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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	CC Docket No. 94-1
Price Cap Performance Review for Local Exchange Carriers	)	
	)	

ERRATUM

U S WEST Communications, Inc. ("U S WEST"), through counsel, hereby respectfully submits this Erratum to U S WEST's Comments filed in the above-captioned proceeding on May 9, 1994. The Erratum corrects the numbering of the footnotes in the text of the Comments, amends and clarifies the Table of Contents and subheadings in Sections O (Transition Issue 1) through T (Transition Issue 6) (pages 69-92), and corrects minor typographical errors in the filing. Appended to this Erratum are the corrected Comments (with attachments), and U S WEST requests that the Federal Communications Commission ("Commission") substitute these Comments for the Comments filed with the Secretary's Office on May 9, 1994.

U S WEST is serving a copy of this Erratum, together with the corrected Comments (with attachments), on all parties served with its Comments on May 9, 1994. U S WEST does not believe acceptance by the Commission of this Erratum will in any way prejudice any of the parties to this proceeding.

U S WEST apologizes for any inconvenience this Erratum may cause the Commission and parties to this proceeding.

Respectfully submitted,

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May 12, 1994

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
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COMMENTS

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May 9, 1994

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SUMMARY

Price cap regulation is no longer an untested theory. Many uncertainties have been resolved and fears put to rest. Under price cap regulation:

- access prices have declined;
- service quality has been maintained;
- significant infrastructure investments have been made;
- telephone service has become even more "universal;" and
- LECs have increased efficiency.

Clearly, price cap regulation has lived up to expectations since its implementation on January 1, 1991. In this price cap review the Commission must take great care to avoid jeopardizing the efficiency gains that have been achieved or diminishing the incentives contained in the current price cap plan.

U S WEST believes the goals of this proceeding should be simple:

- to remove the last remnants of rate of return regulation from price cap regulation;
- to modify the price cap plan to accommodate competition; and
- to streamline the rules for introducing new services.

These goals are refinements of the Commission's original goals. Modifying the price cap plan to accommodate these goals would serve the public interest by increasing the efficiency incentives of the current plan.

One of the last remnants of rate of return regulation is the sharing and low-end adjustment mechanism. These adjustments are essentially rate of return overlays which dull and distort LEC incentives under price cap regulation. An indirect, but equally troubling, aspect of these adjustments has been their impact on Commission decisions in related proceedings (e.g., depreciation simplification, affiliated transactions, etc.). The time has come to eliminate the sharing and low-end adjustment mechanism. It is no longer needed and is counter-productive. The Commission adopted this mechanism "to compensate for the possibility of an error in the choice of the productivity factor and variations among different LECs" -- not to regulate LEC earnings.* The price cap plan already incorporates a productivity offset, a consumer productivity dividend and numerous indices and sub-indices to protect consumers from unreasonable prices. There is no justification for continued use of the sharing and low-end adjustment mechanism. It serves only to reduce the incentives of price cap regulation.

Another Commission objective in this proceeding should be to modify the current price cap plan to accommodate competition. U S WEST believes the best way to do this is by removing competitive services from price cap regulation using the USTA Access Reform Proposal. Once competition has reached a certain level in a market area, pervasive price and service regulation is no longer necessary. In fact, continued price and service

* NPRM ¶ 17.

regulation might send the wrong signals to competitors, customers and financial markets and unfairly penalize LECs.

The Commission's Rules continue to impede the introduction of new LEC services. These Rules must be streamlined if the Commission is to achieve its price cap objectives. At a minimum, the Commission must:

- eliminate the requirement to obtain Part 69 waivers;
- reduce notice periods;
- reduce the need for detailed cost showings;
- streamline the Section 214 process for video dialtone service;
- reduce the need for Part 61 waivers; and
- allow LECs greater freedom to modify new service prices.

In addition to the above items, U S WEST also addresses potential changes in the price cap formula in its comments. U S WEST opposes either one-time adjustments or ongoing adjustments to reflect changes in interest rates or the cost of capital. To adopt such a change would be a step backward toward rate of return regulation. Interest rate changes are no different from changes in any other endogenous cost.

U S WEST supports eliminating exogenous cost adjustments from the price cap formula. Exogenous cost adjustments represent a deviation from price cap regulation. There is no need to incorporate an exogenous cost adjustment in the LEC price cap formula -- it only detracts from the efficiency incentives of the overall plan.

Lastly, U S WEST believes that if the Commission adopts a price cap plan which accommodates competition, eliminates sharing and the low-end adjustment mechanism and streamlines the introduction of new services, the plan should remain in place for six years. This is a long enough period of time to ensure that the plan includes sufficient efficiency incentives but not so long as to incur inordinate risk in a rapidly changing environment.

Before the
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Washington, DC 20554

In the Matter of	)	
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Price Cap Performance Review	)	
for Local Exchange Carriers	)	

COMMENTS

U S WEST Communications, Inc. ("U S WEST"), through counsel, and pursuant to the Federal Communications Commission's ("Commission") Notice of Proposed Rulemaking,[1] hereby files its Comments in the above-captioned proceeding. These Comments complement the Comments of the United States Telephone Association ("USTA") which are being filed simultaneously in this proceeding ("USTA Comments"). U S WEST and numerous other local exchange carriers ("LEC") joined with USTA to commission a number of economic studies in order to respond to the Commission's inquiries. While these studies are referenced throughout U S WEST's Comments, every effort has been made to minimize the amount of repetition and duplication between these Comments and those of USTA. U S WEST incorporates by reference the studies contained in USTA's Comments and leaves detailed discussion of these studies to USTA. This approach should allow the Commission to use its resources in the most efficient manner in reviewing both the Comments filed herein and USTA's Comments.

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[1]In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Notice of Proposed Rulemaking, FCC 94-10, rel. Feb. 16, 1994 ("NPRM").

I. INTRODUCTION

In adopting price cap regulation for LECs in 1990, the Commission found that price cap regulation -- incentive regulation -- was a much more efficient form of regulation than traditional rate base rate of return regulation.[2] Price cap regulation provided positive incentives for LECs to operate in a more efficient manner and removed many of the distortions embodied in rate of return regulation -- which was essentially "cost plus" regulation. However, given the Commission's inexperience with price cap regulation, it was reluctant to totally sever all ties with rate of return regulation. Initial price cap rates were reset using rate of return methods, and sharing and low-end adjustment mechanisms with rate of return thresholds were incorporated in the LEC price cap plan.

Price cap regulation is no longer an untested theory.[3] Both the Commission and LECs have learned much about price cap regulation over the last three years. Many uncertainties have been resolved, and many fears put to rest. The last three years

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[2] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786, 6787 ¶ 3 (1990) ("Price Cap Order"); Order on Reconsideration, 6 FCC Rcd. 2637 (1991) ("Price Cap Order on Reconsideration").

[3] In fact, the Commission modeled its recent price cap scheme for cable operators after telephone industry price cap regulation. See In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 92-266, Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, FCC 94-38, rel. Mar. 30, 1994, in which the Commission noted the "benefits . . . we have already witnessed from our telephone price cap regulations: lower prices for regulated services, service innovation, and increased operator efficiency, all of which contribute to industry growth and increased competition." Id. ¶ 24.

of experience demonstrate that the benefits of incentive regulation far outweigh any residual concerns over giving LECs more control over their destiny. In a nutshell, under price cap regulation:

- access prices have declined[4] in the face of continued inflation, albeit a low level of inflation;[5]

- significant infrastructure investments[6] and improvements[7] have taken place[8] rather than being curtailed as some earlier price cap critics asserted;

- telephone service has become even more "universal," with telephone subscribership increasing to over 94 percent of all households;[9]

- service quality has been maintained, if not improved, from previous levels;[10] and

- LECs have been incented to increase efficiency -- most LECs maintained profit levels comparable to those existing before price cap regulation despite rate reductions to re-target initial price cap rates to an 11.25 percent rate of return and subsequent price decreases.

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[4]U S WEST has decreased prices approximately $310 million since Jan. 1, 1991.

[5]NPRM ¶ 25.

[6]U S WEST has invested $6.7 billion, an average increase of more than 12 percent from 1990's capital expenditures.

[7]U S WEST has spent $0.8 billion upgrading 534 offices with digital switches and providing one-party service in rural areas.

[8]Id. ¶ 29.

[9]Id.

[10]Id. ¶ 27.

Clearly, price cap regulation has lived up to expectations.[11] In this review, the Commission should take great care to avoid taking any actions which might jeopardize the efficiency gains and incentives contained in the current price cap mechanism. This price cap review should not be used as a vehicle to address every problem facing the telecommunications industry today or to advance any particular social agenda -- regardless of its importance. For example, no one disputes the importance of creating new jobs in America. Despite this, the Commission should not attempt to "fine tune" the price cap plan to achieve this result. Increased employment in America is a secondary result of a more efficient price cap plan. It is not necessary to make any specific modifications in the price cap plan to achieve this objective. Higher nationwide employment will be the natural result of a more efficient price cap plan. However, the benefits of price cap regulation can easily be diminished, if not lost entirely, if the Commission modifies the price cap plan in an attempt to accomplish too many divergent objectives.

In this price cap review proceeding, the Commission should restrict itself to two major objectives:

- removing the last remnants of rate of return regulation from price cap regulation; and

[11]In concluding its review of the AT&T price cap plan, the Commission stated that "[t]he success of the AT&T price cap plan in achieving the goals the Commission envisioned for it argues persuasively that revisions to any major component are unnecessary. Indeed, such revisions could be counter-productive." In the Matter of Price Cap Performance Review For AT&T, Report, 8 FCC Rcd. 6968 ¶ 2 (1993).

- modifying the price cap plan to accommodate local exchange competition in those areas where it exists or is evolving.

Another area of great concern -- while not technically under price cap regulation -- is new service introduction. Despite the importance of new services to both LECs and the Commission, regulation of new services remains very much a "rate of return-like" type of regulation with all the traditional tariff and cost rules. New service requirements continue to frustrate LECs and their customers. These requirements unnecessarily delay the introduction of new services and minimize the number of new services introduced. It makes little sense to saddle new services with rate of return-like requirements prior to moving these services under price cap regulation. Therefore, in addition to the above two "price cap" objectives, the Commission should streamline its rules for introducing new services in this proceeding.

In the comments which follow, U S WEST summarizes its overall position and then responds to specific inquiries contained in the Commission's NPRM. Before reviewing U S WEST's position, one aspect of the structure of the NPRM needs to be addressed. That is, the NPRM attempts to distinguish between "baseline" issues and "transition" issues. The Commission defines baseline issues as those issues associated with revising the current plan to improve performance or reflect changes in circumstances,[12] while transition issues "relate[] to adjustments needed to prepare the baseline plan for anticipated

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[12] NPRM ¶ 35.

changes in the market, technology, and regulation within the next few years."[13] This delineation between baseline and transition issues -- "revisions" in today's plan versus "adjustments" to address anticipated changes in the next few years -- is troubling. In some instances it is impossible to distinguish between these two types of issues; in other cases it is unwise to do so because the baseline and transition issues are inextricably intertwined, as is the case with the composition of price cap baskets. Overall, one clearly cannot successfully revise a plan to yield "improved performance" without taking into account market, technological and regulatory factors which are expected to impact LEC performance in the near-term future; it would be foolhardy to attempt to do so.

The other troubling aspect of this categorization is the natural tendency to resolve only the issues which must be resolved -- baseline issues -- and leave the other issues -- transition issues -- unresolved or to a later proceeding.[14] This increases uncertainty for LECs and thereby dulls incentives. Incentive regulation is not much more efficient than rate of

[13] Id.

[14] The Commission need look no further than the local transport proceeding, CC Docket No. 91-213, to see the price that is paid for adopting temporary measures. That proceeding is in its fourth year, and there is no end in sight -- LECs are operating under an interim rate structure through 1995 while the Commission continues to consider the appropriate long-term rate structure. See In the Matter of MTS and WATS Market Structure, Transport Rate Structure and Pricing, Order and Further Notice of Proposed Rulemaking, 6 FCC Rcd. 5341, 5348 ¶ 37 (1991) ("Transport Rate Structure FNPRM"); In the Matter of Transport Rate Structure and Pricing, Petition for Waiver of the Transport Rules filed by GTE Service Corporation, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd. 7006, 7008 ¶ 3 (1992).

return regulation if the incentive plan may be revised significantly at any time.

One of LECs' greatest complaints with price cap regulation over the last three years has not been with the plan as adopted -- but with the Commission's tendency to "fine tune" the price cap plan in virtually every major proceeding (e.g., local transport, expanded interconnection, Open Network Architecture ("ONA"), Billing Name and Address ("BNA"), 800 Database, Addback and Operator Services).[15] This has been counter-productive. Price cap plan stability, plan incentives and economic efficiency go hand-in-hand. The greater the stability of a price cap plan -- the greater the incentives to carriers and the greater the overall improvements in economic efficiency.[16] With these comments in mind, U S WEST urges the Commission to avoid making an artificial distinction between "baseline" and "transitional" issues and to resolve all relevant issues in the instant proceeding.

II. U S WEST'S POSITION

As stated earlier, U S WEST believes that price cap regulation has largely lived up to expectations since its inception on January 1, 1991. Under price cap regulation, customer benefits have been realized; LEC incentives have been increased; access prices have been reduced; service quality has

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[15]See Attachment 4 for diagrams comparing the structure of the price cap plan at its inception and today.

[16]See Attachment 5, Regulatory Reform for the Information Age: Providing the Vision, Strategic Policy Research, Jan. 11, 1994 ("SPR Study").

been maintained; and the administrative burden of the tariff filing process generally has been reduced.

A. Sharing

Despite the success of price cap regulation, a major obstacle to improving economic efficiency remains -- the sharing and low-end adjustment mechanisms. These mechanisms are essentially rate of return overlays which dull and distort LEC incentives.

Even more troubling is the disproportionate role that these mechanisms have played in many key Commission proceedings. That is, the sharing mechanism, much to the surprise of U S WEST and other LECs, has turned out to be the "tail that wagged the dog" in these proceedings. The claim that LECs could manipulate earnings through the sharing mechanism has been used as a reason for adopting rules and regulations which cannot be justified economically. These rules harm efficiency and send the wrong signals to both the marketplace and LECs. Clearly, the Commission would not be adopting rules of such questionable economic validity but for the continued existence of the sharing mechanism.

For example, in its recent depreciation simplification proceeding, the Commission declined to allow price cap LECs to use the liberalized "price cap option" for establishing service lives and depreciation rates[17] -- despite proposing this option

[17]In the Matter of Simplification of the Depreciation Prescription Process, Report and Order, 8 FCC Rcd. 8025, 8042 ¶ 42 (1993) ("Depreciation Simplification Order").

in its Depreciation Simplification NPRM.[18] The Commission asserted that the existence of sharing in the LEC price cap plan would allow LECs to "manipulate earnings" by changing depreciation expense.[19] LECs' arguments that depreciation is an endogenous cost and that price cap regulation does not allow carriers to change access rates (i.e., with changes in depreciation expense)[20] failed to persuade the Commission to modify its position. LEC evidence of substantially longer prescribed service lives (i.e., vis-a-vis other telecommunications carriers and cable companies) for similar equipment went unchallenged, but was given little weight. Conversely, in the same proceeding, the Commission allowed the American Telephone and Telegraph Company ("AT&T") to use the price cap option to establish depreciation service lives, citing the absence of a sharing mechanism in the AT&T price cap plan as a primary reason.[21]

Similarly, the Commission's Notice of Proposed Rulemaking proposing modifications in its affiliate transactions rules raises the issue of cross-subsidization via the price cap sharing

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[18] In the Matter of Simplification of the Depreciation Prescription Process, Notice of Proposed Rulemaking, 8 FCC Rcd. 146 (1993)("Depreciation Simplification NPRM").

[19] Depreciation Simplification Order, 8 FCC Rcd. at 8042 ¶ 42.

[20] See, e.g., In the Matter of Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Comments of U S WEST Communications, Inc., filed Mar. 10, 1993, at 3-4.

[21] Depreciation Simplification Order, 8 FCC Rcd. at 8062 ¶ 92.

mechanism.[22] This occurred despite the fact that price cap regulation largely eliminates the possibility of cross-subsidization between regulated and unregulated LEC operations. It is dismaying that the Commission cited the existence of the LEC price cap sharing mechanism as a reason for needing additional constraints on affiliated transactions. Likewise, cross-subsidization issues continue to arise with the introduction of new competitive services. Invariably, opponents claim that LECs will engage in cross-subsidization via the sharing mechanism despite the existence of price caps.[23] With price cap regulation and its associated sub-indexes, bands and baskets, cross-subsidization should be a non-issue in most LEC proceedings, but it continues to arise because of the existence of sharing.

The time has come to eliminate the sharing and low-end adjustment mechanisms. The Commission adopted these mechanisms "to compensate for the possibility of an error in the choice of the productivity factor and variations among the different LECs"

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[22] In the Matter of: Amendment of Parts 32 and 64 of the Commission's Rules to Account For Transactions between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, 8 FCC Rcd. 8071 (1993)("Affiliate Transactions NPRM").

[23] For example, in filings associated with the construction of LEC facilities to provide video dialtone service, the issue of cross-subsidization continues to arise. Critics claim that LECs will cross-subsidize video dialtone service by misallocating costs and increasing the rates of telephone customers. Clearly, this is not possible with price cap regulation. The only "thread" that provides any support for this argument is the claim that LECs can manipulate earnings through the price cap sharing mechanism. See Petition to Deny of the Center for Media Education and the Consumer Federation of America, File Nos. W-P-C-6944 and W-P-C-6945, filed Apr. 22, 1994, at 5-7; Petition to Deny of the National Cable Television Association, Inc., File No. W-P-C-6945, filed Apr. 22, 1994, at 9-10.

-- not to regulate LEC earnings.[24] The price cap plan already incorporates a productivity offset, a consumer productivity dividend and numerous baskets and bands to protect consumers from unreasonable prices.

Sharing is not needed and is counter-productive.[25] After three years of experience with price caps, there is no justification for continued employment of these "rate of return" mechanisms. They serve only to reduce the incentives of price cap regulation. The research of Strategic Policy Research ("SPR")[26] demonstrates that the existence of sharing significantly reduces efficiency incentives in the LEC price cap plan. SPR estimates that sharing reduces the efficiency incentives in a price cap plan by approximately half of what they would be in its absence.[27]

As stated above, an indirect but equally troubling aspect of sharing has been its impact on Commission decisions in related proceedings. If the past three years is any indication, the Commission will be reluctant to give LECs much of the costing and

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[24] NPRM ¶ 17. See also Price Cap Order, 5 FCC Rcd. at 6801 ¶ 120.

[25] It is ironic that the Commission has not found a sharing mechanism to be necessary in the AT&T price cap plan when AT&T sells its interstate services to millions of residential and small business customers but has required a sharing mechanism in the LEC price cap plan when the LECs sell the vast majority of their interstate access services to three very large interexchange carriers ("IXC").

[26] See Attachment 5.

[27] For example, in a price cap plan with a four-year term, without sharing efficiency, incentives are expected to be 35 percent of those of unregulated markets. With sharing, these efficiency incentives are reduced to 18 percent. SPR Study at 16-24.

pricing freedom they need in today's environment if sharing remains a part of the LEC price cap plan. The Commission should eliminate the sharing and low-end adjustment mechanisms effective January 1, 1995.[28] By taking this action, the Commission can finally free the LEC price cap plan from the grasp of the dead hand of rate of return regulation.

B. Pricing Freedom/Flexibility

One of the major objectives of this proceeding should be to modify the current price cap plan to accommodate competition. U S WEST believes that the best way to do this is by removing competitive services in their entirety from price cap regulation[29] using the USTA access reform proposal.[30] The USTA Proposal does this by identifying competitive wire centers, or a reasonable grouping of wire centers, and removing all services in these wire centers (i.e., Competitive Market Areas ("CMA")) from

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[28]The possibility that the operation of the price cap mechanism might subject a LEC to confiscatory returns over any period of time is not a justification for continuing to include these counter-productive mechanisms in the LEC price cap plan. Efficiency gains should not be sacrificed and price cap regulation should not be distorted in order to develop a plan which accommodates the exception. Waivers are for exceptions. If, by chance, the price cap mechanism results in unreasonably low prices and confiscatory returns for a LEC, the Commission has sufficient authority to remedy this problem. It is not necessary to build a low-end adjustment mechanism in the price cap plan to address this contingency.

[29]This, of course, presumes that these services would not be subject to rate of return regulation after they are removed from price cap regulation.

[30]See In the Matter of Reform of the Interstate Access Charge Rules, RM-8356, USTA's Petition for Rulemaking, filed Sep. 17, 1993 ("USTA Proposal").

price cap regulation.[31] LEC wire centers are classified as: Initial Market Areas ("IMA"), Transitional Market Areas ("TMA") or CMAs. USTA proposes a mechanism for measuring competition and establishes threshold levels for TMAs and CMAs. The point is that pervasive price and service regulation is no longer necessary once competition has reached a certain level in a market area.[32] In fact, continued price and service regulation might send the wrong signals to both competitors and customers. In this proceeding, the Commission has the opportunity to modify

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[31]The USTA Proposal can also accommodate the removal of a subset of a wire center's services (e.g., high capacity special access and local transport) from price cap regulation.

[32]Implementing USTA's Proposal or any other proposal to segregate competitive services would be quite problematic if the sharing and low-end mechanisms remain in place. The reason being that any attempt to implement such a proposal would quickly degenerate into an endless battle over cost allocation. With the elimination of these rate of return adjustments -- sharing and low-end adjustments -- cost allocation goes away as an issue.

Commissioner Barrett recognized this in his speech to the Florida Economic Club on Aug. 27, 1992, noting that:

> [A]s long as we impose an overall rate of return ceiling, we must either regulate the prices of all services even if it's only incidentally through the imposition of a cap, or we must engage in some sort of cost allocation scheme between those services we regulate and those services we don't.
>
> * * *
>
> However, if we drop the rate of return ceiling while continuing to maintain our ability to regulate prices, we can transition services out of regulation smoothly as they become more competitive. And we can cap baskets on the basis of their respective revenues -- not on the basis of costs.

Andrew C. Barrett, Beyond Price Caps: Escaping the Traditional Regulatory Framework, Address Before the Florida Economic Club (Aug. 27, 1992)(on file in the Office of the Commissioner Andrew C. Barrett at the Commission).

price cap regulation to accommodate competition and should do so.[33]

In a similar vein, the Commission should re-examine existing baskets and service categories/bands. Since the adoption of the original price cap plan, there has been a proliferation of service categories/bands.[34] The structure of the price cap plan has become unnecessarily complex and administratively burdensome. Also, with the restructuring of local transport, the price baskets had to be restructured. Thus, it is an opportune time for the Commission to re-examine and simplify the overall structure of price cap baskets and service categories/bands. U S WEST supports USTA's proposal that four price cap baskets be used -- transport, switching, public policy and other.[35]

The Commission's Rules continue to impede the introduction of new LEC services. Existing rules must be streamlined if LECs are to fully participate in competitive telecommunications

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[33]In moving forward in this proceeding the Commission should not lose sight of the unique characteristics of the access market. That is: access demand is highly concentrated in a few customers; a majority of demand is concentrated in a small number of market areas in each LEC's serving area; most access customers are IXCs, not end users; and there is no national uniformity in the access market. Furthermore, access services are highly substitutable for one another.

The Commission's own data clearly indicate how highly concentrated demand is for interstate access. The three largest customers -- AT&T, MCI Telecommunications Corporation ("MCI") and Sprint Communications L.P. ("Sprint") -- account for 93.6 percent of all presubscribed telephone lines and 85.7 percent of all interstate toll revenues. See Long Distance Market Shares, Fourth Quarter, 1993, Industry Analysis Division, Federal Communications Commission, Apr. 15, 1994, Tables 4 and 6.

[34]See Attachment 4 for diagrams comparing the structure of the price cap plan at its inception and today.

[35]See Section III(D) below.

markets and if customers are to gain the full benefits of price cap regulation. At a minimum, the Commission must eliminate the requirement to obtain Part 69 waivers to introduce new switched access services; reduce notice periods; reduce the need for and burden of detailed cost showings; eliminate the requirement to obtain Part 61 waivers to reference technical publications; and allow LECs greater freedom to change the prices of new services. In a word, the Commission must "simplify" the process for introducing new services. The present system serves the needs of LEC competitors -- but it does not serve the needs of LEC customers or the public interest.[36]

C. The Price Cap Formula

The current price cap formula contains a productivity offset of 2.8 percent and a consumer productivity dividend of 0.5 percent -- for a total of 3.3 percent.[37] Continued use of a 3.3 percent total productivity offset is not unreasonable. This level of productivity offset has forced companies to become more efficient, while allowing consumers to gain significant benefits from price cap regulation. U S WEST does not object to continued use of a 3.3 percent factor even though the work of Christensen

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[36] See Section III(J) for a further discussion of new service requirements.

[37] A LEC may also select a 4.3 percent productivity factor if it wishes to operate under expanded sharing thresholds during a given tariff year. See Price Cap Order, 5 FCC Rcd. at 6801-02 ¶ 126.

and Associates[38] indicates the differential since divestiture between LEC productivity gains and those of U.S. industry as a whole has been only 1.7 percent.[39] While the Christensen study more accurately reflects LECs' experience since divestiture, use of this lower productivity factor in the price cap plan might also provide a rationalization for continued use of a sharing adjustment in the LEC price cap plan to guard against the possibility of a LEC windfall. As such, U S WEST believes the better course of action is to leave the productivity factor unchanged and eliminate sharing -- despite the fact that LECs will find it more difficult to achieve the same level of productivity gains with increasing competition.[40]

U S WEST opposes any adjustment to the price cap formula or price cap rates to reflect changes in interest rates or the cost of capital. Any such adjustments would undercut price cap regulation and be a step backward toward rate of return

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[38]See USTA Comments at Attachment 4, "Productivity of the Local Telephone Operating Companies" by Lauritis R. Christensen, Phillip E. Schoech and Mark E. Meitzen ("TFP Study").

[39]The fact that U S WEST does not object to use of a 3.3 percent productivity offset in the interstate price cap plan does not imply that it is appropriate to use this level for adjusting intrastate (i.e., local exchange) rates in any intrastate price cap plan.

[40]The greatest opportunities for productivity gains are in the most dense markets (e.g., central business districts in large cities). New methods and cost-saving technologies can be introduced in these areas at a much lower per-unit cost than in less dense markets. However, the most dense areas are also the most attractive to competitors and the most likely areas for LECs to experience competitive losses. As customers in high density areas are lost to competitors, the average density of LEC traffic and services will decline. Consequently, LECs will have greater difficulty in achieving the same level of productivity gains than they did in the past.