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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

MCI

MCI Communications Corporation
1801 Pennsylvania Ave., NW
Washington, DC 20006
202 887 2731

Michael Hydock
Sr. Staff Member
Regulatory Affairs

October 1, 1993

Mr. William Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, D.C. 20554

Re: In the Matter of: In the Matter of: MCI Telecommunications Corporation, Petition for the Establishment of Price Cap Rules to Account for Changes in Price Cap Indices Impacted by the Transfer of Service Territory Exchanges Between and Among Local Exchange Carriers

Dear Mr. Caton,

Enclosed herewith for filing are the original and nine (9) copies of MCI Telecommunications Corporation's Petition for Rulemaking in the above captioned matter. Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Petition furnished for such purpose and remit same to the bearer.

Yours truly,

Michael F. Hydock

Michael F. Hydock
Senior Staff Member
Federal Regulatory Analysis

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:	)
MCI TELECOMMUNICATIONS CORPORATION	)
Petition for the Establishment of Price Cap Rules to Account for Changes in Price Cap Indices Impacted by Transfer of Service Territory Exchanges Between and Among Local Exchange Carriers	) **RM -**

PETITION FOR RULEMAKING

Pursuant to Section 1.401 of the Commission's Rules[1], MCI Telecommunications Corporation (MCI) hereby requests the Commission to initiate a proceeding to establish price cap regulations to govern the adjustment of price cap indices (PCIs) when a price cap local exchange carrier (LEC) alters its study area(s).

The current price cap rules do not fully consider the situation where a price cap LEC divests a portion of its service exchanges. Without adjustments to the price cap rules, price cap LECs are able to maintain pre-divested PCIs that are different than the theoretical PCI would be after the sale or transfer of exchanges. To remove the artificial incentive for price cap LECs to divest exchanges, the price cap rules must contain explicit regulations dealing with the impacts of such exchanges.

[1] 47 C.F.R. §1.401

Summary of the Issues

There are two main reasons why the Commission must act promptly in the aforementioned matter. First, the existing price cap rules were largely devised to deal with the situation where a price cap LEC would be tempted to transfer part or all of a study area to a non-price cap affiliate in an effort to thwart the efficiency incentives of the price cap rules.[2] This cost shifting between a parent and an affiliate might be used to game the system of price caps by shifting high cost areas to rate of return regulated affiliates in order to maximize returns.[3] What the rules have not been designed to prevent, however, is the artificial benefit received by price cap carriers when they sell or transfer exchanges to a non-price cap, unaffiliated LEC.

The second rationale for prompt Commission action is the increased pace by which price cap LECs appear to be selling off high cost exchanges.[4] GTE and US WEST have announced plans to sell off high cost exchanges affecting 845,000 access

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[2]In the Matter of Policies and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd. 6786 (1990) (Price Cap Order); In the Matter of Policies and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 6 FCC Rcd. 2637 (1991) (Recon Order). In the former order, ¶ 271-284 summarize the Commission's rationale for the existing rules in the context of the all-or-nothing rule, as well as the treatment of mergers and acquisitions. The Recon Order made no substantive changes to the original rules, see ¶ 146-49.

[3]See US WEST Communications, Inc. and Wiggins Telephone Association, Joint Petition for Waiver of the Definition of "Study Area" contained in Part 36, Appendix-glossary of the Commission's Rules, and wiggins Telephone Association, Petition for Waiver of Section 61.41(c), Memorandum Opinion and Order, released August 10, 1993, ¶ 18, citing Price Cap Order.

[4]See, In the Matter of American Telephone and Telegraph Company, Petition for the Establishment of Additional Standards to Govern Study Area Boundary Changes in Connection with the Transfer of Service Territories Between or Among Local Exchange Carriers, RM-8334, September 3, 1993. (AT&T Petition).

lines.[5] As indicated in the AT&T Petition, the Commission received eight new petitions for study-area waivers in July of 1993 alone. Given the plans announced by GTE and US WEST this level of waiver requests is likely to increase.

Statement of the Problem

There are two impacts on access charges when a price cap LEC sells off high cost exchanges to a smaller, rate of return carrier. The first impact is a potential effect on the level of the Universal Service Fund and the Dial Equipment Minutes Weighting subsidy, which will not be the subject of this petition. The second impact is the effect on access charges. This latter impact has not been fully addressed within the context of price cap LEC sales of exchanges.

At the outset of price caps, existing rates were deemed appropriate as the starting point of the new regulatory regime.[6] The existing rates reflected the carriers underlying costs and rate of return at the initialization of the price cap program. These rates were chosen based on the price cap LECs' pre-existing study area boundaries. Moreover, the productivity factor within the price cap program was based upon productivity studies encompassing those same LECs' underlying cost, investment and study area profiles. Thus, the PCIs at the start, and the productivity index, all reflect the carriers' entire costs and study area characteristics.

Under the current rules, when a price cap carrier sells exchanges it makes no adjustment to its PCI to reflect this change. Therefore, access customers will pay higher

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[5]Ibid., p. 5.

[6]Price Cap Order, ¶ 232-244.

charges than justified, despite the fact that the price cap LEC's underlying costs, and rate of return, have now been altered.

The Commission, in this proposed rulemaking, should establish the following rules to apply when a price cap LEC transfers exchanges to another LEC. First, the seller should provide a pro-forma revenue requirement worksheet showing the relevant revenues, expenses, investment, and return[7] for both its remaining territory and that portion of its territory that it is transferring. The LEC transferring the exchanges should then make an adjustment to all its PCIs equal to the ratio of the rate of return of the old total study area to the new total study area.

MCI has attached Exhibit 1 to demonstrate the mechanics of this process. In this simplified example, the LEC "X" is transferring a set of exchanges represented by the column marked "TRANSFER AREA". In this particular example, the old total area had a rate of return of 12.0 percent, while the new study area without the transferred exchanges has a rate of return of 12.3 percent. The PCI is then reduced by a factor of .9744, representing the ratio of 12.3 percent to 12.0 percent.

In establishing the rules, the Commission should require this one-time adjustment to account for price cap LEC sales or transfers of exchanges. This would ideally be based on a basket-by-basket derivation of the revenue requirement so that the appropriate access baskets would receive credit for the sale of the exchanges. All the required information should be available to the LEC. nor would it be burdensome, as it is more than likely the purchaser of the exchanges would require such information.

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[7]The worksheets should closely resemble the ARMIS 43-01 reports.

CONCLUSION

MCI strongly urges the Commission to take prompt action on this request for rulemaking. As indicated above, under the current rules, price cap LECs are receiving artificial profit windfalls based on the fact that the price cap rules do not address this phenomena. Consequently access customers will see their total access bills increase, even though there are no new costs created by such a transfer of exchanges. To insure that the adverse effect on access customers is mitigated the Commission must require the appropriate adjustment to the PCI of the price cap LEC divesting itself of high cost exchanges.

Respectfully submitted,

MCI TELECOMMUNICATIONS CORPORATION

Michael F. Hydock
Senior Staff Member
1801 Pennsylvania Ave. NW
Washington, DC 20006
(202) 887-2731

Dated: October 1, 1993

MCI EXHIBIT 1

LEC X	TOTAL AREA	TRANSFER AREA	NEW AREA
REVENUE	$1,450	$102	$1,349
EXPENSE	$850	$68	$782
NET INCOME	$600	$34	$567
AVG. NET INVESTMENT	$5,000	$400	$4,600
RATE OF RETURN	12.0%	8.4%	12.3%
PCI (TOTAL)	100		
PCI ADJUSTMENT	0.974404		
NEW PCI	97.44042		

STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on October 1, 1993.

Michael F. Hydock
Senior Staff Member
1801 Pennsylvania Ave. NW
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(202) 887-2731

CERTIFICATE OF SERVICE

I, Susan Travis, do hereby certify that copies of the foregoing MCI Filing were sent via first class mail, postage paid, to the following on this 1st day of October, 1993:

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Susan Travis

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