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

In the Matter of	)	
	)	
Amendments of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes	)	CC Docket No. 92-133

REPLY COMMENTS OF THE AMERITECH OPERATING COMPANIES

The Ameritech Operating Companies[1] submit these reply comments in the above-captioned proceeding. The Companies limit their comments to a response to certain of the claims of the General Services Administration ("GSA"). GSA argues that the Commission should promptly initiate a new proceeding to determine the appropriate prescribed rate of return under current market conditions and that the new prescribed rate should be applied to price cap local exchange carriers ("LECs") in two ways -- first, by adjusting the parameters of the sharing mechanism and, second, by requiring an adjustment of all rates in next April's access filing to reflect the change the prescribed rate or return. In these matters, GSA is simply wrong.

First, GSA's claim of the necessity of an immediate adjustment in the prescribed rate of return is based on deficiencies in GSA's choice for a trigger mechanism. As USTA notes, GSA's proposal to use ten-year treasury bonds is inappropriate because, as an intermediate-term debt instrument, it is more volatile than a long-term instrument such as the long-term bonds proposed by USTA. Further, GSA suggests an annual "spot check" to determine whether the

[1] The Ameritech Operating Companies are: Illinois Bell Telephone Company, Indiana Bell Telephone, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, and Wisconsin Bell, Inc.

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trigger has been activated. As USTA points out, such a spot-check analysis looks at a "spot rate," subject to any unique short-term seasonal distortions, and is not an indication of the long-term cost of capital.

Second, GSA's claim that any change in the prescribed rate of return should be imposed on price cap carriers is also severely flawed. As GSA notes, the Commission, in the LEC Price Cap Order stated:

> In order to provide a reasonable period in which to review the operation of the price cap plan, we anticipate continuing the earnings levels in the backstop at the levels adopted here, for at least the initial four-year price cap period, absent a compelling reason to adjust them.[2]

GSA claims that the Commission intended a continuous link of the price cap sharing zones to the current prescribed rate of return and that a change in the prescribed rate of return for non-price cap LECs "would in itself be a 'compelling reason to adjust' the backstop."[3] That interpretation, however, defies a reasonable interpretation of the order. The term "compelling" in this context implies an extraordinary or unusual event. The Commission's own rate of return rules, however, call for represcription proceedings on a biannual basis. Such adjustments are not unusual, but rather routine. If the Commission had contemplated a *pro forma* adjustment in the sharing mechanism to correspond to the regular rate of return represcription, it would have so stated. Rather, a more reasonable reading of paragraph 129 is that it does not mean to imply that the sharing mechanism should be routinely adjusted with routine adjustments in the prescribed rate of return for non-price cap carriers. In other words, the specific

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[2] *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, FCC 90-314, (released October 4, 1990) ("LEC Price Cap Order") at ¶ 129.

[3] GSA at 5-6.

exclusion of price cap carriers from the rate of return provisions of Part 65 of the Commission's rules means what it says.[4]

This view is supported by the Commission's reasoned determination that the initial period of price caps before a review is commenced be long enough for fair evaluation:

> We believe that a four-year period without major adjustment (to, for example, the productivity factor) is reasonable. The real test of any such program is experience. Failure to provide a reasonable period of acclimation could result in regulatory ambiguity, and resulting uncertainty, that could effectively stifle the intended incentives.[5]

Although the Commission specifically referred to the productivity factor in this case, a change in the sharing mechanism benchmark would be as equally a major adjustment.

The fact that the Commission did not intend a routine adjustment of the sharing mechanism with the routine adjustment of the prescribed rate of return for non-price cap LECs is reinforced by the Commission's specific reference to the possibility of adjusting the sharing mechanism as part of the four-year review process:

> The performance review should provide sufficient information to allow the Commission to reevaluate the need for lower-end adjustment and sharing mechanisms, and <u>to adjust the sharing mechanism</u> and productivity factor if necessary.[6] (Emphasis added.)

Thus, it is clear that, in its articulation of price cap regulation for large LECs, the Commission indicated its intent that the represcription of the authorized rate of return for non-price cap LECs would have no effect. That is consistent with the

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[4] See Section 65.1 of the Commission's rules.

[5] LEC Price Cap Order at ¶ 386.

[6] *Id.* at ¶ 394.

Commission's considered judgment that the structure and significant aspects of price caps should remain unchanged for a reasonable period to give an opportunity for appropriate evaluation of the incentive effect of this form of regulation. Moreover, any deviation from this position would constitute a change in price cap regulation and would itself require the separate notice and comment that would be required of any other change in the Commission's rules.

Further, GSA demonstrates a misunderstanding of the purpose of the sharing mechanism when it argues that the sharing zone in the price cap mechanism must be changed when the authorized rate of return is changed because it was linked to the authorized return initially. While it is true that the sharing zone for LEC price caps was keyed to the 11.25 % return in effect when price caps commenced, that was because that was the rate at which the LEC price cap carriers targeted their rates going into price caps. Since the sharing mechanism is intended to work as a backstop to the productivity factor[7] (not as a mechanism to refund unlawful over earnings), it made sense to key the sharing mechanism to the rate of return at which the rates were targeted. Nothing in this process even impliedly requires any adjustment to the sharing mechanism trigger or a retargeting of rates based on the Commission's adjustment of the prescribed rate of return for non-price cap carriers. As long as the sharing mechanism is keyed to the rate of return at which the price cap LECs' rates were targeted going into price caps, no adjustment is required, and the sharing mechanism will serve its function as a productivity adjustment factor.

Finally, GSA has argued that "the very legality of the LEC price cap plan depends on the maintenance of this linkage [between the sharing zone and the current authorized rate of return]."[8] That is not the case. The legality of price

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[7] *Id.* at ¶ 120.

[8] GSA at 4.

cap regulation in the achievement of just and reasonable rates is based on the fact that the price cap mechanism itself will guarantee to customers that their rates overall will decrease relative to inflation. Nothing in the Communications Act requires that the test of the reasonableness of rates rely on an analysis of the earnings of the regulated carrier. If that were the case, price cap regulation itself would arguably be unlawful even if the sharing zone were adjusted constantly to reflect the current prescribed rate of return.[9]

In summary, the Commission is correct in its determination not to amend the sharing zones for price cap LECs based on the periodic represcription of the rate of return fro non-price cap LECs.

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[9] Opponents of price caps have argued that the Commission has no authority not to require carriers to refund 100% of their earnings above the prescribed rate of return.

CERTIFICATE OF SERVICE

I, Jenell Thompson, do hereby certify that copies of the foregoing Reply Comments of the Ameritech Operating Companies have been mailed this 13th day of October, 1992, by first-class mail, postage prepaid, to the parties on the attached service list.

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