

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.**

In the Matter of)	
)	
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
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45

Notice of Proposed Rulemaking

COMMENTS OF THE COMPETITION POLICY INSTITUTE

On the Revised CALLS Proposal

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I. INTRODUCTION AND SUMMARY

In August 1999 a coalition of local and long distance companies submitted a proposal to the Federal Communications Commission negotiated among the coalition's members. The proposal of the Coalition for Affordable Local and Long Distance Services ("CALLS") attempted to address several nettlesome problems involving the structure of carrier access charges, consumer confusion about line item charges on monthly bills, and the size of the federal universal service fund. On March 8, 2000 the CALLS proposal sponsors filed a revised proposal (CALLS 2) that is the subject of this round of comments. The revision was motivated by criticisms of the original proposal (CALLS 1) and followed negotiations with some consumer organizations. The Competition Policy Institute (CPI)¹ appreciates the opportunity to comment on the revised CALLS proposal.

In our comments on CALLS 1, we advised the Commission to reject the proposal unless it were substantially modified to create more consumer benefits. Unfortunately, CALLS 2 is only marginally better than the original proposal. It still suffers from the same fundamental defect that afflicted CALLS 1: **the proposal is first and foremost an attempt to shield access revenues of the ILECs by shifting their recovery to end-user charges.** Instead of actually reducing above-cost access charges, both CALLS 1 and CALLS 2 merely shifts them from long distance carriers to end users and from usage charges to flat-rate charges.

The main engine of the CALLS scheme is the fact that telecommunications industry costs

¹ CPI is an independent, non-profit organization that advocates state and federal policies to promote competition in telecommunications and energy services in ways that benefit consumers. Complete information about CPI can be obtained from our web site at <www.cpi.org>.

are falling. The proposal focuses price cap reductions on the carrier-paid portion of access while denying the benefits of those same cost reductions to end-user consumers. CALLS 2 differs from CALLS 1 mainly by adopting a revised schedule of maximum subscriber line charges (SLCs), which is, as we show later, of limited value. The revised proposal also includes a commitment by AT&T and Sprint to eliminate or forgo Minimum Usage Charges (MUCs) on consumer long distance bills. For reasons we develop below, these concessions by AT&T and Sprint do not affect the merits of CALLS 2, constitute questionable public policy and are, in any event, of dubious value.

In our original comments we acknowledged some of the benefits of the CALLS 1 proposal and we note here that CALLS 2 retains those advantages: lower carrier access prices that will lead to reductions in long distance rates, simplified monthly bills, and explicit federal universal service support. But this list of advantages comes at a substantial cost: higher monthly fixed charges, a shift of costs from interexchange carriers to end-users and total access revenues that will be higher than under the current system. Thus, while there are some meritorious aspects to the CALLS 2 proposal, its shortcomings outweigh its merits, making it unacceptable.

In summary, here are the major shortcomings of the CALLS 2 proposal:

- The proposal is (at best) revenue-neutral with respect to the access revenues of price cap local exchange carriers; more likely, the proposal will produce higher access revenues than would the *status quo*.
- The CALLS 2 proposal defeats the Commission's policy of using market forces to drive access charges toward costs. By sharply reducing usage-based access prices (and shifting them to end-users) the proposal blunts the competitive pressures that the ILECs will otherwise feel from CLECs.
- The proposal reduces the likelihood that total access revenues (carrier plus end-user) will ever be reduced in the future by regulatory action.

The CALLS coalition has shown an impressive ability to craft a proposal that satisfies the needs of its members. Unfortunately, the CALLS members have not shown a comparable ability to serve the public interest with their proposal and its modifications. Of course, it is not surprising that negotiations among these private parties would yield a result that is not coincident with the public interest. The missing component in the negotiations is direction from the Commission as to what general outcome would be acceptable. CPI recommends that the Commission send the parties back to their negotiations with some directions. Specifically, the Commission should ask the CALLS members to negotiate an agreement that meets three simple guidelines:

1. The PICC should be combined with the Subscriber Line Charge.
2. The cap on the residential subscriber line charge (PICC plus SLC) should not exceed \$4.35, the initial level proposed by the parties in the CALLS 2 proposal.
3. Any subsequent CALLS proposal should contain a detailed estimate of the effect the proposal will have on total year-to-year access revenues over the life of the plan, compared to the assumed *status quo*.

In the comments that follow, we will justify why the Commission should decline to accept the CALLS 2 proposal and, instead, encourage the parties to continue negotiations, aided by direction from the Commission.

II. THE MARGINAL IMPROVEMENTS OF CALLS 2 DO NOT RESCUE THE PROPOSAL

The CALLS 2 proposal modifies the earlier version of the proposal in two ways. First, CALLS 2 abandons a provision to shift 25% of LEC local switching revenues to end-user common line charges. This change permits the Subscriber Line Charge cap under CALLS 2 to be

set at a lower level. Second, the IXC members of the coalition have pledged to eliminate or forgo minimum usage charges for their basic schedule long distance services. In CPI's view, these two changes taken together are not of sufficient merit to make the CALLS 2 proposal acceptable to consumers.

A. The Proposal Does Not Reduce the Level of Access Charges.

We estimate that the total access revenues collected by the price cap LECs will increase, rather than decrease, over the life of the CALLS 2 plan as compared to *status quo* price cap regulation. While the CALLS 2 proposal would cause revenues to change each year compared to the *status quo*, the proposal will apparently result in both a nominal and real (net present value) increase in total access revenues over the five years of the plan. Not surprisingly, the CALLS proponents have not discussed this fact, preferring instead to focus on the first year reductions in usage charges and illustrating the effect of the proposal on selected model consumers.

But this is not Lake Wobegon where all the children are above average. It's not possible for total access revenues to increase, yet for all consumers to come out ahead.

The CALLS 2 proposal's best year (compared to the *status quo*) is the first year of the plan in which usage-sensitive access charges are reduced by \$2.1 billion. But this advertised reduction counts a \$650 million shift to a federal USF assessment that will apparently appear as a flat-rated item on consumer bills. Moreover, each element of the first year reduction, except the elimination of some local switching costs, can be traced either to the application of the business-as-usual price cap formula or to a shift of cost responsibility from carriers to end-users. In subsequent years the annual net benefit of CALLS 2 (compared to the *status quo*) declines and then reverses. By the end of the plan, consumers will have paid more in access charges than they

would have absent the CALLS 2 proposal. Even on a discounted net present value basis, consumers will pay more.

One improvement that CALLS 2 offers over CALLS 1 is that 25% of LEC switching revenues are no longer proposed to be shifted to end-user common line charges. This change permits residential price SLC caps to be lower under CALLS 2 compared to CALLS 1. While this change is welcome, CPI notes that the previous proposal, opposed by many parties in initial comments, was not defensible.

We understand that it is difficult to compare the CALLS 2 proposal with *status quo*. Perhaps this is one of the reasons why the CALLS proponents did not offer any evidence describing the effect the proposal will have on total access revenues over the life of the plan. Instead, the proponents have tried to demonstrate the proposal's merits through illustration. But, as the Commission knows, it can be very misleading to focus on this or that customer profile. There is no substitute for considering the macro effect of the proposal. As far as we are aware, the record does not contain such an analysis and we cannot understand how the Commission could accept the CALLS 2 proposal without examining such a record.

Of similar interest should be the effect that the CALLS 2 proposal will have on the calculated rates of return on equity for the price cap LECs. We suspect that the interstate rates of return, already in excess of market levels, will continue to march upward during the five year period in which CALLS 2 is in effect, **due to effects of CALLS 2 alone**. As we have counseled the Commission before, while rates of return are not necessarily the way to judge the performance of a price cap plan, neither are they irrelevant. If a restructuring proposal, like CALLS 2, has the effect of raising rates of return *a priori* (i.e., without any effort on the part of the regulated

companies) its fairness should be viewed with great skepticism.

Some may object that the CALLS 2 proposal actually lowers the caps on subscriber line charges compared to what they would be without this proposal. How does the CALLS 2 approach achieve its results? The explanation is simple: because of the shifts from carrier access charges to end-user charges, the CALLS proposal means that, on average, *actual* subscriber line charges (as distinct from “caps” on this charge) will be at a higher level for a longer period of time than they would have otherwise. To be sure, it is possible to find customers whose total bill will be lower under the CALLS proposal. But it is also possible to find customers who will pay more than they would have under the Commission’s existing price cap plan. The detail is certainly bedeviling, but when the various effects of the CALLS 2 proposal are summed over all consumers, the total revenue collected will be seen to be higher, compared to the same calculation over all consumers under *status quo* regulation.

B. The “Consumer Benefits” Modifications Do Not Redeem CALLS 2.

One of the new features of the CALLS 2 proposal (and loudly extolled by the plan’s proponents) is a commitment on behalf of AT&T and Sprint to forgo monthly minimum long distance charges (MUCs) for customers of the companies’ basic long distance schedule. We are unimpressed with this provision and think the Commission should deeply discount its value when judging the merits of the CALLS 2 plan. Three facts lead us to this evaluation of the “no-MUC” provision.

First, it is unwise public policy for the Commission to require or even countenance such extraordinary intervention in a competitive market. Regardless of how one feels about MUCs, the simple fact is that these companies undoubtedly incur a cost in maintaining a customer account

and rendering a monthly bill. It is completely inconsistent to argue that fixed costs like the loop must be recovered through SLCs (in a regulated market) and then argue that fixed costs like billing should not be recovered through MUCs (in a competitive market!). The lesson here is perhaps too obvious. The residential long distance market is far better at making these decisions than the Commission or, for that matter, consumer negotiators around the CALLS table. Whether or not a minimum usage charge can (or should) be sustained in a competitive environment is a matter for the market to sort out.

Second, even if we agree it is a good idea to insist that these prices depart from market-based prices, it is unclear which consumers benefit from this *ad hoc* policy. While the “no-MUC” policy favors low-volume long distance users, the profile of these customers is decidedly mixed. Some may be low income consumers, but a “no-MUC” policy will be a very inefficient way to subsidize those customers if that is the goal.

Many of the beneficiaries of the subsidy will likely fit an entirely different profile. Consider all the residential second lines used for dial-up Internet access that are presubscribed to an IXC. The consumers purchasing such second lines will likely make very few long distance calls on that line — their modems will be dialing local numbers to reach ISPs. We also doubt whether these second line customers will tend to be low-income. But all such customers will be subsidized by a “no-MUC” policy. Similar comments may apply to seasonal cabins and second homes.

We also think it is fanciful to imagine that these costs will simply disappear and be “eaten” by the long distance companies. We fully expect the forgone revenues now collected in MUCs to show up in somebody’s usage charges, possibly in the per-minute rates of the very customers the

“no-MUC” policy tries to help. This complicates the analysis even further, since some low-income consumers are *not* low-volume long distance users.

Third, we note that the “no-MUC” policy is not even related to the changes in access charges in CALLS 2. The CALLS proponents argue that eliminating the MUC is necessary “to ensure that low-volume customers also benefit from any per-minute access charge reductions...”² But this is very nearly nonsense. Why should *non-users* of long distance service benefit from lower *usage* charges? Why should access charge reform result in a reduction of \$4.68 in the monthly phone bill of a customer who doesn’t even use long distance service in a given month? Suppose eliminating the MUC leads to higher per-minute long distance rates for these same customers. Will CALLS proponents then claim these customers have received the benefits of per-minute reductions?

In truth, the “no-MUC” provision is offered as a sweetener to those parties who wish long distance rates were still regulated. The Commission should resist the temptation to make such a clumsy intervention in a competitive market. Sprint and AT&T are free to make concessions to gain political support for the CALLS proposal, but the Commission should not be a party to gathering such concessions and should disregard the “no-MUC” provision when evaluating CALLS 2.

III. The CALLS 2 Proposal Defeats the Commission’s Plan to Employ Market Forces to Reduce Access Charges.

In its last major order on access charges, the Commission committed to a policy course that employs market forces to reduce access charges, backed up by a policy of prescriptive

² See “New vs. Old CALLS Plan” at <http://www.phonepolicy.com/newvsold.html>.

reductions in access charge levels if market pressures were not sufficient to reduce access prices in an appropriate time frame. CPI supported that approach, believing that competition in the exchange access market, boosted by facilities-based and UNE-based local market entry, will keep access charges on a downward trajectory. We also strongly support the Commission's commitment to use additional prescriptive reductions in access prices if market forces develop too slowly. In its *First Report and Order*, the Commission stated:

In addition, we also adopt a prescriptive "backstop" to our market-based approach that will serve to ensure that all interstate access customers receive the benefits of more efficient prices, even in those places and for those services where competition does not develop quickly.³

The CALLS 2 proposal is an all-out retreat from this policy course. By transforming carrier access charges to end-user surcharges, the CALLS 2 proposal short-circuits the developing competitive market in exchange access and eliminates the ability of the exchange access market to force excess costs out of the LECs' cost structure and their access rates. Along the way, it reduces the threat that the Commission will step in to reduce access rates further if LECs block the development of market forces that would otherwise do so. When considering the CALLS proposal, the Commission must recognize that this is a sharp departure from its current policy, not an adjustment to it.

This same point has been made, albeit for different purposes, by the competitive local exchange carriers. CLECs, through their trade association ALTS, argues that CALLS 2 permits the ILECs to strategically reduce access charges in those areas most susceptible to competitive

³ *First Report and Order*, 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. CC Dockets Nos. 96-262, 94-1, 91-213 and 95-72, ¶267.

pressure.⁴ We concur with ALTS' observation. Shifting revenues out of usage-sensitive access elements and onto end-users (through increased SLCs or USF charges) puts the Commission in the position of bankrolling the ILECs' competitive response to the CLECs.

The Commission should not mistake our point here: we do not think the Commission should keep usage-based charges high in order to keep CLECs healthy. ILECs should have the ability to respond to competition from CLECs for access services by lowering their prices for these services. But it is wrong as a matter of policy to ensure that these ILECs are kept whole (or worse) by allowing them to make up the discounts in end-user charges.

IV. By Shifting the Revenue Burden onto End Users, CALLS 2 Reduces the Likelihood That Total Access Revenues Will Ever Be Reduced.

The Commission has received many comments about who has responsibility for paying to use the LECs' network to provide long distance service— carriers or end-users. Without entering that debate directly, we wish to make a related point. The CALLS 2 proposal will affect the way regulation deals with access charges in the future, reducing the likelihood that total access charges will ever be moved toward economic costs.

Historically, pressure for reduced access charges has come mainly from two sources: CLECs that compete with ILECs for access business and the IXC's that purchase access services from the ILECs. We have already discussed how the CALLS proposal relieves some of the pressure applied by CLECs while keeping the ILECs whole with respect to access revenues.

IXCs have placed pressure on access in two ways: in the marketplace, IXCs continue to

⁴ See, for example "ALTS PROPOSES 'CONSUMER FRIENDLY' CALLS ALTERNATIVE", Communications Daily, Vol. 20, No. 64 (Monday April 3, 2000) at 1; see also ALTS news release at <http://www.alts.org/NewsPress/022500calls.DOC>.

seek out access arrangements that bypassed the LECs. In regulatory proceedings, IXCs have been vigilant, providing the Commission with essential information and advocacy to put pressure on access charges through the regulatory process. By taking IXCs out of the regulatory picture, the CALLS proposal reduces substantially the likelihood that the new end user charges negotiated by the CALLS sponsors will ever be reduced through regulatory action, regardless of the changing future for the LECs. Simply put, there will be no lobby for lower access charges except for end-users; they are far less equipped to press the case for lower access prices than the IXCs. For this reason we expect that, the access levels negotiated by the CALLS members will persist at higher levels than would have been seen absent this settlement among IXCs and LECs.

V. THE COMMISSION SHOULD SEND THE PARTIES BACK TO THE BARGAINING TABLE WITH PARAMETERS TO GUIDE NEGOTIATIONS.

The CALLS coalition has made a proposal that satisfies the needs of its members. They have addressed the issues that matter most to the carriers involved in the negotiations: total revenue recovery, per minute access rates, and universal service support. Under CALLS 1 or CALLS 2, the LECs will recover their historic costs in a much more stable way, insulating these revenues from the near-term pressure from exchange access competition in favor of the more distant threat of competition for local service. The IXCs get the result they've wanted for a long time: the access prices *they* pay will be reduced to near economic cost levels. Only end-users in this arrangement lose by inheriting the cost responsibility formerly borne by the IXCs in the first instance.

Given the way these negotiations have proceeded, it is not surprising that the CALLS members did not address either the policy goals espoused by the Commission in its access charge

dockets or issues that matter most to consumers. Clearly, satisfying the needs of some IXC's and some LEC's is not the same as moving access charges to market-based costs, a prominent goal of the Commission's agenda. The access revenues of the price cap LEC's today are too high in aggregate and CALLS 2 does not change this fact.

With this background, we recommend that the Commission inject itself into the CALLS negotiation process in a way that is transparent to all parties in the Commission's docket, whether or not they are involved in direct negotiations. Given the relative shortness of time before new access tariffs will have to be developed, CPI recommends that the Commission send the parties back to their negotiations with some general directions. Specifically, the Commission should ask the CALLS members to attempt to agree on a proposal that meets three simple guidelines:

1. The PICC should be combined with the Subscriber Line Charge.
2. The cap on the residential subscriber line charge should not exceed \$4.35, the level proposed by the parties in the CALLS 2 proposal
3. Any subsequent CALLS proposal should contain a detailed estimate of the effect the proposal will have on year-to-year access revenues over the life of the plan, compared to the assumed *status quo*.

Under these conditions, the CALLS members may be able to craft a settlement that serves the public interest in time for the Commission to implement a new regime by July 1, 2000. If necessary, the Commission should consider staying the effect of access changes scheduled for that date to permit implementation of true access charge reforms.

VI. CONCLUSION

The CALLS 2 plan represents a marginal improvement to the original CALLS proposal. Unfortunately, it must be greatly modified before it serves consumers' interests and furthers the

Commission's goal of aligning access charges to competitive levels in a way that is fair to consumers. While some of the proposal's features would benefit some consumers in specific ways, these benefits are offset by the shift of access cost responsibility away from carriers and onto end-user consumers. This shift occurs at exactly the time when the Commission should be using prescriptive reductions to reduce access charges more rapidly than the Commission's price cap plan is doing.⁵ Moreover, the modification of the price cap plan in the CALLS 2 proposal appears to ensure that total access charges (carrier plus end-user) will be higher than they would be absent this proposal. This is not progress.

Since the CALLS petitioners have presented this as an all-or-nothing proposal, it is difficult to see how the Commission can significantly modify the proposal without invoking the opposition of some of the key CALLS members. In view of this, we think the Commission has no choice but to reject the proposal and invite the parties to resume negotiations within guidelines we recommend in these comments.

Respectfully submitted,

/s/ _____

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⁵ CPI has advocated this policy in our support of a pending petition. *See* Comments of the Competition Policy Institute in the Matter of the Petition for Rulemaking of the Consumer Federation of America, International Communications Association and National Retail Federation, CC Docket Nos. 96-262, 94-1, 91-213 and 95-72. (*CFA/ICA/NRF Petition*)