Jo Ann Goddard
Director
Federal Regulatory Relations

1275 Pennsylvania Avenue, N.W., Suite 400
Washington, D.C. 20004
(202) 383-6429

DOCKET FILE COPY ORIGINAL

PACIFIC TELESIS
Group-Washington

RECEIVED

SEP - 1 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

September 1, 1993

William F. Caton
Acting Secretary
Federal Communications Commission
Mail Stop 1170
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Mr. Caton:

Re: *CC Docket No. 93-179 - Price Cap Regulation of Local Exchange Carriers; Rate of Return Sharing And Lower Formula Adjustment*

On behalf of Pacific Bell and Nevada Bell, please find enclosed an original and six copies of their "*Reply Comments*" in the above proceeding.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,

Jo Ann Goddard /JCN

Enclosures

No. of Copies rec'd 0+5
List A B C D E

DOCKET FILE COPY ORIGINAL

RECEIVED

SEP - 1 1993

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	)	
	)	

REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL

Pacific Bell and Nevada Bell ("the Pacific Companies") submit these comments in response to comments filed in the above-captioned docket. The Commission has proposed that the rate of return used to calculate backstop adjustments be adjusted to exclude the effect of the prior year's backstop adjustments ("add-back"). With a few exceptions, commentators, including the Pacific Companies, do not support a rule change for proposed mandatory add-backs at this time. AT&T supports the Commission's proposal. MCI supports the Commission's proposal only in part: MCI argues against applying add-back to lower formula adjustments ("LFA").

I. MCI'S ARGUMENTS AGAINST ADD-BACK FOR LFA ALSO APPLY TO ADD-BACK FOR SHARING AMOUNTS

The Pacific Companies suggest that MCI ignored the obvious implications of its arguments against add-back for LFA. MCI's position supports add-back for sharing amounts but not for

LFA. Asymmetrical application of add-backs makes no logical sense but it has obvious benefits to MCI as a carrier's ratepayer. MCI's arguments against add-back for LFA equally support the inappropriateness of add-back for sharing.

a. Add-back revenue treatment

MCI asserts that the LFA add-back excludes revenues derived from LFA rate increases from being included in the calculation of base period earnings and that it makes no sense to exclude revenues actually billed to customers from earnings calculations.[1] By the same logic, it clearly also makes no sense to include in earnings calculations revenues which were not billed to customers. Yet that is what the sharing add-back accomplishes.

b. Inconsistency with earnings monitoring under rate of return regulation

MCI argues that add-backs for LFAs are not consistent with the treatment of rate increases under rate of return regulation.[2] That argument misses the point. Add-backs for LFAs and for sharing amounts under price cap regulation should be judged on the basis of price cap principles. What was done under rate of return regulation is not relevant. As shown below,

---

[1] MCI Comments, p. 6.

[2] MCI Comments, p. 10.

add-back is not necessary under the principles of price cap regulation.

c. Inconsistency with price cap objectives

MCI's assertion that LFA add-backs diminish incentives for LEC performance applies equally to add-backs for sharing. The Commission appears to be willing to sacrifice the linchpin of price cap regulation -- incentives for improvement -- for measurement objectives. Price cap regulation was meant to harness the profit-making incentives common to all business to produce a set of outcomes that advance the public interest goals of just, reasonable, and nondiscriminatory rates.[3] Earnings that are above the maximum allowable rate of return but below the 100% sharing level are meant to be an incentive for the carrier to increase efficiencies. The Commission recognizes that add-backs reduce the efficiency incentive by reducing the range of earnings permitted under the backstop adjustments,[4] but it does not explain why the basic motive for price cap regulation should be undercut for the sake of measuring productivity.

d. Insulating earnings

MCI argues that LFA insulates price cap LECs from earning below a 10.25 percent rate of return under price cap

---

[3] See Comments of the Pacific Companies, 2.

[4] NPRM, para. 14.

regulation. MCI's asymmetrical application of add-back only to sharing amounts but not to LFA must be rejected because it duplicates the possibility of eventual under recovery similar to that addressed by the court in AT&T v. FCC. There the court rejected the automatic refund mechanism because it had the effect of preventing carriers from retaining earnings above the maximum allowable rate of return while requiring carrier to absorb any deficiency below the minimum allowable rate of return. Over time, carriers would be unable to earn its overall authorized return.[5] MCI's proposal that add-back should only apply to the sharing amount would have an analogous effect.

II. THE COMMISSION SHOULD NOT IMPLEMENT ADD-BACKS AT THIS TIME

The Pacific Companies do not support the add-back adjustment. There is no merit to the approach of add-backs except perhaps to measure the purely hypothetical effect of productivity over time. And the accuracy of that measurement is subject to question given the influence of other factors on a company's productivity. Add-backs would be less objectionable if the adjusted rate of return were used only to monitor productivity. But the add-back adjustments proposed will have a real economic effect on a carrier's revenue and sharing obligation. The benefit of using add-backs to obtain productivity information is severely outweighed by their

---

[5] AT&T v. FCC, 836 F2d 1386, 1391 (D.C. Cir. 1988).

distortive effect on a carrier's future revenue. Moreover, the administrative burden in maintaining add-backs will be substantial and compounded year after year as a carrier's price cap performance fluctuates and the effects of multiple years' add-backs are factored into the rate of return calculation.

If the Commission wishes to propose changes to price cap regulation it should do so in a comprehensive manner during the LEC price cap performance review.[6] At that time, the price cap plan can be evaluated as a whole and coordinated and systematic changes to improve the plan would be appropriate. Piecemeal changes now are imprudent, particularly because the proposed add-back substantively changes the overall balance of the risks and benefits in the price cap rules that were adopted.

III. CONCLUSION

For the reasons discussed above, the Pacific Companies urge the Commission to reject the add-back adjustment or to defer consideration of methods to obtain better measure of productivity

---

[6] See Comments of Southwestern Bell Telephony Company, August 2, 1993.

gains to the comprehensive review of price cap regulation scheduled to begin in the near future.

Respectfully submitted,

PACIFIC BELL
NEVADA BELL

JAMES P. TUTHILL
JOHN W. BOGY

140 New Montgomery St., Rm. 1530-A
San Francisco, California 94105
(415) 542-7634

JAMES L. WURTZ

1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004
(202) 383-6472

Their Attorneys

Date: September 1, 1993

CERTIFICATE OF SERVICE

I, C. A. Peters, hereby certify that copies of the foregoing "REPLY COMMENTS OF PACIFIC BELL AND NEVADA BELL" re CC Docket 93-179, were served by hand or by first-class United States mail, postage prepaid, upon the parties appearing on the attached service list this 1st day of September, 1993.

By: _____
C. A. Peters

PACIFIC BELL
140 New Montgomery Street
San Francisco, California 94105

Service List
CC Docket 93-179

William F. Caton*
Secretary
Federal Communications Commission
1919 M St., N.W., Rm. 222
Washington, D.C. 20554

International Transcription Service*
1919 M St., N.W., Rm. 246
Washington, D.C. 20554

MCI Telecommunications Corp., Inc.
1133 19th St., N.W.
Washington, D.C. 20036

Randy R. Klaus, CPA
Sr. Staff Member for MCI
701 Brazos St., Ste. 600
Austin, TX 78701

James T. Hannon
Attorney for USWC
1020 19th St., N.W., Ste. 700
Washington, D.C. 20036

Martin T. McCue
Attorney for USTA
900 19th St., N.W., Ste. 800
Washington, D.C. 20005-2106

Richard McKenna HQE03J36
Attorney for GTE
P.O. Box 152092
Irving, TX 75015-2092

Gail L. Polivy
Attorney for GTE
1850 M St., N.W., Ste. 1200
Washington, D.C. 20036

Michael S. Pabian
Attorney for Ameritech
2000 W. Ameritech Center Dr.,
Room 4H76
Hoffman Estates, IL 60195-1025

Edward R. Wholl
Attorney for NYNEX
120 Bloomingdale Road
White Plains, NY 10605

Edward Shakin
Attorney for Bell Atlantic
1710 H St., N.W.
Washington, D.C. 20006

Thomas A. Pajda
Attorney for SWBT
One Bell Center, Ste. 3520
St. Louis, MO 63101

Michael J. Shortley, III
Attorney for Rochester
180 South Clinton Ave.
Rochester, NY 14646

M. Robert Sutherland
Attorney for BellSouth
4300 Southern Bell Center
675 W. Peachtree St., N.E.
Atlanta, GA 30375

Rochelle D. Jones
Director-Regulatory for SNET
227 Church St.
New Haven, CT 06506-1806

Francine J. Berry
Attorney for AT&T
295 North Maple Ave., Rm. 3244J1
Basking Ridge, NJ 07920

* Service by Hand
0555B