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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

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

In the Matter of	)	
	)	
Price Cap Regulation of Local Exchange Carriers	)	CC Docket No. 93-179
	)	
Rate of Return Sharing and Lower Formula Adjustment	)	

AT&T REPLY COMMENTS

American Telephone and Telegraph Company ("AT&T) hereby replies to the comments of other parties on the NPRM in this proceeding,[1] which proposes that local exchange carriers ("LECs") subject to price cap regulation be required to recalculate their current earnings to reflect the effects of adjustments to those carriers' rate of return in a prior year under the Commission's "backstop" mechanism.[2]

Predictably, almost all of the LECs oppose the Commission's proposal to "add back" the effects of past backstop mechanism adjustments when calculating their current year's earnings.[3] None of these parties,

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1 Price Cap Regulation of Local Exchange Carriers (Rate of Return Sharing and Lower Formula Adjustment), CC Docket No. 93-179, Notice of Proposed Rulemaking, FCC 93-325, released July 6, 1993 ("NPRM").

2 A list of the commenters is provided in Appendix A.

3 The sole exceptions are NYNEX and SNET, which added back the lower formula adjustments to their 1992-93 price caps when calculating their 1992 earnings for their current annual access tariffs. Both of these

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however, provides any credible evidence for their claims that the add back procedure would adversely affect the efficiency incentives of the LEC price cap plan. Similarly, these LECs show no basis for the Commission to defer adoption of the NPRM's proposal until after its scheduled comprehensive review of LEC price cap regulation, or to grant a "credit" against the add back for below cap rates. Accordingly, the Commission should promptly adopt the NPRM's proposal without change.

As AT&T pointed out in its comments (p. 5), the principal objective of the NPRM is to assure consistency between the method of calculating a LEC's earnings under rate of return regulation (in which carriers were required to add back the amount of a prior refund to their return for the current period), and the methodology for computing those carriers' current earnings under price cap regulation. This revision to the rules is necessary, as the Commission has explained (NPRM, ¶ 13), to accurately maintain the upper and lower earnings ranges originally prescribed in the LEC price cap plan as

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LECs, however, claim that the NPRM's proposal simply "clarifies" the Commission's existing procedures, rather than modifies the current rules. See NYNEX, p. 11; SNET, p. 3.

the basis for implementing sharing and lower formula adjustments.

Those parties that oppose this proposal claim that it is somehow at odds with the LEC price cap plan, which they point out was intended to supplant rate of return regulation with incentives to encourage efficiencies on the part of those carriers.[4] Contrary to these claims, there is no conflict between the overall objectives of the Commission's incentive regulation plan and the NPRM's add back proposal. As shown above, the purpose of this revision is to maintain the integrity of the "backstop" mechanism, which the Commission established to account for unanticipated deviations in a LEC's earnings from the industry average embodied in the price cap formula. The backstop mechanism was expressly created to preserve LEC efficiency incentives by providing for sharing and lower formula adjustments within a wide rate-of-return range around the initial authorized earnings level of 11.25 percent.[5] The NPRM

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4 Ameritech, pp. 2-3; Bell Atlantic, p. 3; GTE, pp. 2-6; Pacific Companies, pp. 2-3; Rochester, p. 3; USTA, pp. 2-3; U S WEST, p. 4.

5 Depending on the productivity offset selected by the LEC, its obligation to share one half of its earnings with access customers (via a downward adjustment in the LEC's price cap indices) begins at either 12.25 percent or 13.25 percent. The LEC is obligated to return all excess earnings to ratepayers beginning at either 16.25 or 17.25 percent (again, depending on the carrier's chosen productivity offset).

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affirmatively seeks to assure that the LECs annual earnings continue to be calculated in a manner that preserves the rate of return range originally established for the backstop mechanism, as well as the efficiency incentives embodied in that mechanism.[6] The NPRM's proposal is thus necessarily related to, and entirely consistent with, the goals of the Commission's price cap plan.

Almost uniformly, the LECs also urge the Commission to defer any action on the NPRM's add back proposal until its upcoming review of the operation of the LEC price cap plan.[7] Many of these parties base that request on their unilateral expectations -- unsupported by any formal Commission pronouncements or proposed

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Conversely, to assure that price cap carriers are not subjected to unduly low earnings that could impair service, a LEC that achieves base period earnings of 10.25 percent or less may implement a temporary exogenous increase to its PCIs. See Policies and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786, 6801-2 (1990)("LEC Price Cap Order").

6 See NPRM, ¶ 13 ("[F]or the LECs the Commission established . . . a range of reasonableness for the LEC earnings. Without add-back, the double-counting of backstop adjustments could effectively permit earnings outside the range of reasonableness we designated.")

7 Bell Atlantic, pp. 4-5; BellSouth, pp. 2-3; GTE, pp. 14-15; Pacific Companies, pp. 3-4; Rochester, p. 4; Southwestern Bell, p. 2; USTA, pp. 2-4.

actions -- that the Commission's review will somehow result in the complete elimination of the backstop mechanism to which the NPRM's add back procedure is addressed.[8] Other LECs assert that the Commission must avoid any alterations to its price cap plan in the period prior to the review, to afford sufficient time for incentive regulation to operate.[9]

Contrary to these parties' claims, the Commission never committed itself to refrain from implementing any change whatever to the LEC price cap plan prior to conducting its review; the LEC Price Cap Order stated only that it would be reasonable for the Commission to observe a four year period "without major adjustments," such as a change to the productivity factor.[10] Consistent with this undertaking, the Commission has previously adopted numerous lesser modifications to the overall structure of the LEC price cap plan.[11] The NPRM's proposal now to implement another

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[8] See BellSouth, p. 2; Rochester, p. 4; Southwestern Bell, p. 5; USTA, p. 2.

[9] See Bell Atlantic, pp. 2-3; GTE, p. 15; Pacific Companies, pp. 3-4.

[10] 5 FCC Rcd. at 6834.

[11] For example, since the inception of LEC price cap regulation the Commission has established or proposed the creation of several additional service "bands," with limitations on upward or downward price changes by the LECs for those service categories. See, e.g., Policies and Rules Concerning Local Exchange Carrier

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such evolutionary revision to the LEC price cap plan likewise accords fully with the Commission's intent in adopting incentive regulation for these carriers.

Finally, the LECs urge the Commission to grant those carriers credit against the amount of any add back if a LEC has priced its access rates below the level of its price cap for the relevant basket.[12] Their purported rationale for this procedure is to provide an incentive for LECs voluntarily to price below their price caps.[13]

However, as AT&T demonstrated in its Comments (p. 4 n. 6), the Commission has already rejected as "administratively burdensome" a substantially similar proposal to afford LECs index credit for their past below-cap rates.[14] NYNEX strongly agrees (pp. 12-13) that this proposal "does nothing to improve the price cap

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Validation and Billing Information for Joint Use Calling Cards, CC Docket No. 91-115, Second Report and Order, FCC 93-254, released June 9, 1993, ¶ 24; Provision of Access for 800 Service, 8 FCC Rcd. 907, 912 (1993)(¶¶ 34, 36); Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd. 7369, 7456 (1992)(¶¶ 181-183); Transport Rate Structure and Pricing, 7 FCC Rcd. 7006, 7043-44, 7046 (1992)(¶¶ 74-76, 82).

[12] See Ameritech, p. 7; Bell Atlantic, p. 7; BellSouth, pp. 9-10; U S WEST, p. 6.

[13] See, e.g., Ameritech, p. 7; BellSouth, p. 10.

[14] See LEC Price Cap Order, 5 FCC Rcd. at 6803.

system, and it adds administrative complexity and confusion . . . ." As that carrier correctly points out (p. 13), it would be extremely difficult for the Commission to determine the amount of any credit because access rates (and, hence, the level of a LEC's API) typically fluctuate during the base year. Moreover, in response to the LEC's incentive claims, NYNEX notes (id.) that under the NPRM's add back revision to the backstop mechanism a LEC that has set its API below the level of its PCI already obtains a significant benefit, because under a sharing that carrier is required to reduce its revenues less than if the API were equal to the price cap for that basket. The LECs thus already have more than sufficient incentive under the Commission's plan to price their rates below cap.[15]

[15] Granting the LECs credit against add backs for their already below-cap rates could also effectively "double count" the below-cap pricing by further reducing the amount of their sharing obligations applied to those carriers' PCIs. Because these adjustments are applied to the basket caps, a LEC that has priced its rates below the PCIs can already attenuate the amount of any rate reductions resulting from sharing. Allowing that carrier an additional "credit" against the amount of its sharing obligation, based on the existing below cap rates, would further reduce -- or even entirely eliminate -- the need for that carrier to reduce rates in response to the imposition of sharing.

WHEREFORE, for the reasons stated above and in AT&T's Comments, the Commission should adopt the NPRM's proposed "add back" procedure for computing base period earnings of price cap LECs.

Respectfully submitted,

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September 1, 1993

APPENDIX A

List of Commenters

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Bell Atlantic Telephone Companies ("Bell Atlantic")

BellSouth Telecommunications, Inc. ("BellSouth")

GTE Service Corporation ("GTE")

MCI Telecommunications Corporation ("MCI")

NYNEX Telephone Companies ("NYNEX")

Pacific Bell and Nevada Bell ("Pacific Companies")

Southern New England Telephone Company ("SNET")

Southwestern Bell Telephone Company ("Southwestern Bell")

United States Telephone Association ("USTA")

U S WEST Communications, Inc. ("U S WEST")

CERTIFICATE OF SERVICE

I, Ann Marie Abrahamson, do hereby certify that on this 1st day of September, 1993, a copy of the foregoing "AT&T Reply Comments" was mailed by U.S. first class mail, postage prepaid, to the parties on the attached Service List.

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