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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

ORIGINAL FILE

In the Matter of	)	
	)	
Regulatory Reform for	)	CC Docket No. 92-135
Local Exchange Carriers	)	
Subject to Rate of Return	)	
Regulation	)	

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

COMMENTS OF CENTRAL TELEPHONE COMPANY

Carol F. Sulkes
Vice President - Regulatory
Policy
8745 Higgins Road
Chicago, Illinois 60631

Theodore D. Frank
Vonya B. McCann
Arent, Fox, Kintner, Plotkin
& Kahn
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5339
(202) 857-6401

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SUMARY

Central Telephone Company ("Centel"), on behalf of itself and its affiliated local exchange carriers ("LECs"), hereby submits these comments in response to the Notice of Proposed Rulemaking, CC Docket No. 92-135, FCC 92-258, released July 17, 1992 ("Notice"). In the Notice, the Commission proposes regulatory reform for interstate access services offered by small and mid-sized LECs that remain subject to rate of return regulation. The Commission's proposal is designed to establish a continuum of incentive based options that permit LECs to choose a plan which best fits their needs.

Centel strongly supports the Commission's efforts to implement regulatory reform for small and mid-sized LECs. In these comments, Centel makes several recommendations to improve the optional incentive regulation plan. These recommendations include: permitting LECs to file revisions within the two-year tariff period; increasing the proposed earnings band; using projected rather than historical data or, alternatively, establishing a broad definition of "known and measurable" costs; and eliminating or reducing the infrastructure and service quality reporting requirements.

Centel also makes certain recommendations regarding the proposed baseline rate of return regulation option. Centel recommends that the Commission expand the earnings buffer zone and permit LECs to use projected data in developing rates.

Further, in implementing regulatory reform, the Commission should take into account the existing differences in efficiency and rates among LECs. This approach will ensure that all LECs have the capabilities and incentives to develop and maintain an advanced telecommunications infrastructure and to provide high-quality service at reasonable rates.

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COMMENTS OF CENTRAL TELEPHONE COMPANY

I. INTRODUCTION

Central Telephone Company ("Centel"), on behalf of itself and its affiliated local exchange carriers ("LECs"), hereby submits these comments in response to the Notice of Proposed Rulemaking, FCC 92-258, released July 17, 1992 ("Notice") in the above-referenced proceeding. In the Notice, the Commission proposes regulatory reform for interstate access services offered by small and mid-sized LECs that remain subject to rate of return regulation. The Commission's proposal is designed to establish a continuum of incentive based options that permit LECs to choose a plan which best fits their needs.[1/]

Centel strongly supports the Commission's efforts to implement regulatory reform for small and mid-sized LECs. In these comments, Centel makes several recommendations to improve

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[1/] The Commission's regulatory reform proposal has three parts: (a) an optional incentive plan for rate of return LECs that is designed as an intermediate step on the road to price cap regulation; (b) expansion of the existing Section 61.39 rules to use historical costs to compute common line rates; and (c) streamlined basic rate of return regulation for LECs not electing the other optional regulatory plans. The Commission's goal is to maintain revenue neutrality among the options. Notice at ¶¶ 3-4.

the optional incentive regulation plan. These recommendations include: permitting LECs to file revisions within the two-year tariff period; increasing the proposed earnings band; using projected rather than historical data or, alternatively, establishing a broad definition of "known and measurable" costs; and eliminating or reducing the infrastructure and service quality reporting requirements.

Centel also makes certain recommendations regarding the proposed baseline rate of return regulation option. Centel recommends that the Commission expand the earnings buffer zone and permit LECs to use projected data in developing rates.

Further, in implementing regulatory reform, the Commission should take into account the existing differences in efficiency and rates among LECs. This approach will ensure that all LECs have the capabilities and incentives to develop and maintain an advanced telecommunications infrastructure and to provide high-quality service at reasonable rates.

II. DISCUSSION

A. Optional Incentive Regulation Plan

1. LECs Must Be Permitted To File Revisions Within The Two-Year Period.

Under the incentive plan, the Commission proposes to replace the annual tariff filing requirement with a biennial filing requirement. Notice at ¶ 10. The Commission seeks comment on whether LECs participating in the plan should retain the option of filing revisions within the two-year period. Id.

Fair and sound public policy dictates that LECs be permitted to file rate revisions within the two-year period. Prohibiting mid-course filings would be tantamount to instituting a two-year rate freeze. Such a freeze would harm the financial health of LECs and threaten the availability of universal service.

Furthermore, the Communications Act of 1934, as amended, authorizes carriers to initiate rate changes by filing new tariffs with the Commission.[2/] The courts have held that under the carrier-initiated tariff filing scheme established by the Act, the Commission is precluded from promulgating procedural rules that prevent carriers from revising their tariffs.[3/] In American Telephone and Telegraph Co. v. FCC, the court stated: "...it is abundantly clear to us that the statutory scheme of the Communications Act reflects the realization of Congress that when a carrier is prevented from placing in effect new rate increases it may suffer irreparable loss which in turn may impede the provision of adequate service during a period of rising costs." Id. at 874 (footnotes omitted). Thus, judicial precedent

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[2/] Sections 203 through 205 of the Act establish precise procedures and limitations concerning the Commission's processing of carrier initiated rate revisions. See 47 U.S.C. §§ 203-205.

[3/] See American Telephone and Telegraph Co. v. FCC, 487 F.2d 865 (CA 2d 1973); MCI Telecommunications Corp. 765 F.2d 1186 (D.C. Cir. 1985). Concluding that the effect of such rules would be to freeze rates, the court in American Telephone and Telegraph Co. v. FCC held that this is the same as prescribing rates, which the Commission can do only after hearings have been held and the prescribed rates found to be just and reasonable. Id. at 874-875.

requires that LECs be permitted to file revisions within the two-year tariff period.

In the Notice, the Commission suggests that a LEC seeking mid-term changes should be required to bear "a heavy burden" in justifying those changes. Notice at ¶ 10. Centel opposes that suggestion. Under price caps, a LEC is permitted to "adjust its rates upward" if they fall below the lower earnings zone and the price cap index.[4] A LEC under the incentive plan should not have a higher burden in making mid-term changes than does a LEC making similar changes under price caps.

2. **The Proposed Earnings Band Should Be Increased.**

Under the incentive plan, the Commission proposes to establish an earnings band which would permit LECs which lower costs by realizing efficiencies to retain higher earnings as a reward for the efficiencies gained. Notice at ¶¶ 11-12. The Commission seeks comment on its tentative conclusion that the appropriate earnings zone for the plan would extend from 100 basis points above and below the authorized rate of return. Id.

Centel believes that the proposed earnings ceiling of 100 basis points above the prescribed rate of return is inadequate. Currently, LECs are allowed to retain earnings of 25 basis points above the authorized rate of return.[5] Thus, the incentive plan merely increases the current earnings level by 75 basis points.

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[4] Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6802 (1990).

[5] 47 C.F.R. § 65.700(b).

An increase of that size provides little incentive for LECs to participate in the plan. This is especially true considering the risks inherent in the plan. For example, since the incentive plan does not include an adjustment for cost of living increases, that plan could be viewed as being more risky than price caps, which does include an automatic inflation adjustment and a 200 basis point earnings band plus sharing. Additionally, as pointed out above, a LEC under the incentive plan has a higher burden in making mid-term changes than does a LEC under price caps.

The Commission should permit LECs participating in the incentive plan to retain earnings of up to 200 basis points above the prescribed rate of return.[6/] This earnings level would fairly balance the risks and rewards under the plan. In addition, Centel supports the establishment of a sharing mechanism that would permit LECs with earnings in excess of that level to share the excess earnings between consumers and shareholders. A sharing mechanism would balance the Commission's goals of safeguarding consumers' interests with providing an extra incentive to LECs to increase their efficiency.

[6/] Centel also believes that if a LEC is earning within the authorized zone, it should not be required to revise its rates at the biennial tariff filing. Rather, the LEC should be permitted to certify that its rates are within the authorized zone. A certification option is consistent with the Commission's goals of reducing regulatory burdens and securing reasonable rates for consumers.

3. LECs Should Be Permitted To Use Projected Data.

Under the Commission's proposal, a LEC participating in the incentive plan would base the rates in its biennial tariff filing on historical demand and cost data. Notice at ¶ 13. A LEC would be permitted to include exogenous cost changes and other "known and measurable" cost changes to the extent such costs would cause the LEC's earnings to fall below the minimum level. Id. at ¶ 14. If the LEC proves that its known and measurable costs would result in a shortfall, the LEC would be required to target its rates to recover revenues at the lower earnings limit. Id. For the reasons discussed below, Centel opposes this aspect of the Commission's incentive plan.

The Commission's proposal to use historical cost and demand data has several problems. First, the use of historical data may prevent LECs from earning the authorized rate of return. This result could occur if in a subsequent period, a LEC experiences an increase in costs and no change or a decrease in demand. The use of historical data is appropriate for only those LECs whose past resembles their future. It is not appropriate for LECs, such as Centel, which have operated efficiently in the past but face increasing costs in the future.

Second, although the Commission proposes to allow LECs to adjust historical data for "known and measurable" cost changes,

it has not defined that term.[7] Notice at ¶ 14. Centel believes that the term must be defined broadly enough to permit a LEC to include in its revenue requirement any costs that the LEC can demonstrate are actually increasing. Such costs should include labor rates, taxes, inflation,[8] depreciation and infrastructure investments, such as fiber optic deployment, central office upgrades, SS7 and network upgrades. These costs are over and above the normal year-to-year trends.

Third, under the plan, known and measurable costs will only be allowed to the extent that they bring the LEC's earnings to the lower earnings limit. This restriction is unreasonable. Known and measurable costs should be included in a LEC's revenue requirement even if the LEC's earnings are not below the low end of the earnings zone. A LEC should be allowed to target its rates at the authorized rate of return, and not at the lower earnings limit, to recover these legitimate costs.

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[7] Centel believes that a LEC should also be able to make changes in historical data to reflect actual changes in demand. For example, if a large military complex or prison closes, that closing could devastate the LEC's demand for services since a small or mid-sized LEC may not have any other large customers in its serving area. Under the circumstances, it would be unjust and unreasonable to require the LEC to rely on historical data that does not reflect actual changes in the demand for its services.

[8] Unlike the LEC price cap plan, the proposed incentive plan has no productivity offset. Therefore, LECs participating in the incentive plan will be required to absorb all inflation costs rather than inflation minus a productivity offset. Such a requirement significantly increases the LECs' risk of under-earning.

Finally, as the Commission acknowledges in the Notice, small and mid-sized LECs vary substantially in efficiency, investment in network upgrades, and rates. Notice at ¶ 2. Centel, for example, has already reduced its operating costs and improved efficiency and the quality of its services through the deployment of digital technologies and other network upgrades.[9] Since Centel has already implemented many significant network improvements, it does not have the same opportunities as less efficient LECs do to reduce costs. To be fair and effective, the incentive plan must recognize these differences.

4. Centel Supports The Proposal For New Services.

Centel supports the Commission's proposal to permit LECs participating in the incentive plan to offer new services with a presumption of lawfulness if the anticipated earnings are de minimis[10] and do not exceed the rate charged by the geographically closest price cap LEC offering the same or similar service. Notice at ¶ 16. The Commission's proposal will encourage LECs to offer new services. It will also expedite the delivery of new services to consumers.

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[9] Due to these network improvements, Centel's average interstate access rates rank among the lowest in the nation.

[10] Centel also supports the Commission's tentative conclusion that 2 percent or less of a non-price cap LEC's total annual operating revenue is de minimis for purposes of the introduction of new services. Notice at ¶ 16.

5. **Centel Supports The Pricing Flexibility Proposal.**

Centel also supports the Commission's proposal to give LECs participating in the incentive plan some pricing flexibility by incorporating a "basket" and "service category" system similar to that of price caps. Notice at ¶¶ 17-19. In the Notice, however, the Commission states that within the two-year tariff period, "aggregate rates" for each basket must remain unchanged. Id. at ¶ 18. Centel believes that the Commission meant to state that "aggregate revenues" for each basket must remain unchanged. To avoid confusion, the Commission should clarify that language.

6. **LECs Should Not Be Required To File Reports.**

The Commission tentatively concludes that LECs participating in the incentive plan should be required to file quarterly service quality reports and biennial infrastructure reports. Notice at ¶ 21. Centel objects to the proposed reporting requirement. The requirement would substantially increase the administrative expense and burdens imposed on small and mid-sized LECs. Since the reports are detailed and complex, LECs would have to invest considerable time and resources to compile the data and prepare the reports. The administrative and financial costs imposed by the reporting requirement are contrary to the purpose of this regulatory reform proceeding and the Commission's goal of reducing the administrative burdens on small and mid-sized LECs. The potential benefits offered by the reporting requirement are clearly outweighed by the costs.

7. LECs Should Be Allowed To Return To The Plan In Two Years.

The Commission proposes that a LEC participating in the incentive plan must remain in the plan for two years. Notice at ¶ 26. After a LEC leaves the plan, it would not be eligible to return to the plan until the fourth year after the year in which it ceased its participation in the plan. Id. Centel believes that four years is too long a period to require a LEC to wait to return to incentive regulation. A four-year waiting period unnecessarily penalizes a LEC desiring to return the plan. It also unnecessarily delays the benefits of incentive regulation for the LEC's customers. Centel recommends that if a LEC leaves the incentive plan, it should be required to wait one full tariff period, i.e. two years, before returning to the plan.

B. Baseline Rate of Return Regulation

1. LECs Must Be Permitted to Use Projected Data.

The Commission proposes that baseline rate of return regulation would apply to rate of return LECs that do not participate in the incentive plan and to rates of small LECs not governed by the Section 61.39 filing option. Notice at ¶ 42. In an effort to reduce the administrative burdens on LECs subject to baseline regulation, the Commission proposes to require tariff filings every other year, and seeks comment on whether the rates in those filings should be developed from "simple extrapolations of historical costs and demand" or from historical data adjusted for exogenous changes. Id. at ¶¶ 43-44.

Centel applauds the Commission's efforts to reduce the level of detail required to support baseline filings. In doing so, however, the Commission should not preclude LECs from using projected cost and demand data. As discussed previously, the use of historical data prevents LECs from earning the authorized rate of return by not accounting for future cost or demand changes. Indeed, Centel internal analyses reveal that it would underearn if it elected to participate in the baseline plan and that plan relied on historical costs. Regulatory reform should reduce administrative burdens, not impose financial losses on LECs.

2. **The Earnings Zone Should Be Expanded.**

Currently, the earnings buffer zone for rate of return LECs is 25 basis points above the authorized rate of return.[11/] There is no indication in the Notice that the Commission proposes to alter that zone for LECs under baseline regulation. Centel suggests that the earnings zone should be increased to 100 basis points above the authorized rate of return. A modest increase in the buffer would provide an adequate range to accommodate fluctuations in the cost of capital, as well as to provide a fair opportunity for LECs under baseline regulation to earn their allowed rate of return over time.

11/ 47 C.F.R. § 65.700(b).

III. CONCLUSION

Centel supports the Commission's efforts toward implementing regulatory reform for small and mid-sized LECs. The recommendations set forth herein represent reasonable improvements on the Commission's optional incentive plan to benefit consumers, promote efficiency, and encourage infrastructure development.

Respectfully submitted,

CENTRAL TELEPHONE COMPANY

Carol F. Sulkes

Carol F. Sulkes
Vice President - Regulatory Policy
8745 Higgins Road
Chicago, Illinois 60631

OF COUNSEL:
Theodore D. Frank
Vonya B. McCann
Arent, Fox, Kintner, Plotkin & Kahn
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5339
(202) 857-6401

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