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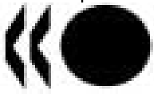

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Working Party No. 2 on Competition and Regulation

ROUNDTABLE ON MEASURING COSTS OF ACCESS SERVICES

-- The United States --

This document is submitted by the Delegation of the United States to the Working Party No. 2 FOR DISCUSSION at its next meeting on 7 June 2002.

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"MEASURING COSTS FOR ACCESS PRICING" ROUNDTABLE

1. The United States regulatory framework established for access pricing is influenced by the fact that regulatory responsibilities are divided between federal and state level regulators. Oversimplifying somewhat, there are three basic access pricing regimes in the United States, which are discussed in somewhat more detail in Attachment 1. First, under the Telecommunications Act of 1996, local exchange carriers that originate local calls are required to compensate the terminating local exchange carrier for the cost of transporting and terminating the call to the called party. For these two-way access arrangements, the federal regulator, the Federal Communications Commission is authorized to establish general pricing rules or guidelines, but state regulators set the actual rates for transport and termination. Second, the Federal Communications Commission has exclusive jurisdiction to regulate *interstate access charges.* 21

proposal suggesting that bill-and-keep may be one approach that could go some distance toward resolving some of these issues.[3] The views of fellow delegates on these matters would be welcome.

4. Two important telecommunications cases have recently been decided by the federal courts in the U.S. In *Verizon Communications, Inc. v. FCC*, No. 00-511 (decided May 13, 2002), the U.S. Supreme Court resolved a long-running dispute in the appellate courts by upholding the FCC's rules mandating use of the Total Element Long-Run Incremental Cost (TELRIC) methodology for pricing of interconnection and unbundled network elements (UNEs) provided by incumbent carriers on a wholesale basis to competitors under Sections 251 and 252 of the 1996 Telecommunications Act. This decision ends

ATTACHMENT 1

"In the Matter of Developing a Unified Intercarrier Compensation Regime." Notice of Proposed Rulemaking. FCC 01-132. Adopted April 19, 2002. Paragraphs 5 –10. This excerpt provides an overview of access pricing regimes in the United States. [http://ftp.fcc.gov/Bureaus/Common_Carrier/Orders/2001/fcc01132.doc]

> 5. Interconnection arrangements between carriers are currently governed by a complex system of intercarrier compensation regulations. These regulations treat different types of carriers and different types of services disparately, even though there may be no significant differences in the costs among carriers or services. The interconnection regime that applies in a particular case depends on such factors as: whether the interconnecting party is a local carrier, an interexchange carrier, a CMRS [cellular mobile radio service] carrier or an enhanced service provider; and

regulation in the United States and abroad.[10] An alternative to such CPNP arrangements, however, is a "*bill-and-keep*" arrangement. Because there are no termination charges under a bill-and-keep arrangement, each carrier is required to recover the costs of termination (and origination) from its own end-user customers.[11] As previously noted, under the Commission's rules, state PUCs may impose bill-and-keep arrangements on interconnection agreements involving an ILEC, provided that the traffic between the carriers is relatively balanced and neither carrier has rebutted the presumption of symmetrical rates. In addition, bill-and-keep arrangements are found in interconnection agreements between adjacent ILECs.[12] Finally, some Internet backbones have voluntarily negotiated interconnection agreements that resemble bill-and-keep arrangements.[13]

10. Finally, when entities connect to telephone networks as end users rather than as interconnecting networks, they do not pay usage-sensitive access or reciprocal compensation charges. For example, residential customers typically pay flat-rated subscription charges (or

ATTACHMENT 2

"In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long-Distance Users, Federal-State Joint Board On Universal Service." FCC 00-193. Adopted May 31, 2000. Paragraphs 5 – 33. This excerpt provides an overview of the interstate regime.

[http://ftp.fcc.gov/Bureaus/Common_Carrier/Orders/2000/fcc00193.doc]

Access Charges. Overview

5. For much of this century, most telephone subscribers obtained both local and long-distance services from the same company, the pre-divestiture Bell System, owned and operated by AT&T. Its provision of local and intrastate long-distance services through its wholly-owned operating companies, the Bell Operating Companies (BOCs), was regulated by state commissions. The

Exchange Network Facilities for Interstate Access (ENFIA), that set rates that AT&T would charge long-distance competitors for originating and terminating interstate traffic over the facilities of its local exchange affiliates.[18] Several years afterwards, AT&T's divestiture was completed, separating the local exchange operations of the BOCs from the rest of AT&T's operations, including AT&T's long-distance business. The BOCs maintained monopoly franchises in their local market, but by splitting them off from AT&T's long-distance business, the federal courts removed an incentive for the BOCs to favor AT&T's long-distance business over its competitors. Now AT&T competed directly with MCI and the other competitors to provide interstate service, and all of the competitors, including AT&T, paid the BOCs for the service of providing the necessary access to end users.

7. In 1978, the Commission commenced a wide-ranging review of the system by which LECs were compensated for originating and terminating interstate traffic. In 1983, following the decision to break-up AT&T, the Commission adopted uniform access charge rules in lieu of earlier agreements.[19] These rules governed the provision of interstate access services by all incumbent LECs, BOCs as well as independents. The access charge rules provide for the recovery of the incumbent LECs' costs assigned to the interstate jurisdiction by the separations rules.

8. The Commission uses a multi-step process to identify the cost of providing access service. First, the rules require an incumbent LEC to record all of its expenses, investments, and revenues in accordance with accounting rules set forth in our regulations.[20] Second, the rules divide these costs between those associated with regulated telecommunications services and those associated with nonregulated activities.[21] Third, the separations rules determine the fraction of the incumbent LEC's regulated expenses and investment that should be allocated to the interstate jurisdiction.[22] After the total amount of interstate cost is identified, the access charge rules translate these interstate costs into charges for the specific interstate access services and rate elements. Part 69 of our rules specifies in detail the rate structure for recovering those costs.[23] That is, the rules tell the incumbent LECs the precise manner in which they may assess charges on interexchange carriers and end users.

9. Determining the costs that an incumbent LEC incurs to provide interstate access services and that, consequently, should be recovered from those services, is relatively straightforward in some cases and problematic in others. Some facilities, such as private lines, can be used exclusively for interstate services and, in such cases, the entire cost of those facilities is assigned to the interstate jurisdiction by the separations rules. Most facilities, however, are used for both intrastate and interstate services. The costs of some of these facilities vary depending on the amount of telecommunications traffic that they handle. The separations rules typically assign

[18] For additional background on the ENFIA agreement, *see, e.g.,* Investigation of Access and Divestiture-Related

13. Briefly stated, rate-of-return regulation is designed to limit the profits an incumbent LEC may earn from interstate access service, whereas price cap regulation focuses primarily on the prices that an incumbent LEC may charge and the revenues it may generate from interstate access services. Under the Part 69 cost-of-service rules, revenue requirements are based on embedded or accounting costs allocated to individual services. Incumbent LECs are limited to earning a prescribed return on investment and are potentially obligated to provide refunds if their interstate rate of return exceeds the authorized level.

14. By contrast, although the access charges of price cap LECs originally were set at the levels that existed at the time they entered price caps, their prices have been limited ever since by price indices that have been adjusted annually pursuant to formulae set forth in our Part 61 rules. Price cap carriers whose interstate access charges are set by these pricing rules are permitted to earn returns significantly higher, or potentially lower, than the prescribed rate of return that incumbent LECs are allowed to earn under rate-of-return rules. Price cap regulation encourages incumbent LECs to improve their efficiency by harnessing profit-making incentives to reduce costs, invest efficiently in new plant and facilities, and develop and deploy innovative service offerings, while setting price ceilings at reasonable levels.[28] Individual companies retain an incentive to cut costs and to produce efficiently, because in the short run their behavior has no effect on the prices they are permitted to charge, and they are able to keep any additional profits resulting from reduced costs. In this way, price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.[29]

or some price cap LECs were required to "share," or return to ratepayers, earnings above specified levels. This sharing requirement was eliminated in 1997.[30]

16. With the passage of the 1996 Act, the Commission determined that it was necessary to make substantial revisions to access charges. In the *Access Charge Reform Order*, the Commission instituted reforms that changed the manner in which price cap LECs recover access costs by aligning the rate structure more closely with the manner in which costs are incurred.[31] Prior r

A. Universal Service

19. One of the primary purposes of universal service support is to allow LECs and other eligible telecommunications carriers to provide certain basic services to customers in high-cost areas without having to charge these customers unaffordable rates.[36]

service support in access charges,[45] the X-factor remand,[46] the *Low-Volume Long-Distance Users NOI*,[47] the pending NPRM on geographically deaveraging SLCs[48] and the next scheduled price cap performance review.[49] In addressing these issues, the CALLS Proposal reduces, and in most instances eliminates, implicit subsidies among end-user classes; makes implicit universal service

10. Elimination of MUCs by participating long-distance carriers;

11. A commitment by participating long-distance carriers to flow through reductions in access rates to residential and business customers over the life of the plan; and

12. Adjustment of the Lifeline Assistance universal service support mechanism to shield low-income customers from increases in the residential SLC.

29. As an initial point, the CALLS Proposal reduces, and in many cases eliminates, implicit subsidies among customer classes through two means. First, by permitting a greater proportion of the local loop costs of primary residential and single-line business customers to be recovered through the SLC, rather than through the CCL charge and the multi-line business PICC, the CALLS Proposal reduces, and in most instances removes, the subsidies associated with both of the latter charges. Second, by permitting participating LECs to deaverage their SLCs once the CCL charge and multi-line business PICCs are eliminated, the CALLS Proposal reduces the subsidy that subscribers in low-cost areas provide those in higher cost areas.

30. The CALLS Proposal reduces these subsidies, and keeps rates affordable in high-cost areas, by replacing the subsidies with explicit interstate access universal service support. In section 254(e), Congress stated that federal universal service support should be made explicit.[51] The CALLS Proposal identifies and removes $650 million of implicit universal service support in interstate access charges, creates an explicit interstate access universal service support mechanism in this amount to replace the implicit support, and makes interstate access universal service support fully portable among eligible telecommunications carriers.[52] The CALLS Proposal conforms with our tentative conclusion in the *Universal Service Seventh Report and Order* that price cap LECs should reduce their interstate access rates to reflect any increase in explicit high-cost support.[53] In addition, we conclude that this interstate access universal service