing dramatically, it is impossible to properly estimate the costs of primary lines without taking into account the existence of second lines. The CALLSII approach also violates the fundamental principle that charges should be based on costs. The FCC's cost model indicates that the cost of second lines is less than one half that of first lines.

Average SLC must reflect efficient costs and total cost recovery in the federal jurisdiction. As defined by CALLSII, the cost proceeding would preclude the possibility of analyzing cost recovery in zones that are below the cap. The CALLSII proposal would only look at single lines in the highest cost zones. However, costs may have initially been set too high in those areas or they may be declining as second lines are added. Without looking at the cost of all lines, the

[11] CALLSII, ensures that such a furor will develop by asserting that data, other than that based on forward looking economic costs will be presented to the Commission (CALLSII, p. 8):

> To facilitate this verification, the LEC members of the Coalition commit to provide the Commission with economic data, including data identifying the forward looking costs associated with the provision of retail voice grade access to the public switched network for those areas.

[12] CALLSII Memorandum, p. 8.

LECs are more likely to receive over-recovery of loop costs. CALLS III recognizes this problem.

Universal service funds must be cost justified and properly targeted. CALLS proposes a new $650 million universal service fund, which appears to be immune from cost analysis. The derivation of the $650 million universal service fund is subject to intense dispute. Five of the members of CALLS do not subscribe to the justification of the fund.[13] The sum must be included in any analysis of the total cost recovery in the Federal jurisdiction and it must be scrutinized. A well designed forward looking economic cost proceeding would establish a legitimate basis for this number, but CALLSII does not appear to contemplate the inclusion of such an analysis in the proceeding that commences in July 2001. [14] Other sources of subsidy to fund high cost areas must be included and scrutinized. CALLS III appears to recognize this problem.

Any cost proceeding at the Commission must include the possibility for revenues to decrease as well as increase. CALLSII includes a "make whole provision" that makes a mockery of the cost proceeding.[15] In essence, if the Commission finds on the basis of the forward

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[13] CALLSII Memorandum, p. 10, footnote 10.

> Bell Atlantic, BellSouth, GTE, and SBC do not support use of a model to calculate universal service support, and together with Sprint do not join in the citation of AT&T's model-based calculation.

[14] Numerous commentors also point out that the creation of a universal service fund of $650 million to compensate large LECs for so called subsidies embedded in switching charges and the establishment of a floor on access charges has no basis in empirical

[15] Modified Proposal, p. 5.

> In a zone where the Commission has taken such action to change the applicable cap, the difference between the SLC cap that originally would have been applicable and the new SLC cap set by the Commission will not be included in the maximum permitted Average SLC for purposes of section 2.1.6., and that difference will be recovered through the other common line elements. In that event, the Commission should adjust the multiline PICC caps to the extent necessary to mitigate any changes in the CCL rates.

looking cost analysis that there is excessive common line cost recovery on the basis of fixed, subscriber line charges, CALLSII proposes to lower the line charges (or not institute the increases) but to recover those costs from the carrier common line pool or the multiline business PICC. This shows that the members of CALLS have no intention of allowing the result of the cost proceeding to prevent the over-recovery of cost.

III. CURRENT COST RECOVERY IN THE FEDERAL JURISDICTION IS EXCESSIVE

The CALLS proposal is based on an incorrect premise about the subscriber line charge and its relationship to other rates. It assumes, incorrectly, that the current recovery of costs in the federal jurisdiction is inadequate to cover the costs properly assigned to it.

A. FORWARD LOOKING COSTS

1. The Synthesis Proxy Cost Model

The economic evidence before the Commission shows that the current recovery of costs is excessive. The Commission acknowledges that the Joint Board has not reached a conclusion about the existence of subsidies in the current recovery of common-line revenues.

> The Joint Board, however, made no finding as to whether implicit support exists in interstate access rates, or whether the Commission should make such support explicit if it does exist. (Joint FNPRM, ¶ 42).

We arrive at this empirical result in the following fashion. Exhibit 2 is based on the cost of loop and port as calculated by the SPCM at the wire center level. It shows the cumulative percentage of lines falling below a specific dollar figure.

The statewide average for Texas is $18.22 per month. Since 25 percent of these costs have been allocated to the Federal Jurisdiction, the Federal charges should cover $4.55 per month. Similar estimates for over a dozen states representing almost two-thirds of the lines in the country are presented in Exhibit 3. This analysis shows that Texas is typical of the nation.

Before we estimate how much is collected from residential ratepayers in Texas, there is one observation we would like to make. These data are somewhat old, apparently reflecting 1996

line counts and costs. For example, the data imply that only 4 percent of households have second lines. This would be consistent with 1996 data. By 1997, which is the latest period for which the FCC has data, the percentage on a national basis had increased to about 12 percent.[16] In the 18 months since then, the momentum for second lines has increased. SBC is one of the leaders in selling second lines. For the purpose of this analysis, we use a conservative figure of 20 percent[17] for second lines. This is particularly appropriate since the impact of the FCC decisions that would flow from the instant proceeding will be next year and beyond.[18]

The addition of second lines has a dramatic effect on loop costs. The incremental cost of providing the second line is considerably lower than the first, because most of the capital equipment is deployed. This is especially true of loop and port costs. Consider the following example, which we believe is reasonable. Assume that second line penetration has moved from 4 percent to 20 percent. This assumption is supported by a recent national survey that indicated 24 percent of respondents have a second line.[19] Further assume that the second line costs half as

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[16] Federal Communications Commission, Trends in Telephone Service (February, 1999), table 20.4

[17] *See* Application of Southwestern Bell Telephone Company for Rate Group Reclassification Pursuant to Section 58.058 of the Texas Utility Code, (Jan. 26, 1999), General Counsel Exhibit No. 1 at pg. 23. SWBT indicates that improved marketing of additional [second] phone lines resulted in sales which accounted for approximately 14% of new access line in 1993, 18% of new access lines in 1994, 25% of new access lines in 1995, and 29% of new access lines growth in 1996, in Texas. A recent national survey conducted for Joint Consumer Commentors indicates that 24 percent of respondents have more than one line. This is consistent with the assumed 80% primary and 20% non-primary lines.

[18] Trends, Table 20.4, gives year end figures of 114.4 million for residential loops and 17.9 million for additional lines. The figure of 20% for year end 1999 is derived from setting second lines at approximately 25 million and total lines at 123 million. This acceleration of second lines is consistent with the acceleration in Texas as noted in footnote 8.

[19] The October 1999 national survey was conducted by Opinion Research Corporation for Joint Consumer Commentors. The results of this survey are discussed in the Reply Comments, In the Matter of Low-Volume Long-Distance Users, CC Docket No. 99-249 (October 20, 1999).

much as the first line. This is a conservative assumption supported by testimony before the FCC and the cost model itself. The statewide average cost for loop and port in Texas would decline from $18.20 to $16.60. In other words the average cost recovery in the federal jurisdiction should be closer to $4.15.

If the Commission implements its decision to utilize forward-looking economic costs and treat the loop as a common cost, it must conclude that fixed end-user charges (*i.e.*, the subscriber line charge and the PICC) should not be increased but decreased.

- Based upon the results of the default runs of the Synthesis Cost Proxy Model for Texas, we conclude that at least 80 percent of residential lines in Texas are covering 100 percent of the forward looking economic costs of loops and ports (*i.e.*, the non-traffic sensitive portion of costs) that are allocated to the Federal jurisdiction.

Exhibit 4 presents our estimate of the amount collected from residential customers for access in the federal jurisdiction. We assume that 80 percent of the lines in the state are first lines and that 20 percent are additional lines. Based upon the estimates provided by the CALLS, we estimate that in excess of $6.00 per residential account is being collected for access – including the SLC, the PICC and the CCL. In addition, about $2 billion of high cost support is already being recovered in the federal jurisdiction. Since the above analysis looks at average loop costs, that include high cost support, this adds another $.25 to $.50 per month to the over recovery of costs.[20]

The charges exceed the costs that should be recovered for the vast majority of residential lines in Texas. The federal charges should cover $4.15 to $4.55 per month. However, the federal jurisdiction is collecting over $6.00 per residential account. In other words, based on forward-

[20] The CALLS proposal seeks to "settle" the question of subsidies in other rates at the level of $650 million. This

looking economic costs, the federal jurisdiction is over recovering $1.50 to $2.00 per month from residential consumers.

Texas is used as an example because it is a large state that is very close to the national average in forward-looking costs. We reach similar conclusions for other states as well (*see* Exhibit 3). These results show that between three-quarters and nine-tenths of the residential customers already cover the loop costs allocated to the federal jurisdiction. There are a few instances of high-cost states in which a much smaller percentage of the residential customers cover the costs allocated to the federal jurisdiction. That is an issue to be addressed by high cost fund policy.

2. Unbundled Network Elements

As noted, the Commission has required that the rates for unbundled network elements (UNEs) be set on the basis of forward looking economic costs. Examining the outcome of the application of that principle at the state level reinforces our conclusion that there is an over recovery of costs in the Federal jurisdiction.

Although UNE rates are not available on a national average basis, examination of these rates on a state-by-state basis indicate that they have been set in the same range as the cost estimates generated by the SPCM. A few examples demonstrate the point.

UNE rates in Texas are $18.36 for Southwestern Bell Telephone Company (SWBT). Forward-looking costs in Texas are $19.07 for SWBT. The statewide average for all loops in Texas (for all companies covered in the FCC support analysis) is $21.38. With second line growth this number would fall into the range of $15 to $18.

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works out to about $.21 per line. In the debate over subsidies, estimates run as high three times that level.

We obtain similar results for Virginia and Delaware for UNEs. In comments in this proceeding TXOPC, CFA, CU demonstrated similar outcomes for other states with the SPCM results.

In summary, over-recovery of costs falls in the range of $1.50 to $2.00 per month per residential line. The total falls in the range of $2.25 to $3 billion annually. Instead of increasing the bottom-of-the-bill charges by almost $2 billion in the residential sector, charges should be decreasing by $2 to $3 billion.

B. ONGOING PROCEEDINGS AT THE FCC

The conclusion that current cost recovery in the Federal jurisdiction is excessive is also supported by the results of ongoing proceedings at the Commission. Year-after-year, when the local exchange companies report their earnings in the Federal jurisdiction, they are far above the targeted level. As demonstrated in several proceedings at the FCC, this over-recovery arises because the Commission has not established sufficient productivity goals or held the local company books up to rigorous scrutiny.

Technological progress has made the industry a declining cost industry. Over the period since divestiture, the spread of digital line carrier systems, increasing population densities, and the growth of second lines have spurred a dramatic decline in costs. The FCC has erroneously applied all of the increased productivity to the carrier common line component of the federal cost recovery mechanism since it adopted price cap regulation. This has resulted in a dramatic reduction in usage charges. As a result, the compromise that the FCC struck between recovery of federal costs on a fixed and usage basis has been destroyed. In 1984 when the subscriber line

charge was instituted, the costs were split on a 50/50 basis. Today, the fixed charges exceed 80 percent of the total. This change in policy and resulting shift in cost responsibility has occurred without justification.

The audit has found phantom assets and the FCC has noted that the RBOCs report far more assets to regulators than they carry on their financial books. This raises cost recovery far in excess of where it should be (*see* Exhibit 6). For example, the audit yielded a discrepancy of $5 billion, which would generate cost recovery reductions of about $.25 billion in the federal jurisdiction. Reconciling the depreciation discrepancy between financial and regulatory books would increase the total reductions in cost recovery dramatically -- some $1.5 billion. Reinitializing rates would result in another $2.5 billion reduction.

The FCC uses a company-wide productivity factor, rather than an interstate specific productivity factor. As a result, productivity growth is vastly understated. Each year, when rates are adjusted, they are under corrected and the over earnings reappear. Using an interstate productivity factor, based on the FCC methodology, would raise the productivity factor to 10.2%, resulting in reductions of $.9 billion in cost recovery. Reinitializing the rates for underestimated productivity in the past 3 years would reduce costs recovery by another $2.9 billion.

The FCC uses a return on investment of 11.25 percent. Just getting the local exchange companies back to that level would lower cost recovery by $2.6 billion. Lowering the return to more reasonable levels would yield even larger reductions of cost recovery.

Some of the reductions identified in Exhibit 6 interact, so one cannot simply sum them to a grand total. However, the proposed reduction needed to "pay for" the restructuring is $4 billion in the first year, which could be easily accounted for by aggressive reductions in one

category or moderate use of all three.

Although the FCC has routinely used any scheduled reductions in cost recovery to lower the switching rates, all of these sources of over recovery of costs apply to both loop costs and switching costs. A major source of the discrepancy between the regulated books and the financial books stems from the write off of loop costs. Loop costs have been falling because of the adoption of digital line carrier technology. Average loop costs have also been falling because of the growth of second lines, which are far lower in cost than first lines. The FCC's forward-looking cost methodology concludes that efficient loop costs would be far lower than claimed embedded loop costs.

C. IMMEDIATE AND PERMANENT REDUCTIONS IN COST RECOVERY ARE NECESSARY

Based on the evidence before the Commission, an immediate and permanent reduction in cost recovery in the Federal jurisdiction is necessary to return rates to a just and reasonable level. CALLSII proposes no reduction in rates. It lowers rates modestly in the first year but then allows them to rise dramatically in later years. Further, it raises the cost recovery in line items charged to consumers and perpetuates the gross overcharging on residential second lines.

The public relations claims of CALLS members that its proposal dramatically lower bills is not based on the regulated costs that are at issue in this proceeding. Individual companies have made private decisions about how they will recover their unregulated costs and tried to tie those decisions to the CALLS proceeding. The Commission cannot cite such actions in demonstrating that the rates it regulates are just and reasonable, since such commitment are irrelevant and, in any

case, not binding.

IV. SERVICES THAT USE THE LOOP MUST PAY A REASONABLE SHARE OF ITS COSTS

Both CALLS proposals anticipate the use of the loop by Interexchange Carriers (IXCs) without paying for it. In our view, this violates section 254 (k) of the 1996 Act, which requires that competitive services not be cross subsidized and that basic service bear no more than (and perhaps less than) a reasonable share of joint and common costs. In our view, the loop is a shared cost between all of the services that use it. Therefore, long distance service must bear a reasonable share of such costs.

In this proceeding, the vast majority of phone companies share our view that the uncompensated use of loop facilities to provide long distance services violates section 254 (k) of the Act. In their comments in this proceeding, the small local exchange companies directly oppose the arguments of the large ILECs that support the uncompensated use of the loop. They challenge the economic argument that IXCs do not cause costs. Several parties remind the Commission that the loop is a shared cost of local and long distance service. The small local exchange companies also challenge the legal sophistry of not defining long distance as a service under 254 (k).

A. SHARING OF COSTS BETWEEN SERVICES THAT USE JOINT AND COMMON FACILITIES IS SOUND ECONOMIC AND PUBLIC POLICY.

Conceptual definitions of costs, analysis of the historic patterns of investment and current, real world activity all indicate that the distribution plant is a shared facility whose costs should be recovered from all services that use it.

1. Conceptual Definitions of Cost

Joint Commentors have consistently argued that the loop is a common cost for all telecommunications services that utilize it.[21]

The Commission has adopted a cost and pricing methodology that recognizes the fundamental economics of the modern telecommunications network. This approach involves (1) the recognition of the telecommunications network as a multi-product undertaking exhibiting strong economies of scale and scope; (2) the treatment of the loop as a common cost; and (3) the comprehension of competitive market behavior. The economic evidence that the telecommunications network is a multi-product enterprise enjoying economies of scale and scope is overwhelming.

- On the supply-side all long distance calls use the network exactly the same way local calls do. Vertical services (like Call Waiting, Call Forwarding and Caller ID) are supported by all parts of the network. Basic service accounts for about one-quarter of total revenues generated per line because the line is shared by an ever-increasing array of services.

- The demands on shared facilities are likely to accelerate as advanced services begin to share in the use of these facilities.

- On the demand-side, customers expect to receive long distance service when they order telephone service. Vertical services are strong complements of basic service. If a provider sells basic service to a customer, competitors are very unlikely to sell that customer Call Waiting.

[21] "Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, p. 6. Initial Comments of the Texas Office of Public Utility Counsel," In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, May 16, 1996, pp. 21-22.

- Companies are eager to sell local service and long distance service bundled together. One-stop shopping is an integral part of providers' business plans. In such a bundle, why is local cost the "cost causer", as the LECs and IXCs claim?

A reasonable basis to determine the allocation of shared costs is to analyze the facilities and functionalities necessary and actually used in the production of goods and services. In order to produce a long distance call IXCs need distribution plant, as well as switching plant and transport plant. Instead of basing economic analysis on a guess about what consumers really wanted when they purchased a bundle of services, the Commission should rely on a "service pays" principle. That is, services that use facilities should be considered to benefit from the deployment of those facilities and every service that uses a facility should help pay for it.

2. Historic Patterns of Investment Reveal the Fallacy of Attributing Loop Costs to only Basic Local Service

Historical analysis of why telecommunications investments were actually made shows that most telecommunications technologies were deployed for and used by business customers first. Hence, it is more reasonable to assume that those customers caused the investment. History shows that the integration of the long distance network into the local network (they actually started as two separate networks) raised the cost of the integrated network. Since the integrated network costs more as a result of the addition of long distance, it is reasonable to assume that long distance causes costs in the integrated network. In other words, complaints that business customers and long distance users pay too much actually ignore the historic pattern of cost causation.

Now that the companies are intensely competing to sell bundles of services, the fiction

that local service causes the loop cost should be put to rest once and for all. In truth, since the first decade of this century, the network, including the loop, has been consciously designed to serve local and long distance. Long distance was not an afterthought; it was always a forethought, included in the design, development and deployment of the network. Vertical services have been included in economic analyses of network design and architecture for over a decade.

Although historical analysis demonstrates the fallacy of attributing loop costs to only basic local service, it is clear that efforts to unravel the network into cost causation categories are difficult. For that reason, the analysis of costs should be based on the only footing on which sensible economic analysis can be launched -- an assessment of the product, not the psychology of the customer. Regulators should analyze the facilities and functionalities necessary and actually used in the production of goods and services. They should rely on a service pays principle. That is, services that use facilities should be considered to cause the deployment of those facilities. Assumptions about prime movers are arbitrary. There should be no free rides; every service that uses a facility should be required to share in the recovery of the cost of that facility on a reasonable basis.

- As a matter of economics, costs for joint and common facilities should be recovered on the basis of the nature and quality of use that each service makes of those facilities.

- As a matter of public policy from a universal service docket perspective, recovery of joint and common costs should be structured in such a way as to promote universal service by keeping basic service affordable. Adding line items to the bottom of the bill or increasing them makes connectivity to the network more expense and less affordable.

Although some theoretical economists chafe at the thought of recovering shared costs across a range of products, common sense and real world experience demonstrates that this is the

way markets work. For example, one of the Regional Bell Operating Companies made this argument in the federal universal service proceeding.[22] In a similar proceeding in Texas, one of the potential competitors also made the point that a common sense understanding of economic behavior requires the recovery of costs across all services that share facilities.[23]

Moreover, the SLC and other fixed charges make no sense in a competitive market when competitors sell bundled local, toll, and long distance service. The fictions that the FCC has established among these "classes" of service will no longer be relevant and will be unable to exist in a competitive market where the line has been blurred between jurisdictional offerings. Competitors will not be selling "local" service or "long distance"; they are and will be selling a bundled package of telephony along with cable, data and Internet services.

B. LEGAL PRINCIPLES

1. Federal and State Law

The Telecommunications Act of 1996 certainly understood the economics of the industry and sought efficient entry across a broad range of services.

- The Act promotes the deployment of advanced telecommunications services and information technologies and insists on a sharing of joint and common costs.

- The Act repeatedly recognizes that advanced services and basic service are

[22] "NYNEX Comments," before the Federal Communications Commission, In the Matter Of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, April 12, 1996, pp. 3, 4, 5.

[23] "Reply Comments of Teleport Communications Houston, Inc. and TCG Dallas Concerning Proposed Rules on Universal Service Fund Issues," before the Public Utility Commission of Texas, Investigation of Universal Service Issues, Project No. 14929, October 10, 1997.

linked.

- The Act recognizes that competitive and non-competitive services will be commingled on the network and its purpose is to advance this multi-product network.

The law directly addresses the revenue responsibility of these various services. The cross-subsidy and joint cost language of 47 USC 254 (k) addresses this point.

> Subsidy of Competitive Service Prohibited – A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.

This policy recognizes two distinct steps that are necessary to have fair and efficient pricing in an emerging, partially competitive environment -- a strict prohibition on below cost pricing and a reasonable recovery of joint and common costs across services that share facilities. The Conference Report states this principle more vigorously. The Conference Committee Report clarifies the standard for cost allocation by adopting the Senate report language --

> The Commission and the states are required to establish any necessary cost allocation rules, accounting safeguards, and other guidelines *to ensure that universal service bears no more than a reasonable share (and may bear less than a reasonable share)* of the joint and common facilities used to provide both competitive and noncompetitive services. [24]

In pursuit of universal basic service, this language establishes a reasonable share of joint and common costs allocated to basic service as an *upper* limit.

The FCC, the states, and the courts have found consistently and repeatedly that the loop

[24] Conference Report, p. 129, *emphasis added.*

is a common cost. The courts recognized this almost three quarters of a century ago in Smith v. Illinois.[25] Many of the states have formally recognized this in comments in federal proceedings,[26] and in their own cost dockets.[27]

[25] 282 U.S. 133 (1930).

[26] Two of the Regional Bell Operating Companies take this point of view (Bell Atlantic and NYNEX), as do a number of state regulators: the Texas Public Utility Commission, the Nebraska Public Service Commission, the New Hampshire Public Utilities Commission, the New Mexico State Corporation Commission, the Utah Public Service Commission, the Vermont Department of Public Service and Public Service Board, and the Public Service Commission of West Virginia. In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996 p. 18; "Comments of the State of Maine Public Utility Commission, the State of Montana Public Service Commission". Virtually all other Consumer Advocate commentors share this view in their initial comments. "Comments of the Idaho Public Service Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 17; "Comments of the Public Utility Commission of Texas" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. ii; "Initial Comments of the Pennsylvania Public Utility Commission to the Notice of Proposed Rulemaking and Order Establishing Joint Board" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 7.; Florida, p. 22; "Initial Comments of the Virginia Corporation Commission," In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 5; "Comments of the Staff of the Indiana Utility Regulatory Commission" In the Matter of Federal-State Joint Board on Universal Service, Before the Federal Communications Commission, FCC 96-93, CC Docket No. 96-45, April 12, 1996, p. 9.

[27] "Report of Glenn P. Richardson, Senior Hearing Examiner, Application of GTE South Incorporated For Revisions to Its Local Exchange, Access and IntraLATA Long Distance Rates, Commonwealth of Virginia State Corporation Commission, Case No. PUVC950019, March 14, 1997, p. 84; Application of the Mountain States Telephone and Telegraph Company dong Business as U.S. West Communications, Inc., for Approval of a Five-Year Plan for Rate and Service Regulation and for a Share Earnings Program, Colorado Public Utilities Commission, Docket Nos. 90a-665T, 96A-281T, 96S-257T, Decision No. C97-88, January 5, 1997, pp. 42-43; Decision and Order Rejecting Tariff Revisions, Washington Utilities and Transportation Commission v. U.S. West Communications Inc., Docket No. UT-950200, April 11, 1996 pp. 83-84; Department of Utility Controls' Investigation Into the Southern New England Telephone Company's Cost of Providing Service, Department of Public Utility Control, Docket No. 94-10-01, June 15, 1995, pp. 24-25; Report and Order, In Re: US West Communications, Inc., Utah Public Service Commission, Docket No. 95-049-05, November 6, 1995, p. 95; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-95-10, May 17, 1996, p. 295, 306; Final Decision and Order, In Re US West Communications Inc., Iowa Utilities Board, Docket No. RPU-94-1, November 21, 1994; In the Matter of the Application of GTE Southwest Incorporates and Contel of the West, Incorporated to Restructure Their Respective Rates, New Mexico State Corporation Commission, Docket NO. 94-291-TC, Phase II, December 27, 1995, pp. 11, 14-15; New England Telephone Generic Rate Structure Investigation, New Hampshire Public Utilities Commission, March 11, 1991, DR 89010, slip, op., pp. 39-40; Order No. 18598, Re: Investigation into Nontraffic-Sensitive Cost Recovery, Florida Public Service Commission, 1987; Docket No. 860984-TP, pp. 258, 265-266; Order No. U-15955, Ex Parte South Central Bell Telephone Company, Docket No. 1-00940035, Louisiana Public Service Commission, September 5, 1995, p. 12; In Re Formal Investigation to Examine and Establish Updated Universal Service Principles and Policies for Telecommunications Services in the Commonwealth, Docket No. 1-00940035, September

The failure to take legitimate joint and common costs into account would frustrate the purposes of the 1996 Act. Allowing incumbents to recover joint and common costs excessively from fixed charges on the bottom of the bill discourages efficiency and frustrates competition by allowing incumbents to price more competitive services at an artificially low level. Contrary to the basic premise of the 1996 Act, allowing incumbents to recover an unreasonable share of joint and common costs from basic service insulates incumbents unfairly from market forces.

In the residential sector alone, the CALLS proposal would transform over ten billion dollars of the cost of distribution facilities into a bottom-of-the-bill mandated federal payment to local exchange companies. Once these costs appear on the bottom of the bill, they tend to become institutionalized and are much less likely to be competed away. These line items become a floor that the industry starts with, rather than a cost to be attacked by competition.

2. The FCC's Conceptual Paradigm for Cost Recovery

In a series of recent rulings to implement the 1996 Telecom Act, the FCC has constructed a comprehensive paradigm that starts from the fundamentally correct premise that the loop is a shared cost. There should be no doubt that this is the correct treatment of loop costs and alternatives should be clearly and loudly rejected.

The FCC began in the local competition docket by recognizing that the loop is a shared cost of local, long distance and the other services that use the loop. As discussed above, separate telecommunications services are typically provided over shared network facilities, the cost of which may be joint or common with respect to some services.

5, 1995, p. 12; In the Matter of a Summary Investigation into IntraLATA Toll Access Compensation for Local Exchange Carriers Providing Telephone Services Within the State of Minnesota, Minnesota Public utilities

> The costs of local loops and their associated line cards in local switches, for example, are common with respect to interstate access service and local exchange service, because once these facilities are installed to provide one service they are able to provide the other at no additional cost.[28]

The FCC followed that decision with its proposed rulemaking on access charge reform, in which it reaffirmed the observation that the loop is a common cost.

> 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 service.[29]

The FCC applied this conclusion in its decision to convert the Common Carrier Line (CCL) charge into a flat rate charge to cover loop costs.

> We reject claims that a flat-rated, per line recovery mechanism assessed on IXCs would be inconsistent with section 254 (b) that requires equitable and nondiscriminatory contribution to universal service by all telecommunications providers. The PICC is not a universal service mechanism, but rather a flat-rated charge that recovers local loop costs in a cost causative manner.[30]

In the reform of the separations process, the FCC has stated the economic reasoning and analysis which underpins this treatment of the loop.

> Nearly all ILEC facilities and operations are used for multiple services. Some portion of costs nonetheless can be attributed to individual services in a manner reflecting cost causation. This is possible when one service, using capacity that would otherwise be used by another service, requires the construction of greater

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Commission, Docket No. P-999/CI-85-582, November 2, 1987, p. 33.

[28] Federal Communications Commission, First Report and Order: Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, ¶678.

[29] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: Notice of Proposed Rulemaking, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 237.

[30] Federal Communications Commission, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges: First Report and Order, CC Docket Nos. 96-262, 94-1, 91-213, 95-72, ¶ 104.

> capacity, making capacity cost *incremental* to the service. The service therefore bears a causal responsibility for part of the cost. The cost of some components in local switches, for example, is incremental (i.e. sensitive) to the levels of local and toll traffic engaging the switch. Most ILEC costs, however, cannot be attributed to individual services in this manner because in the case of joint and common costs, cost causation alone does not yield a unique allocation of such costs across those services. The primary reason is that shared facilities and operations are usually capable of providing at least one additional service at no additional cost. In such instances, the cost is *common* to the services. For example, the cost of a residential loop used to provide traditional telephony services usually is common to local, intrastate toll, and interstate toll services. In a typical residence, none of these services individually bears causal responsibility for loop costs because no service places sufficient demands on capacity to warrant installation of a second loop. Another reason why a relationship may not exist between cost and individual services is that some shared facilities or operations provide services in fixed proportion to each other, making the cost *joint* with respect to the services. ILEC billing costs, for example, tend to be joint with respect to local, state toll, and interstate toll services. For the majority of bills rendered, billed charges always include all three services. The fixed combination of services makes it impossible for one service to bear responsibility for billing costs...
>
> Both incremental cost and stand-alone cost (which are usually expressed per unit of output) are greatly affected by the way we choose to define the increment and the service class. The incremental cost of carrying an additional call from residences to end offices, for example, is zero if the residences are already connected to end offices, but the incremental cost of establishing such connections is the cost of the loops. [31]

Moreover, the importance of ensuring the correct loop allocation cannot be overemphasized. As the FCC notes, the proper identification of loop costs is critical to telecommunications pricing because loop costs constitute almost half of all costs of local exchange carriers.[32] For example, ARMIS data indicate that loop plant investment in 1996 was

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[31] Federal Communications Commission, In the Matter of Jurisdictional Separations Reform and Referral to the Federal-State Joint Board, Notice of Proposed Rulemaking, CC Docket No. 80-286, November 10, 1997 (hereafter, Separations NPRM), pp. 14-15.

[32] Separations NPRM, p. 16

49% of total plant investment.

Most importantly, the FCC's methodology for estimating costs of basic service for purposes of identifying high cost areas is consistent with its logic of properly allocating loop costs. Two of the ten criteria it establishes for specification of a cost model require similar treatment of joint and common costs:

> (2) Any network functionality or element, such as loop, switching, transport, or signaling, necessary to produce supported services must have an associated cost...
>
> (7) A reasonable allocation of joint and common costs must be assigned to the cost of supported services. This allocation will ensure that the forward-looking economic cost does not include an unreasonable share of joint and common costs for non-supported services.[33]

[33] FCC, Universal Service Order, ¶ 250.

V. OTHER ELEMENTS OF THE CALLS PROPOSAL RENDER IT ILLEGAL

A. ABSOLVING CARRIERS OF THEIR OBLIGATION TO MAKE A CONTRIBUTION TO UNIVERSAL SERVICE

The CALLS proposal would eliminate the clear requirement in the statute that carriers make a contribution to universal service. It shifts the entire cost of universal service onto end users. The federal statute makes no provision for the federal government to recover telecommunications service provider contributions for universal service from ratepayers in the form of a line item surcharge on ratepayers' bills. The federal statute is quite clear that it is telecommunications service providers who must contribute

> **Sec. 254.** (d) Telecommunications Carrier Contribution - Every telecommunications carrier that provides interstate telecommunications services shall contribute, on an equitable and nondiscriminatory basis... .
>
> **Sec. 254.** (f) STATE AUTHORITY - A state may adopt regulations not inconsistent with the Commissions rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute.

If subscribers are forced to pay a line item surcharge then telecommunications service providers are not contributing, as required by the Telecommunications Act of 1996. Federal case law has properly recognized that IXCs must bear responsibility for contributing as a cost of doing business. Claims that only a line item on a consumer's bill can meet the requirement that universal service is explicit is a thinly veiled effort to avoid the responsibility the law placed on telecommunications service providers. If a telecommunications service provider is assessed a contribution explicitly to be paid to a universal service fund administrator and pays no other

universal service support in any of the prices it is charged, then the funding is explicit. The law does not say funding must be explicit to the customer, it says it must be explicit to the service provider.

As long as all providers are assessed a fair share of the costs of universal service in an explicit rate element, the requirements of the statute will be met. Assessing providers allows them to decide how to recover the universal service costs. Some might pass it through in the form of usage charges. Some might pass it through in the form of customer charges. Still others might not pass it through in an effort to gain market share.

The FCC recognizes this dynamic process in an earlier ruling in this proceeding.

> As telecommunications carriers and providers begin merging telecommunications products into single offerings, for example package prices for local and long distance service, we anticipate that they will offer bundled services and new pricing options. Mandating recovery through end-user surcharges would eliminate carrier's pricing flexibility to the detriment of consumers...
>
> In addition, we agree with the state Joint Board members that an end-user surcharge is not necessary to ensure that contributions be explicit. We find that basing contributions on end-user telecommunications revenues satisfies the statutory requirement that support be explicit because carriers will know exactly how much they are contributing to the support mechanism...
>
> As competition intensifies in the markets for local and exchange services in the wake of the 1996 Act, it will likely lessen the ability of carriers and other providers of telecommunications to pass through to customers some or all of the former's contribution to the universal service mechanisms. If contributors, however, choose to pass through part of their contributions and to specify that fact on customer's bills, contributors must be careful to convey information in a manner that does not mislead by omitting important information that indicates that the contributors has chosen to pass through the contribution or part of the contribution to its customers and that accurately describes the nature of the charge.[34]

[34]FCC, Universal Service Order, paras. 853, 854, 855.

CALLSII creates a new surcharge on the bill to support an unsubstantiated $650 million universal service fund. The recovery of this cost is left to the discretion of the ILEC as a line item either on a per line or a percentage of bill basis.[35] The result is that half of the one year reduction in the SLC can be immediately taken back by the ILEC. By the second year, the SLC charge is higher than it would be today on a primary line.

If the Commission enters into the matter of recovering universal service funds through items on consumers' bills, either implicitly by approving AT&T's shift to a percentage of bill basis or explicitly by putting a new item on the bill for ILEC USF cost recovery, it must come to terms with the question of how telecommunications service providers are making their contribution to universal service.

Unfairly shifting the burden of USF recovery to customers, violates the principles of the Act. Joint Commentors wholeheartedly reject imposing new surcharges on customers' bills while at the same time increasing customers' net bills.

B. DEAVERAGING AND DISCRIMINATORY PRICING WILL MAKE MATTERS WORSE, NOT BETTER

The CALLS proposals contemplate the deaveraging of rates for the new combined SLC/PICC. The Commission has not discussed to what extent differential SLCs are in conflict with the requirement that rates be reasonably comparable between rural and urban areas. Deaveraged rates must be found to be reasonably comparable.

[35] Modified Proposal, p. 1.

The CALLS proposal to deaverage rates is inconsistent with actual market practices and social policy as embodied in the Act of 1996, and is unnecessary if the Commission reforms the SLC in the proper fashion.

The notion that every product is sold at some deaveraged price in the market is simply wrong. Many goods are sold at uniform prices in spite of significant variations in cost. The result is not a subsidy, but a differential mark-up. Any effort by the Commission to deaverage prices will result in massive administrative exercises that companies in competitive markets do not undertake.

Moreover, to the extent that there is a substantial problem of cost difference between areas, there are other policy mechanisms to address this problem. Deaveraging SLC costs would complicate the calculation of necessary subsidies. It would complicate and perhaps violate the Congressional intention to ensure that rates be reasonably comparable between rural and urban areas. It would certainly make it more difficult for long distance companies to maintain geographically averaged rates, as required by section 254 (g) of the Act of 1996.

Joint Consumer Commentors have strenuously rejected the related suggestion that incumbent LECs be allowed to differentially price before all market segments served from common facilities are fully competitive. Incumbents will certainly use their market power to maximize their profit and competitive position. Residential ratepayers who are certain to be the last group offered competitive alternatives will suffer the greatest loss. Moreover, because access is an intermediate good, not an end product, the exercise of market power through differential pricing will significantly hurt competition.

Texas OPC took this view in the Local Competition proceeding in presenting its critique of Ramsey pricing.

> In no event should the Commission adopt Ramsey pricing as a cost allocation scheme. Ramsey pricing has positive welfare properties only under a very stringent set of assumptions. More importantly, the products should be final products not intermediate goods. Because interconnection services and network elements are intermediate goods, Ramsey pricing may well have negative welfare effects. Indeed, given the critical importance of interconnection services and network elements in the competitive strife between new and incumbent LECs, it is likely that a Ramsey pricing (cost allocation) scheme would weight the balance in favor of incumbent LECs, thus hampering rather than furthering the development of local exchange competition.[36]

Differential pricing in a market that is subject to inconsistent levels of competition should be rejected.

Ultimately, if the Commission does away with the SLC altogether, and guarantees a pass through to consumers of this immediate benefit, it will not have to deal with the problem of deaveraging the SLC.

C. RECONCILING REGULATORY AND FINANCIAL BOOKS

In yet another *Ex parte*,[37] the LECs propose to amortize the difference between the asset accounts on their regulatory books and the asset accounts on their financial books. The LECs commit to not seeking rate increases as a result of the charges against income that they will take over a five year period. We believe that there is no legitimate claim to these

[36] OPC Comments, In the Matter of Implementation of Local Competition Provisions in the Telecommunications Act of 1996, Docket No. 96-98 (May 16, 1996) p. 27.

[37] *Ex Parte to Lawrence Strickling,* from CALLS coalition, March 3, 2000.

recovery of these costs, which have long been written off of their financial books. In our view, the excessive rate of return earned by the LECs has more than compensated them for the occasional write-off of assets that all companies take. We have consistently argued this in the earlier rounds of the docketed proceeding.[38] We believe that consumer should be given rate reductions as a result of the reconciliation of these books and that is precisely what we intend to argue in the rate proceeding that must inevitably take place after the CALLS plan expires.

In the mean time, it is critical for the Commission to ensure that the bizarre treatment of these costs have no impact on access charges, UNE rates or USF distribution. In addition to the fact that access charges should not be increased as a result of the reconciliation of books, to which the LECs have agreed, the Commission's order in this proceeding must also ensure that UNE rates and USF distributions, both of which are based on forward looking economic costs, are not increased. The Commission has set its forward looking costs study on the basis of an internally consistent set of assumptions that are independent of the treatment of the historic, embedded costs at issue in the depreciation decision. The model cannot be changed on the basis of an effort to reconcile a discrepancy between regulated and financial books, which are not based on forward looking economic costs.

Furthermore, any proceeding to deal with depreciation charges must be open to public scrutiny.

[38] See, for example, "Reply Comments of The Texas Office of Public Utility Counsel," "Reply Comments of the American Association of Retired Persons, Consumer Federation of America, and Consumers Union, *In the Matter of Federal-State Joint Board on Universal Service*, FCC 96-93, CC Docket NO. 96-45, May 7, 19996.

D. OTHER PROMISES

The CALLS materials distributed with this proposal and the Chairman's comments indicate that a variety of promises have been made about IXC pricing policies. In the past, the Commission has declined to exercise authority over these decisions. Because they appear to be the political foundation for CALLS II and III, the question arises as to whether the Commission will write the promises into its rule, or simply rely on the self serving statements of businesses who are ethically bound to their shareholders' best interests. In either case, legitimate questions arise about whether the promises will be binding or broken the week after the election.

We believe that any promise worthy of consideration as public policy must carry the same accountability and enforceability as Commission regulatory decisions. Therefore, any promise to eliminate minimum monthly charges for the residential basic long distance schedule, preserve reasonable prices for this schedule, or promise to flow through access charge reductions to ratepayer can only be meaningful if the Commission makes such commitments part of its final in this proceeding enforceable like all other regulatory requirements. Based on past experience with "flow-through" promises that have not proven enforceable, we believe the Commission must develop a monitoring and enforcement mechanism designed to ensure that residential and business ratepayers each receive their fair share of access charge reductions.

VI. CONCLUSION

Joint Consumer Commentors urge the Commission to use these proceedings to give verifiable, cost justified savings to consumers who are already paying over $2.5 billion per year in net bill increases since the beginning of the FCC's restructuring. Access charge reductions, in and of themselves, have not benefited the vast majority of consumers.[39] Reform in the guise of higher bottom of the bill charges should certainly be rejected. The FCC is facing a great opportunity to keep the faith with consumers and realize the promises of the Telecommunications Act of 1996. We urge the Commission to write an Order that gives real, rather than illusory, savings to consumers based on sound economic, legal and public policy principles.

[39] *See*, Initial and Reply Comments of TxOPC, CFA, and CU, *In the Matter of Low Volume Long Distance Users*, FCC CC Docket No. 99-249.

STATE OF MARYLAND §
§
COUNTY OF MONTGOMERY §

AFFIDAVIT

DECLARATION OF DR. MARK N. COOPER

I, Mark N. Cooper, on my oath do hereby depose, swear and state as follows:

1. My name is Mark N. Cooper. I am President of Citizens Research. I am also Director of Research of the Consumer Federation of America (CFA). Prior to founding Citizens Research in 1983, a consulting firm specializing in economic, regulatory and policy analysis, I spent four years as Director of Research at the Consumer Energy Council of America. Prior to that I was an Assistant Professor at Northeastern University teaching courses in Business and Society in the College of Arts and Sciences and the School of Business. I have also been a Lecturer at the Washington College of Law of the American University co-teaching a course in Public Utility Regulation.

2. I have testified on various aspects of telephone and electricity rate making before the public utility commissions of 29 states, the District of Columbia, and Manitoba as well as the Federal Communications Commission (FCC), the Canadian Radio-Television and Telephone Commission (CRTC) and a number of state legislatures.

3. For a decade and a half I have specialized in analyzing regulatory reform and market structure issues in a variety of industries including telecommunications, railroads, airlines, natural gas, electricity, medical services and cable television. This includes approximately 300 pieces of testimony presented to state regulatory bodies, federal legislative bodies, and federal administrative bodies.

4. I have written several major works on universal service and the impact of rising prices for utilities on consumer in general and low income households in particular. These include *Equity and Energy: Rising Energy Prices and the Living Standards of Lower Income Americans* (Westview Press: Boulder, 1982), "protecting the Public Interest in the Transition of Competition

in Network Industries," *The Electric Utility Industry in Transition* (Public Utilities Reports, Inc., 1994); *Universal Service: A Historical Perspective and Policies for the Twenty-First Century* (Benton Foundation and the Consumer Federation of America, 1996).

5. I have participated in each of the dockets cited in the caption to this Notice of Proposed Rulemaking.[40] The notice is in response to a proposal from a coalition (Coalition for Affordable Local and Long Distance Service, "CALLS") made up entirely of telecommunications companies. It would radically alter the Commission's approach to access charges and harm the majority of residential consumers.[41]

6. The purpose of this affidavit is to outline the legal and economic problems underlying the CALLS proposal. To that end, I hereby swear and affirm that the information contained in these comments, including the exhibits and attachments is true and correct to the best of my information and belief.

[40] Federal Communications Commission, Notice of Proposed Rulemaking, Access Charge Reform, CC Docket No. 96-262, Price Cap Performance Review for local Exchange Carriers, CC Docket No. 94-1, Low Volume Long Distance Users, CC Docket No. 99-249 In the Matter of Federal-State Joint Board on Universal Service:, CC Docket No. 96-45 (September 15, 1999).

[41] *Universal Service and Access Reform Proposal*, Coalition for Affordable Local and Long-Distance Service. For purposes of these comments, we refer to the rate proposal itself and Proposal. We refer to the justification offered as CALLS.

Further, the affiant sayeth not.

_____

Mark. N. Cooper

SUBSCRIBED and sworn to before me this _____day of April, 2000

_____

Notary Public, State of _____

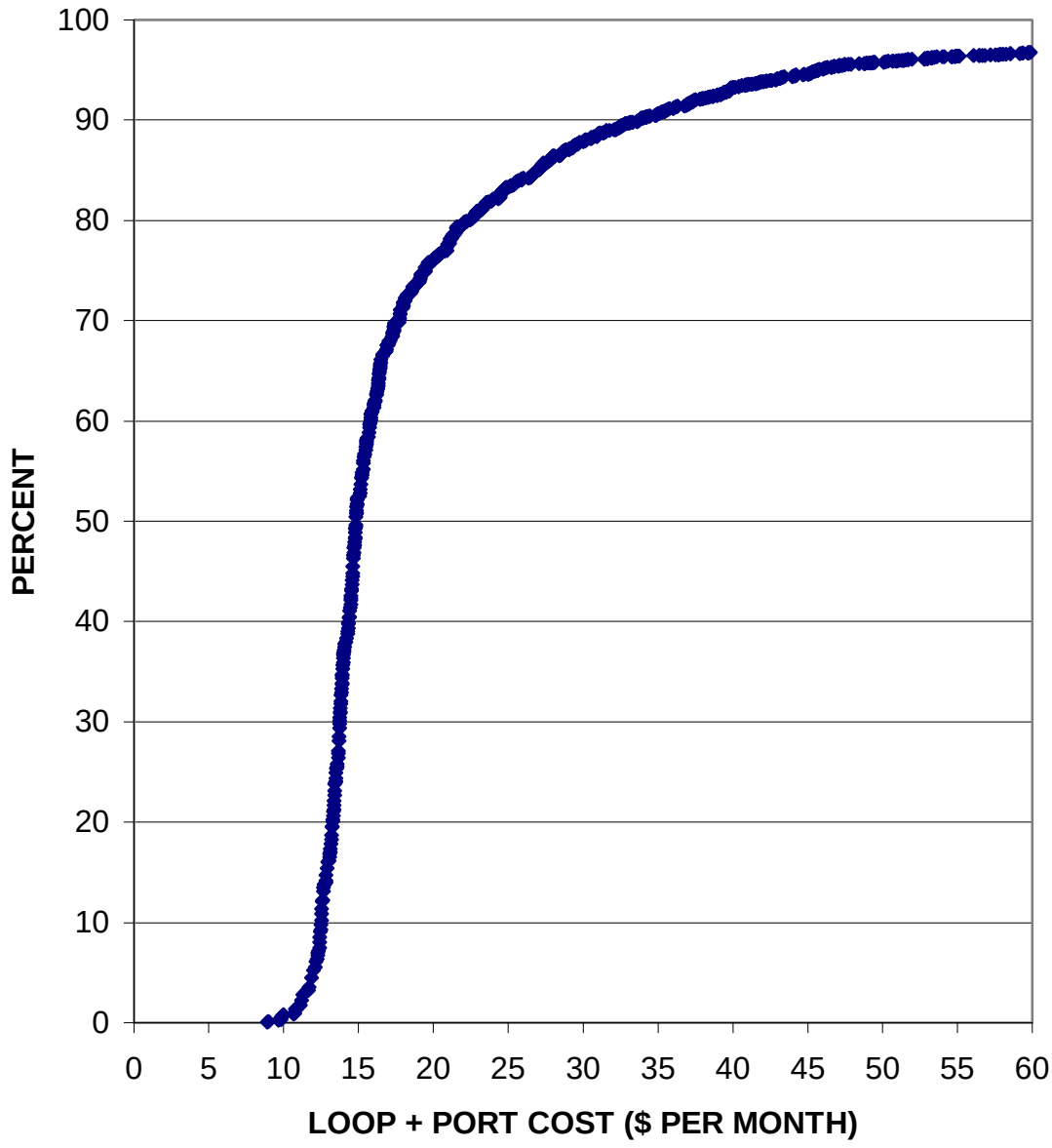
Exhibits

EXHIBIT 1
ESTIMATION OF OVERRECOVERY OF COSTS FOR LOOP AND PORT:
EMBEDDED COSTS COMPARED TO FORWARD LOOKING COSTS

	COST ESTIMATES							EFFICIENCY GAINS					
STATE	EMBED	FCC		BCM		FCC		HTFLD	"1995"		"1998"		FCC
		BCPM	HAT	ARMIS	HTFLD	SPCM		"5.0"	LOW	HIGH	LOW	HIGH	SPCM
AL	36.38	30.98	29.31	26.46	19.19	28.86		26.06	9.92	17.19	5.40	10.32	7.52
AR	43.48	34.48	28.08	33.56	24.34	26.95		24.93	9.92	19.14	9.00	18.55	16.53
AZ	31.18	27.49	21.33	21.26	15.41	17.94		17.22	9.92	15.77	3.69	13.96	13.24
CA	27.97	20.26	18.18	18.05	13.09	15.60		13.65	9.92	14.88	7.71	14.32	12.37
CO	35.72	27.82	24.33	25.80	18.71	20.40		19.93	9.92	17.01	7.90	15.79	15.32
DC	21.11	16.62	13.35	11.19	8.11	11.65		11.77	9.92	13.00	4.49	9.34	9.46
DE	31.85	24.61	21.37	21.93	15.90	18.96		17.92	9.92	15.95	7.24	13.93	12.89
FL	30.32	23.60	19.09	20.40	14.79	17.12		15.34	9.92	15.53	6.72	14.98	13.20
GA	37.41	26.83	23.24	27.49	19.93	21.36		19.94	9.92	17.48	10.58	17.47	16.05
IA	41.50	29.31	23.37	31.58	22.90	21.04		18.72	9.92	18.60	12.19	22.78	20.46
ID	50.86	32.68	27.60	40.94	29.69	25.25		22.38	9.92	21.17	18.18	28.48	25.61
IL	30.65	22.44	19.58	20.73	15.03	15.67		14.85	9.92	15.62	8.21	15.80	14.98
IN	30.50	25.88	20.65	20.58	14.93	20.53		17.76	9.92	15.57	4.62	12.74	9.97
KS	42.93	31.28	25.38	33.01	23.94	22.86		22.58	9.92	18.99	11.65	20.35	20.07
KY	35.37	31.25	29.73	25.45	18.46	29.45		24.12	9.92	16.91	4.12	11.25	5.92
LA	36.37	29.12	25.68	26.45	19.18	24.11		21.94	9.92	17.19	7.25	14.43	12.26
MA	23.04	22.09	20.01	13.12	9.52	16.23		15.82	9.92	13.52	0.95	7.22	6.81
MD	28.48	23.35	21.08	18.56	13.46	17.88		17.29	9.92	15.02	5.13	11.19	10.60
ME	44.16	32.06	31.36	34.24	24.83	29.40		27.66	9.92	19.33	12.10	16.50	14.76
MI	32.87	25.09	20.69	22.95	16.64	19.10		16.86	9.92	16.23	7.78	16.01	13.77
MN	39.36	26.23	22.99	29.46	21.36	20.53		20.13	9.90	18.00	13.13	19.23	18.83
MO	38.35	27.07	23.56	28.43	20.61	21.38		20.39	9.92	17.74	11.28	17.96	16.97
MS	41.96	39.10	38.61	32.04	23.24	38.34		34.22	9.92	18.72	2.86	7.74	3.62
MT	64.50	42.39	32.29	54.58	39.58	29.95		26.55	9.92	24.92	22.11	37.95	34.55
NC	37.24	26.84	23.28	27.32	19.81	21.47		20.53	9.92	17.43	10.40	16.71	15.77
ND	60.52	35.79	28.92	50.60	36.69	24.37		25.07	9.92	23.83	24.73	35.45	36.15
NE	46.45	31.18	31.39	36.53	26.49	25.19		29.69	9.92	19.96	15.27	16.76	21.26
NH	38.23	28.08	26.41	28.31	20.53	23.61		22.74	9.92	17.70	10.15	15.49	14.62
NJ	26.78	20.14	18.36	16.86	12.23	14.99		13.88	9.92	14.55	6.64	12.90	11.79
NM	44.59	31.85	27.40	34.67	25.14	23.55		22.82	9.92	19.45	12.74	21.77	21.04
NV	39.09	32.48	31.81	29.17	21.15	23.74		26.48	9.92	17.94	6.61	12.61	15.35
NY	26.50	21.74	19.64	16.58	12.02	16.03		11.69	9.92	14.48	4.76	14.81	10.47
OH	31.32	24.03	19.41	21.40	15.20	17.58		15.90	9.92	16.12	7.29	15.42	13.74
OK	36.51	31.41	27.90	26.59	19.28	24.69		24.46	9.92	17.23	5.10	12.05	11.82
OR	37.91	27.35	23.94	27.99	20.29	19.87		19.27	9.92	17.62	10.56	18.64	18.04
PA	30.16	23.57	21.16	20.24	14.67	17.61		16.86	9.92	15.49	6.59	13.30	12.55
RI	27.59	24.12	20.25	17.67	12.82	17.22		15.75	9.92	14.77	3.47	11.84	10.37

SC	38.47	29.31	25.54	28.55	20.70	24.66		22.09	9.92	17.77	9.16	16.38	13.81
SD	60.94	38.97	32.06	51.52	37.00	27.30		27.39	9.42	23.94	21.97	33.55	33.64
TN	37.19	38.80	26.34	27.27	19.77	24.96		22.48	9.92	17.42	-1.61	14.71	12.23
TX	35.06	26.15	21.39	25.14	18.23	19.07		17.78	9.92	16.83	8.91	17.28	15.99
UT	37.93	25.72	22.04	28.01	20.31	18.55		17.68	9.92	17.62	12.21	20.25	19.38
VA	29.77	24.98	21.74	19.85	14.39	19.17		18.64	9.92	15.38	4.79	11.13	10.60
VT	45.94	33.91	33.34	36.02	26.12	31.47		29.62	9.92	19.82	12.03	16.32	14.47
WA	33.40	25.32	21.35	24.48	17.02	18.33		17.15	8.92	16.38	8.08	16.25	15.07
WI	37.10	24.29	19.05	27.18	19.71	18.75		15.50	9.92	17.39	12.81	21.60	18.35
WV	41.36	36.39	32.51	31.44	22.80	34.03		33.23	9.92	18.56	4.97	8.13	7.33
WY	58.06	45.87	39.30	48.14	34.91	33.55		33.41	9.92	23.15	12.19	24.65	24.51
AVG.	32.71	25.37	21.89	22.81	16.51	19.27		17.66	9.90	16.19	7.34	15.05	13.44

EXHIBIT 2:
TEXAS,
CUMULATIVE PERCENTAGE OF LINES
BY LOOP + PORT COST
(BASED ON WIRE CENTER ANALYSIS)



Source: FCC, SPCM.

EXHIBIT 3
ESTIMATES OF COST AND COST RECOVERY

STATE	FORWARD LOOKING LOOP + PORT COST (STATE AVERAGE)	PERCENT OF LOOPS COVERING FEDERAL COSTS AT $5.50
TX	$18.22	81%
CA	14.84	94
NY	14.92	91
UT	16.83	90
IL	17.28	87
AZ	15.67	92
MD	16.55	86
FLA	16.67	91
PA	17.17	80
CO	17.70	84
WA	17.89	88
GA	19.99	77
MI	20.16	75
KS	19.82	76
IN	22.55	72
ID	24.17	65
MO	24.32	71
AR	25.93	58
WY	31.03	41

SOURCE: Federal Communication s Commission, *Synthesis Proxy Cost Model*

EXHIBIT 4

ESTIMATED ACCESS COST RECOVERY FOR THE
TEXAS RESIDENTIAL MARKET PROJECTED FOR 2000

	(1) PROPORTION OF LINES	(2) UNIT COST PER LINE	(3=1x2) WEIGTHED COST
SUBSCRIBER LINE CHARGE			
	(a)	(b)	
First Line	1.0	$3.50	$3.50
Second Line	.24	6.07	1.47
Average Per line	1.0		$4.97
PICC			
Average Per Line			$.75
FIXED CHARGES PER LINE			$5.72
USAGE CHARGES			
CCL (100 Minutes @.002/Minute)			.20
Other "subsidies"			.21
TOTAL			$6.13

(a) Derived from Federal Communications Commission, Trends in Telephone Service, February 1999, Table 20.4, as described in text.

(b) Trends, Table 1.2.

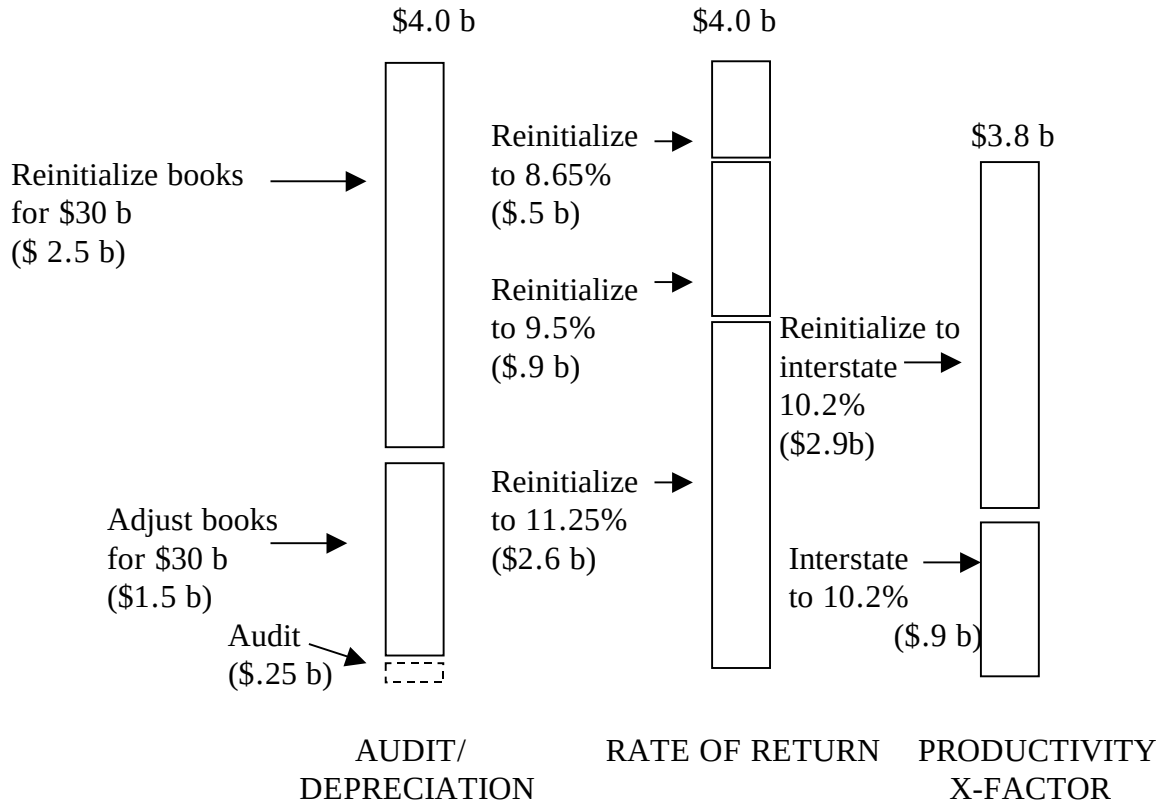
(c) Trends, Table 1.2, adjusted for July 1, 1999 increases.

EXHIBIT 5

USE OF FORWARD LOOKING ECONOMIC COST, AS RECENTLY APPLIED FOR HIGH COST SUPPORT AND STATE UNBUNDLED NETWORK ELEMENT RATES REQUIRES REDUCTION OF LOOP COST RECOVERY IN THE FEDERAL JURISDICTION

	BELL RATES/COST		ALL COMPANIES FCC-SPCM	
	FCC-SPCM 96 SUPPORT	PUC-UNE RATES	FCC-96	2004 ESTIMATED
NATIONAL AVG.			20.14 →	17.00
TEXAS				
Highest Density Zone		16.35		
Middle " "		17.86		
Lowest " "		23.19		
Statewide	19.07	18.36	21.38 →	18.38
DELAWARE				
Zone 1		12.95		
Zone 2		16.01		
Zone 3		19.55		
Statewide	18.96	NA	18.96 →	15.96
VIRGINIA				
Zone 1		12.04		
Zone 2		17.75		
Zone 3		30.78		
Statewide	19.17	NA	22.92 →	19.92

EXHIBIT 6
OVER-RECOVERY OF COSTS IN THE FEDERAL JURISDICTION
(Incremental, New Money)



ATTACHMENT 1

CONSUMER GROUP PROPOSAL TO RESTRUCTURE FEDERAL COST RECOVERY AND SETTLE OUTSTANDING ACCESS CHARGE ISSUES

Supported By

TEXAS OFFICE OF PUBLIC UTILITY COUNSEL, CONSUMER FEDERATION OF AMERICA, CONSUMERS UNION, NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES, AARP, NATIONAL RETAIL FEDERATION, INTERNATIONAL COMMUNICATIONS ASSOCIATION

January 31, 2000

INTRODUCTION: COMPROMISE CONSUMER RESPONSE TO THE CALLS PLAN

The following plan has been endorsed by a number of consumer groups and should be incorporated into the Coalition for Affordable Local and Long Distance Services (CALLS) petition before the Federal Communications Commission (FCC) so that consumer benefit, currently absent from the proposal, may be realized.

The undersigned groups have been concerned from the outset that CALLS provides no tangible benefits for consumers. We are confident that this compromise proposal will bring immediate benefits to consumers via reductions in the cost of telephone service. These reductions in the cost of service will appear on a consumer's bill from the outset regardless of long distance usage. The plan we outline would allow consumers to reap several billion dollars in benefits.

Recognizing that the manner in which revenues are collected in the federal jurisdiction is of utmost importance to the proponents of the CALLS proposal, we have tried to devise a methodology that will enable costs to be recovered without unduly discriminating against any class of customers (residential or business) or segment of the industry (local exchange companies or the long distance carriers). In doing so, the undersigned groups have offered relief to the carriers in many of the areas that precipitated the initiation of the CALLS petition.

On the other hand, the consumer proposal requires the two segments of the industry to each shoulder part of this financial responsibility. Business and residential customers get the same reductions in their fixed charges, under the consumer proposal. Fixed charges and usage charges are reduced equally.

CONSUMER COMPROMISE PLAN ELEMENTS

Business-as-usual (BAU) assumptions produce reductions in cost recovery in the Federal jurisdiction of over $5 billion over five years. Therefore, we are addressing only changes in timing and "new" moneys needed to affect a compromise that restructures federal cost recovery.

CONSUMERS GET UP FRONT BENEFIT

1. SUBSCRIBER LINE CHARGE (SLC) $2.0 billion
Reduce all SLCs by $1.00/mo.

2. PRIMARY INTEREXCHANGE CARRIER CHARGE (PICC) 1.8
Remove all PICCs entirely from consumers' bills.
(IXCs responsible for $.50 payment).

3. SPECIAL ACCESS .2

Total Reductions in ILEC Revenue before 7/1/00 (next BAU change) 4.0

IXC'S GET

4. SWITCHED ACCESS
Lower Switched Access to $.0055 over 4 years.
(This is funded by the continued use of the X-Factor).

5. PICC
Reduced to $.50.

6. NO IMMEDIATE INCREASE IN UNIVERAL SERVICE FUND COLLECTIONS
No new universal service charge of $650 million.

ILECS GET

7. PRODUCTIVITY FACTOR

Keep the X-factor at 6.5% and use reductions to move switching rates to $.0055. When switching rates equal $.0055, the productivity factor is eliminated. At the end of the transition period, switching rates, SLC and PICC charges are capped at then current levels and presumed to be just and reasonable by the operation of market forces. Parties may seek to change the cap but bear the burden of making two showings: (1) demonstration of market failure and (2) economic cost model adopted by FCC supports the requested change. Movant has the burden of proof.

8. AUDIT:

The audit is settled with no further actions required other than the implementation of the reductions and productivity factor discussed above.

BACK UP CALCULATION AND COMPARISONS OF THE ENDPOINT OF RESTRUCTURING OF COST RECOVERY IN THE FEDERAL JURISDICTION.

The up front reduction of charges in the consumer plan comes before, but within the business-as-usual assumptions. Thus, two factors will be at work in restructuring the cost recovery in the federal jurisdiction. It is important to keep the two separate and to understand how they interact to produce the end point that is desired (see Exhibit 1). It is also important to keep the short term, up front reductions and long-term final rate structure in view. The interactions between these effects are important to recognize.

For example, under the current rules, there will be a total reduction of $5.37 billion. Although the consumer proposal makes a $4 billion reduction up front, the total reduction is not $9.37 billion because the productivity factor in the out years is applied to a smaller base. The total reduction necessary to restructure cost recovery in the federal jurisdiction is equal to a total of $7.78 billion. Therefore, the consumer plan requires just under $2.5 billion in new reductions in cost recovery above the base case.

Exhibit 1 shows the recovery of costs in the four categories the consumer proposal affects. The numbers for current rules and CALLS were presented by MCI to the Commission. They are a true representation of the CALLS assumptions. The CALLS Coalition appears to be backing off of its own assumptions since this analysis shows that the CALLS proposal is not revenue neutral; it is obvious that all else equal, CALLS cannot be revenue neutral since it lowers the productivity factor and therefore foregoes rate reductions.

In addition to the up front reductions, there is one other substantial difference between the consumer approach and the CALLS approach. This analysis focuses only on the interstate revenues and does not include any changes in universal service fund payments. In particular, the consumer proposal moves switched access to $.0055 per minute without creating a new universal fund (arbitrarily set at $650 million by CALLS). To the extent that such an accounting item (i.e. implicit subsidy) is necessary, it should be accounted for in settling the audit. We recognize that universal service funds for high cost support will be necessary, but CALLS did not address this issue.

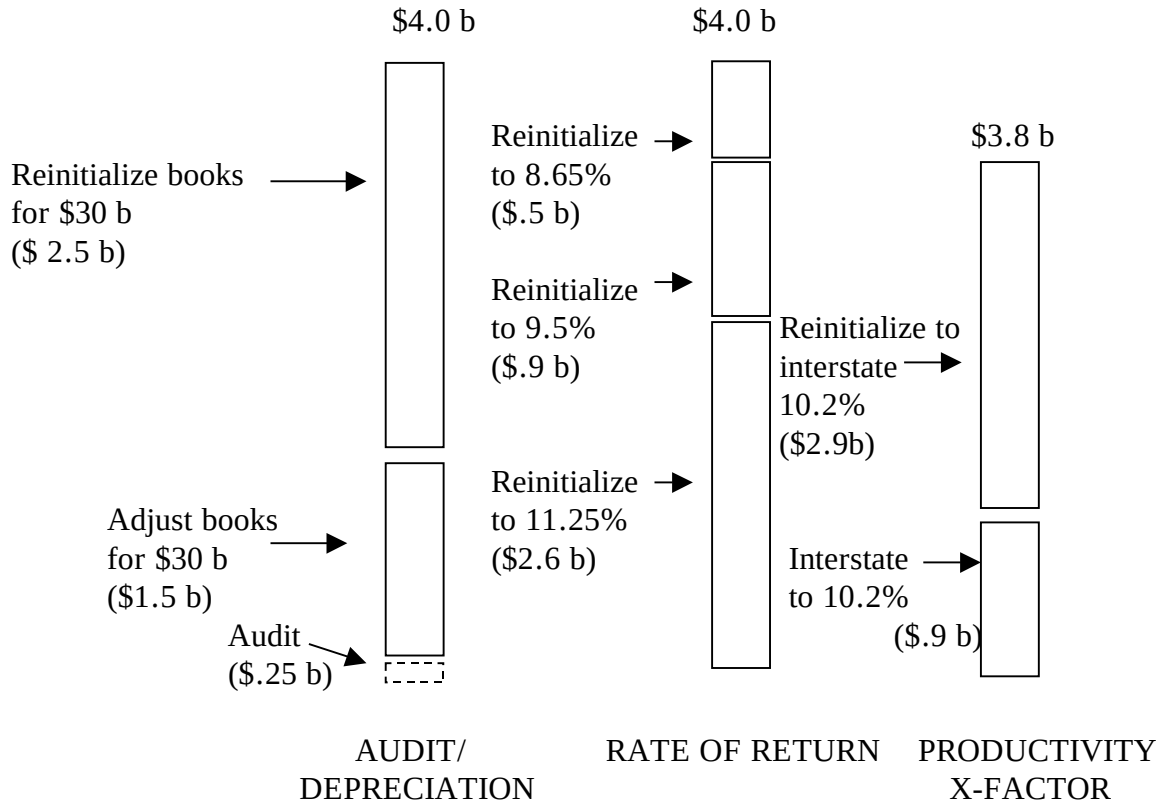
EXHIBIT 1
COMPARISON OF CURRENT RULES, CALLS AND CONSUMER ALTERNATIVE
(Aggregate Collection from all Consumers in $ Billions)

	7/1/99		7/1/00	7/1/04	DIFFERENCE 7/1/99-7/1/04
CURRENT RULES					
PICC	2.83		2.66	1.52	-1.31
SLC	9.28		9.32	8.37	- .91
SPECIAL	5.28		5.28	4.06	-1.22
SWITCHED	5.96		5.20	4.03	-1.93
TOTAL	23.35		22.46	17.98	-5.37
CALLS					
PICC	2.83		.53	.03	-2.80
SLC	9.28		12.44	13.06	+3.78
SPECIAL	5.28		5.13	5.13	- .15
SWITCHED	5.96		3.74	3.20	-2.76
TOTAL	23.35		21.84	21.42	-1.93
CONSUMER	UP FRONT REDUCTION ↓				
PICC	2.83	-1.80	1.03	1.03	-1.80
SLC	9.28	-2.00	7.28	7.28	-2.00
SPECIAL	5.28	- .20	5.08	4.06	-1.22
SWITCHED	5.96		5.20	3.20	-2.76
TOTAL	23.35		18.59	15.54	-7.78

OVER RECOVERY OF COSTS IN THE FEDERAL JURISDICTION IDENTIFIED IN ONGOING PROCEEDINGS

Year-after-year, when the local exchange companies report their earnings in the Federal jurisdiction, they are far above the targeted level. As demonstrated in several proceedings at the FCC, this over recovery arises because the Commission has not established sufficiently productivity goals or held the local company books up to rigorous scrutiny (see Exhibit 2). The reform of rates under the consumer plan is funded by eliminating the over recovery of costs in the Federal jurisdiction.

EXHIBIT 2
OVER RECOVERY OF COSTS IN THE FEDERAL JURISDICTION
(Incremental, New Money)



The audit has found phantom assets and the FCC has noted that the RBOCs report far more assets to regulators than they carry on their financial books. This raises cost recovery far in excess of where it should be. For example, the audit yielded a discrepancy of $5 billion, which would generate cost recovery reductions of about $.25 billion in the federal jurisdiction. Reconciling the depreciation discrepancy between financial and regulatory books would increase the total reductions in cost recovery dramatically -- some $1.5 billion. Reinitializing rates would result in another $2.5 billion reduction.

The FCC uses a company-wide productivity factor, rather than an interstate specific productivity factor. As a result, productivity growth is vastly understated. Each year, when rates are adjusted, they are under corrected and the over earnings reappear. Using an interstate productivity factor, based on the FCC methodology, would raise the productivity factor to 10.2%, resulting in reductions of $.9 billion in cost recovery. Reinitializing the rates for underestimated productivity in the past 3 years would reduce costs recovery by another $2.9

billion.

The FCC uses a return on investment of 11.25 percent. Just getting the local exchange companies back to that level would lower cost recovery by $2.6 billion. Lowering the return to more reasonable levels would yield even larger reductions of cost recovery.

Some of the reductions identified in Exhibit 2 interact, so one cannot simply sum them to a grand total. However, the proposed reduction needed to "pay for" the restructuring is $4 billion in the first year, which could be easily accounted for by aggressive reductions in one category or moderate use of all three.

Although the FCC has routinely used any scheduled reductions in cost recovery to lower the switching rates, all of these sources of over recovery of costs apply to both loop costs and switching costs. A major source of the discrepancy between the regulated books and the financial books stems from the write off of loop costs. Loop costs have been falling because of the adoption of digital line carrier technology. Average loop costs have also been falling because of the growth of second lines, which are far lower in cost than first lines. The FCC's forward-looking cost methodology concludes that efficient loop costs would be far lower than claimed embedded loop costs.

The consumer proposal splits the reductions equally between fixed charges (PICC +SLC = $3.80 billion) and access (switched + special = $3.94).

ANALYSIS OF FORWARD LOOKING COSTS AND RATES FOR UNBUNDLED NETWORK ELEMENTS DEMONSTRATES THAT THE CONSUMER PROPOSAL IS JUST AND REASONABLE

Not only does the consumer proposal fit squarely within the regulatory cost recovery proceedings at the FCC, it is also consistent with the economic policy that the commission has set, as CFA, CU and TXOPC stated in their comments in response to the CALLS proposal. Forward-looking economic costs require a reduction of recovery of loop costs in the federal jurisdiction.

The FCC has recently used its Synthesis Proxy Cost Model (SPCM) to calculate the high cost payments for large LECs. States have begun using forward-looking economic costs to set Unbundled Network Element rates. CALLS defines the reductions in switching costs as movement to forward looking economic levels. A few examples of how these numbers compare are provided below.

As noted in the TXOPC, CFA, CU comments, we must also look forward a bit. That is, the growth of second lines is dramatically lowering costs. In part, this is why there is this

constant over recovery of costs in the Federal jurisdiction. Since CALLS points to 2004 as the end point, the result must be reasonable at that point in time.

National average forward looking costs are just over $20.00 based on 1996 numbers (see Exhibit 3). TXOPC, CFA, CU have demonstrated that the growth of second lines has likely already driven costs down by $1.00 to $1.50 due to the growth of second lines. They will certainly fall another $1.50 by 2004. Thus, by 2004, national average loop costs should be in the neighborhood of $17 per month.

EXHIBIT 3

USE OF FORWARD LOOKING ECONOMIC COST, AS RECENTLY APPLIED FOR HIGH COST SUPPORT AND STATE UNBUNDLED NETWORK ELEMENT RATES REQUIRES REDUCTION OF LOOP COST RECOVERY IN THE FEDERAL JURISDICTION

	BELL RATES/COST		ALL COMPANIES FCC-SPCM	
	FCC-SPCM 96 SUPPORT	PUC-UNE RATES	FCC-96	2004 ESTIMATED
NATIONAL AVG.			20.14 →	17.00
TEXAS				
Highest Density Zone		16.35		
Middle " "		17.86		
Lowest " "		23.19		
Statewide	19.07	18.36	21.38 →	18.38
DELAWARE				
Zone 1		12.95		
Zone 2		16.01		
Zone 3		19.55		
Statewide	18.96	NA	18.96 →	15.96
VIRGINIA				
Zone 1		12.04		
Zone 2		17.75		
Zone 3		30.78		
Statewide	19.17	NA	22.92 →	19.92

Although Unbundled Network Element (UNE) rates are not available on a national average basis, examination of these rates on a state-by-state basis indicate that they have been set in the same range as the cost estimates generated by the SPCM. A few examples demonstrate the point.

UNE rates in Texas are $18.36 for Southwestern Bell Telephone Company (SWBT). Forward-looking costs in Texas are $19.07 for SWBT. The statewide average for all loops

in Texas (for all companies covered in the FCC support analysis) is $21.38. With second line growth this number would fall into the range of $15 to $18.

We obtain similar results for Virginia and Delaware for UNEs. In comments in this proceeding TXOPC, CFA, CU demonstrated similar outcomes for other states with the SPCM results.

The consumer proposal would envision cost recovery for loop in the year 2004 that is generally described in Exhibit 4. Our proposal supports national average loop costs without implicit subsidies, in the range of $20, assuming that the federal share of costs is 25 percent of the loop. This is consistent with the forward-looking costs used by the FCC and the UNE rates adopted by the states.

- Our proposal, which supports loop costs up to $20, actually leaves a little money on the table, since we believe that national average loop costs will be down to $17 by then. CALLS, on the other hand, drives up the costs supported by federal charges to almost $25. CALLS claims a national average SLC of $6.15, which supports total costs of $24.60. It adds in a universal service fund of $650 million (equal to about $.32). Thus, by the time CALLS is through, the institutionalized over recovery of cost will be 50 percent (~ $25/$17= 1.47).

CONCLUSION

Implementation of the consumer proposal will go a long way towards resolving many of the cost issues facing the Commission. Additionally, adoption of the consumer group proposal will assist both long-distance and local service carriers by correcting some of the existing imbalances in federal cost recovery and access charge collection. Most importantly, however, is the fact that this proposal will provide consumers with real, clearly identifiable benefits in the form of lower costs.

EXHIBIT 4
LOOP COST RECOVERY IN THE FEDERAL JURISDICTION
AT THE END OF THE TRANSITION IN 2004
UNDER THE CONSUMER PROPOSAL

RESIDENTIAL CONSUMER (AVG. 1ST & 2ND LINE SLC)	$3.30
(Assumes 1/3 of all lines are second lines in 2004)	
BUSINESS CONSUMER (SLC)	5.00

AVG. RES/BUS SLC (Assumes 1/3 of all lines are Bus)	4.00
PICC (NOT ON BILL)	.50
HIGH COST SUPPORT ($1 billion)	.50
DSL COST RECOVERY	+
TOTAL COST RECOVERY	5.00 +
TOTAL LOOP COSTS SUPPORTED (Assuming 25% Cost Recovery In Federal Jurisdiction)	20.00 +