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

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

REPLY COMMENTS OF
AMERICAN TELEPHONE AND TELEGRAPH COMPANY

Pursuant to the Notice of Proposed Rule Making ("NPRM"), released July 17, 1992, American Telephone and Telegraph Company ("AT&T") hereby replies to the comments filed in response to the NPRM.

The NPRM (¶ 1) "continues the examination of improved regulatory regimes for small and mid-sized local exchange carriers ("LECs") as announced in the LEC Price Caps Order."[1] The NPRM (¶ 4) proposes three types of regulatory reforms for small and mid-size LECs: (1) an optional incentive regulation ("OIR") plan for rate of return carriers that is designed as an intermediate step to price cap regulation; (2) a modification of the Commission's

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1 Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6827 (1990) and Erratum, 5 FCC Rcd. 7664 (1990) ("LEC Price Caps Order"), modified on recon., 6 FCC Rcd. 2637 (1991), petitions for further recon. dism., 6 FCC Rcd. 742 (1991), further modify. on recon., 6 FCC Rcd 4524 (1991) ("ONA Part 69 Order") petitions for recon. of ONA Part 69 Order pending, appeal docketed, D.C. PSC v. FCC, No. 91-1279 (D.C. Cir. June 14, 1991).

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rules for extremely small LECs to allow their carrier common line ("CCL") rates, as well as their traffic sensitive ("TS") rates, to be developed on the basis of historical costs; and (3) streamlining the basic rate of return regulation that would apply to companies not electing price caps or any of the optional regulatory plans proposed in the NPRM.

In its comments (pp. 3-9), AT&T generally supported the NPRM's proposals because they should help to encourage small and mid-size LECs to reduce costs and increase the efficiency of their access operations, and to pass on a portion of that efficiency to their access customers in the form of lower rates. AT&T also showed, however, (p. 5) that the Commission should not adopt its proposal to permit LECs to include "known and measurable" prospectively costs in their biennial tariffs. That proposal, if adopted, would in effect guarantee the carriers an up-front reimbursement of potential prospective costs that may or may not actually materialize during the two-year tariff period. This would diminish LECs' incentives to reduce costs, lengthen and complicate the tariff process, and in all events, is unnecessary in light of the Commission's proposal in the NPRM (¶ 12) to permit mid-term corrections for OIR LECs who demonstrate that actually realized changes in cost have caused their earnings to fall below the lower earnings band.

Predictably, the LECs urge the Commission to allow them to file tariffs under the OIR plan that would recover "known and measurable" costs and permit the use of these costs to retarget rates up to their full authorized rate of return, rather than to their lower earnings band. Indeed, these carriers seek to expand the definition of "known and measurable" costs to include virtually all costs of doing business. For example, Centel (pp. 6-7) proposes that changes in demand, inflation, or any costs that are over and above "normal" year-to-year trends be treated as "known and measurable." Tallon (pp. 5-6) contends that "known and measurable" costs should encompass normal business expenses such as new central office equipment, new distribution facilities, increased postage, labor costs, and billing software. Similarly, Lincoln (p. 6) suggests that any cost changes which can be quantified and which will occur during the two-year tariff period should qualify as "known and measurable."

These contentions should be rejected. If adopted, they would allow LECs to include in their OIR tariffs prospectively, on a rate-of-return type basis, virtually all ordinary costs of doing business. This would essentially give the LECs guaranteed recovery of these costs and thus virtually eliminate their incentives to reduce costs and become more efficient, which were the central reasons for instituting the OIR plan in the first place.[2] Moreover, LECs not wishing to accept the risk of the OIR plan retain the option under the Commission's proposal to remain under traditional rate of return regulation. In no event should LECs obtain the benefits of rate-of-return regulation through guaranteed recovery of their normal business expenses, while at the same time enjoying the generous pricing and earnings flexibility of the OIR plan. Such a regulatory scheme would essentially permit the LECs to earn higher returns simply by raising prices above their guaranteed costs rather than by reducing costs and becoming more efficient. The Commission therefore should not permit LECs which choose the OIR plan to include "known and measurable" costs in their biennial tariffs.

The NPRM (¶¶ 33-34) also proposes that the demand component of OIR and Part 61.39 LECs' carrier common line ("CCL") rates "be determined by a simple extrapolation of base period demand increased by base period percent growth." USTA (pp. 26-29) and other commenters, however, argue that CCL demand should be reduced by the percentage growth in the carriers' historical costs, and that only 50 percent of any

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[2] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd. 6786, 6799 (Second Report and Order), modified on recon., 6 FCC Rcd. 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd. 7482 (1991).

remaining increase in demand be passed on to IXCs and their customers in the form of lower rates.[3]

This proposal should be rejected. It would, in essence, incorporate into LEC rates their historical average increase in costs and thus substantially diminish their incentives to reduce costs, contrary to the objective of the NPRM's proposed reforms.[4] Moreover, including only 50 percent of demand growth in the denominator of the ratemaking equation results in higher charges to customers and denies ratepayers the benefits of lower rates, which the Commission's proposal was (NPRM, ¶ 34) designed to foster. The Commission therefore should adopt its proposed methodology (NPRM, ¶ 34) for calculating small LECs' CCL rates.

Finally, USTA (pp. 5-10) requests the Commission to eliminate the NPRM proposed requirement that LECs who choose the OIR plan must leave all NECA pools and file both

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[3] USTA (Attachment 1) asserts that the percentage growth in carriers' historical costs amounts to 2.5 percent. This figure appears overstated because it is derived by compounding the average growth rates of three overlapping periods: 1987-90, 1988-90, and 1989-90. This methodology neglects growth that occurred from 1986-87, double counts 1988-89 growth and triple-counts 1989-90 growth. The more appropriate historical loop cost growth rate is the average of growth over the 1986-90 period, which USTA's chart (id. indicates is 1.8517 percent.

[4] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd. 6786, 6799 (Second Report and Order), modified on recon., 6 FCC Rcd. 2637 (1991), petitions for further recon. dismissed, 6 FCC Rcd. 7482 (1991).

TS and CCL rates on a de-pooled basis. Rather, USTA urges, LECs should be permitted to file their own TS rates under OIR, while remaining in the NECA pool for purposes of CCL rates.

The Commission should adopt this proposed modification. USTA (p. 7) notes that requiring LECs to leave the NECA pool entirely in order to take advantage of the OIR plan likely "would create a significant price disparity between their [CCL] rates and those of neighboring carriers that remain in the pool, or happen to be low-cost, non-pooled LECs." This is principally because LECs that leave the NECA pool still must make long-term support payments to the pool, which in many instances will cause those LECs' CCL rates to exceed those of the LECs who choose to remain in the pool. As a result, a large number of the small LECs likely would be discouraged from choosing the OIR plan, thereby frustrating the Commission's objective to give the small LECs attractive and viable incentives to reduce costs and increase efficiencies. Moreover, de-pooled CCL rates for the smaller LECs would further diminish the ability of IXCs to maintain nationwide averaged rates for interstate services. The Commission therefore should permit the small LECs to adopt the OIR plan for TS rates and at the same time file CCL rates as part of the NECA pool.[5]

CONCLUSION

For all the foregoing reasons and those in AT&T's original Comments, the Commission should adopt the OIR plan for TS rates, modified as proposed herein.

Respectfully Submitted,

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5 The Commission should not, however, adopt USTA's proposal (p. 20) that cost support for new LEC services would only be required if the new service represents two percent of a LEC's operating revenue or $200,000, whichever is greater. Under this proposal, many small LECs would never file cost support for significant new services because $200,000 may represent a very substantial proportion of their operating revenue.

ATTACHMENT A

Alltel Service Corporation ("ALLTEL")

Central Telephone Company ("Centel")

Concord Telephone Company ("Concord")

Cincinnati Bell Telephone Company ("CBT")

GVNW, Inc. ("GVNW")

Independent Telephone Access Group ("ITAG")

Lincoln Telephone and Telegraph Company ("Lincoln")

MCI Telecommunications Corporation ("MCI")

National Association Of Regulatory Utility Commissioners ("NARUC")

National Exchange Carrier Association, Inc. ("NECA")

National Telephone Cooperative Association ("NTCA")

Organization For The Protection And Advancement Of Small Telephone Companies ("OPASTCO")

PTI Communications ("PTI")

Puerto Rico Telephone Company ("PRTC")

Ronan Telephone Company ("Ronan")

Taconic Telephone Corporation ("Taconic")

Tallon, Cheeseman And Associates, Inc. ("TCA")

U.S. Small Business Administration

United States Telephone Association ("USTA")

CERTIFICATE OF SERVICE

I, Janice Knapp, do hereby certify that a true copy of the Reply Comments of American Telephone and Telegraph Company was served this 28th day of September, 1992, by United States mail, first class, postage prepaid, upon the parties listed on the attached list.

Janice F. Knapp
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September 28, 1992

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