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December 8, 1994

EX PARTE**RECEIVED****DEC - 8 1994****FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

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

RE: Ex Parte Presentation in Price Cap Performance Review, CC Docket No. 94-1

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

This notice of an oral ex parte presentation in the above-referenced proceeding and the attached material are provided for inclusion in the public record pursuant to the Commission's ex parte rules at 47 C.F. R. § 1.1200 et seq. BellSouth representatives met with Kathleen Wallman, Bureau Chief, Richard Metzger, Deputy Chief, David Nall, Anthony Bush and Joanne Wall of the Common Carrier Bureau, to discuss BellSouth's position in this proceeding and to rebut positions advanced by opponents in ex parte presentations in this proceeding.

Representing BellSouth were L. Darby, Economic Consultant, Darby and Associates, G. Epstein, Attorney, Latham & Watkins, Robert Blau and the undersigned. The discussions at the meeting were consistent with BellSouth's position already on file in this proceeding. The attached charts were also passed out during the meeting as an aid to the discussion. Due to the lateness of the hour at the conclusion of BellSouth's ex parte meetings, this notice is being filed on the next business day.

If you have any questions regarding this matter, please do not hesitate to call the undersigned.

Sincerely,



Maurice P. Talbot, Jr.
Executive Director - Federal Regulatory

Attachments

cc: Kathleen Wallman (w/o attachment)
Richard Metzger (w/o attachment)
David Nall (w/o attachment)
Anthony Bush (w/o attachment)
Joanne Wall (w/o attachment)

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OVERVIEW

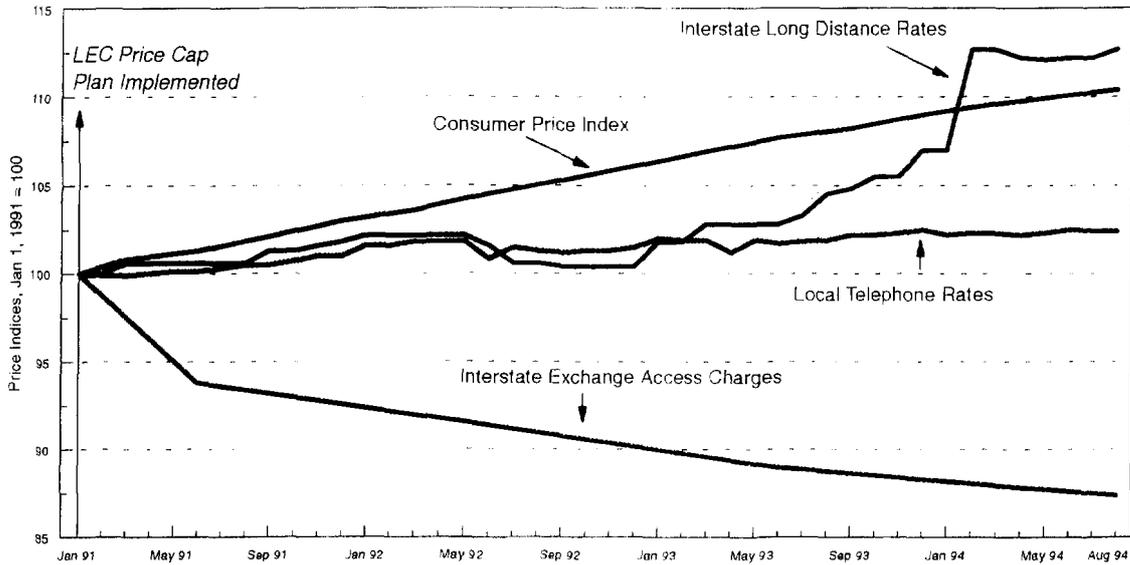
- **Price Caps are "mostly" working**
 - **Access charges going down**
 - **LEC investment going up**
- **Main issues in this proceeding**
 - **Who's benefiting?**
 - **Earning levels**
 - **Investment incentives**
- **Commission should improve plan**
 - **Increase incentives**
 - **Eliminate sharing**

LEC PRICE CAP SCORECARD

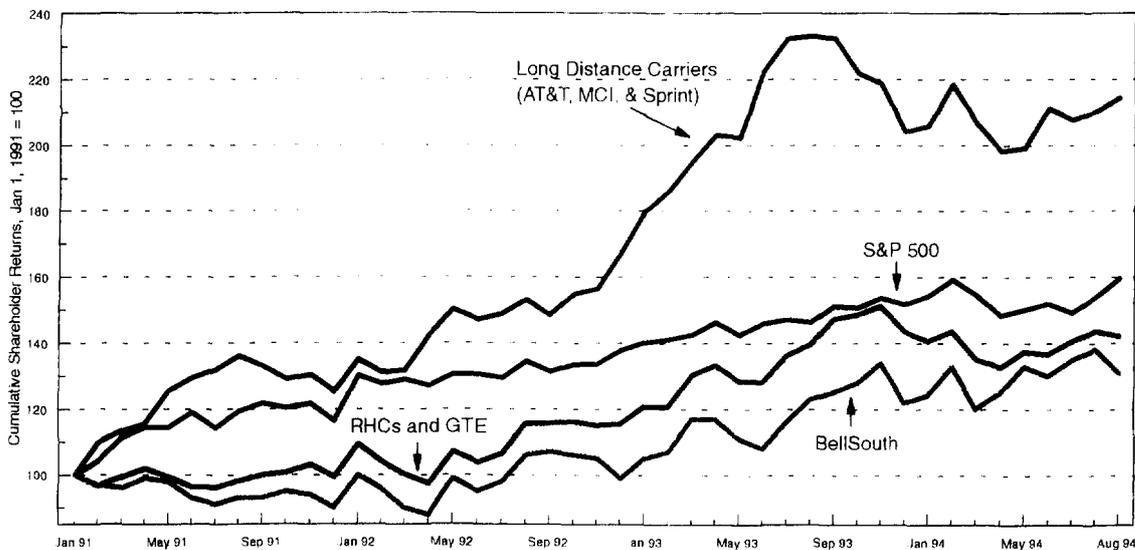
- **\$5.3 billion cumulative value LEC access charge reduction (Jan. 1991 to Dec. 1994)**
- **LEC investment increased - despite increased risk and reduced growth projects.**
 - **Ratio of BOC capital spending to cash flow up - 48% to 52%**
 - **Absolute level also increased**
 - **IXC ratio down - 57% to 48%**

Recent Trends In Prices And Shareholder Returns In Local And Long Distance Telecommunications Markets

Despite reductions in exchange access charges that have occurred since the LECs' price cap plan was implemented in January 1991, the interexchange carriers (IXCs) have raised interstate long distance rates sharply over the past 2 years. . .



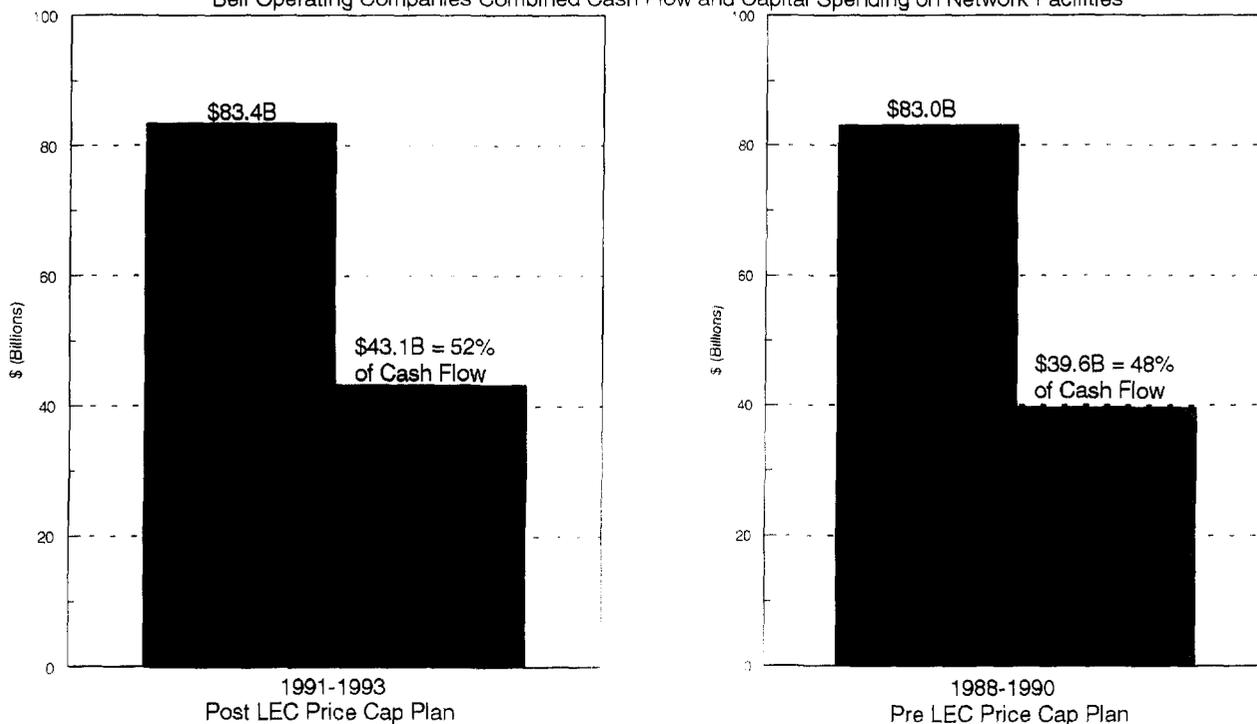
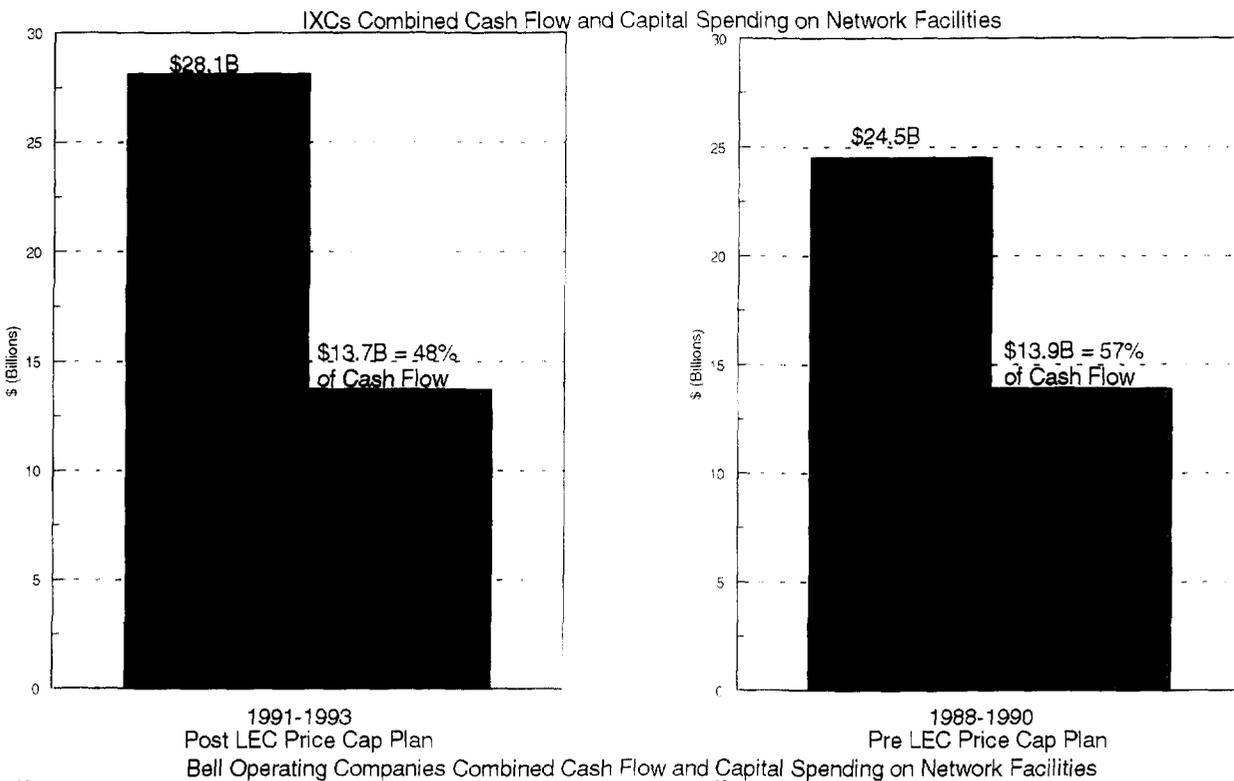
. . . shifting billions of dollars from local and long distance customers to IXC shareholders.



Note: Cumulative shareholder returns are based on market weighted monthly averages of total shareholder returns for individual companies.

Sources: Bureau of Labor Statistics, FCC, Compustat

Percentage of Cash Flow that the Interexchange Carriers and Bell Operating Companies Have Invested in Their Respective Telecommunications Networks Before and After the Implementation of Price Caps



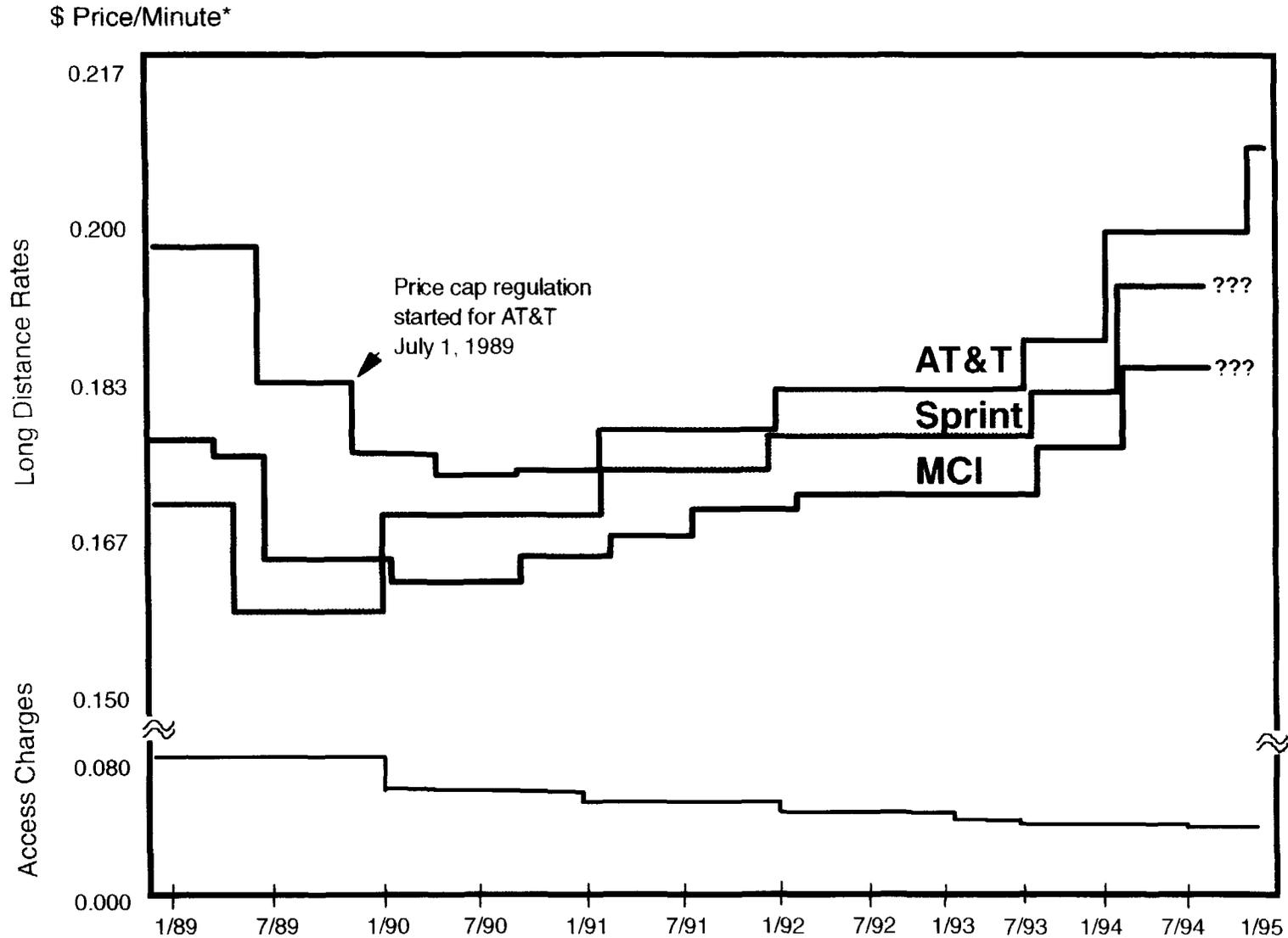
Note: Cash flow is earnings before interest, taxes, and depreciation and amortization.

Sources: Compustat and FCC Form M

WHO BENEFITS?

- **Consumer benefits from LEC improvements contingent on IXC**
- **LEC access charge reductions reaped by IXC shareholders**

Trends in Long Distance Rates and Exchange Access Charges



*Long distance rates based on the average price per minute for basic service.

AT&T's Telecommunications Services

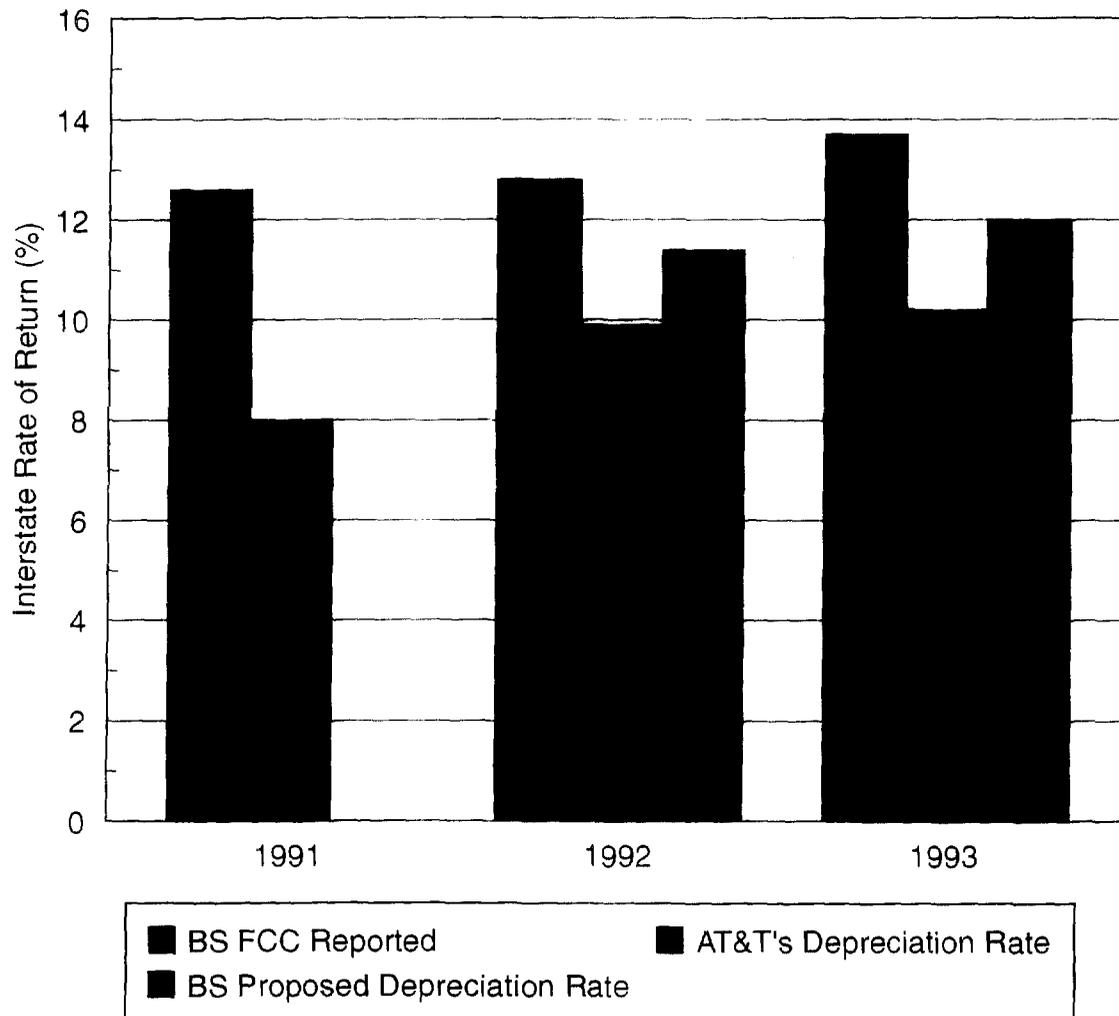
Dollars in Millions	1991	1992	1993	%Change 1991-93
Total Revenues	\$38,805	\$39,580	\$39,863	+2.73%
Access & Other Interconnection Costs	\$18,395	\$18,132	\$17,709	-3.73%
Gross Profit Margin	34.9%	36.2%	38.0%	+8.88%

EARNING LEVELS

- **Several measures of earnings**
 - **Backward looking accounting view not relevant**
 - **Investors consider economic data, prospectively**
- **Book earnings distorted by depreciation**
- **Total shareholder returns relevant and reasonable**

BellSouth's 1993 Interstate Rate of Return Would be Nearly Four Percentage Points Lower if it Depreciated its Plant and Equipment at the Same Rate AT&T Depreciates its Plant and Equipment

	BellSouth Reported Earnings	Earnings with AT&T Depreciation Rate	BellSouth Proposed Depreciation Rate
1991	12.6%	8.0%	N/A
1992	12.8%	9.9%	11.4%
1993	13.7%	10.2%	12.0%



Note: BellSouth's depreciation rate not applicable in 1991

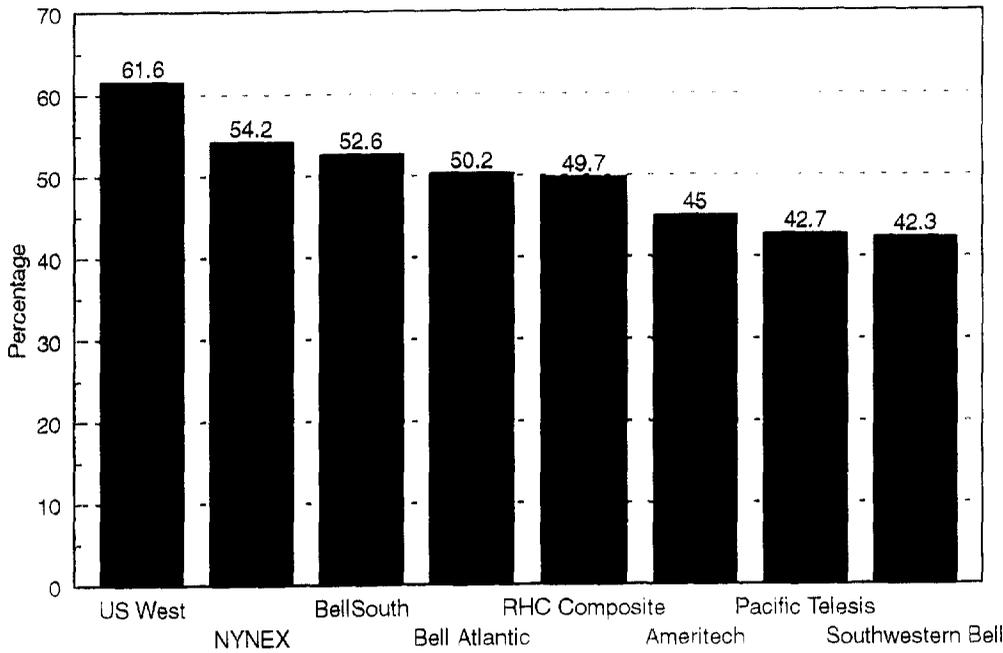
REGULATION MATTERS

- Markets link returns and investment
- RHC shareholders not being rewarded by BOC investing in local network

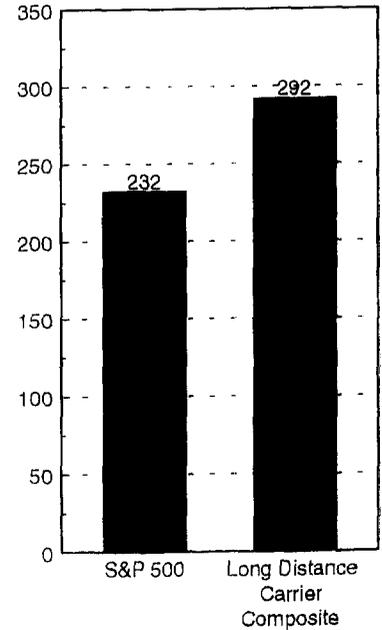
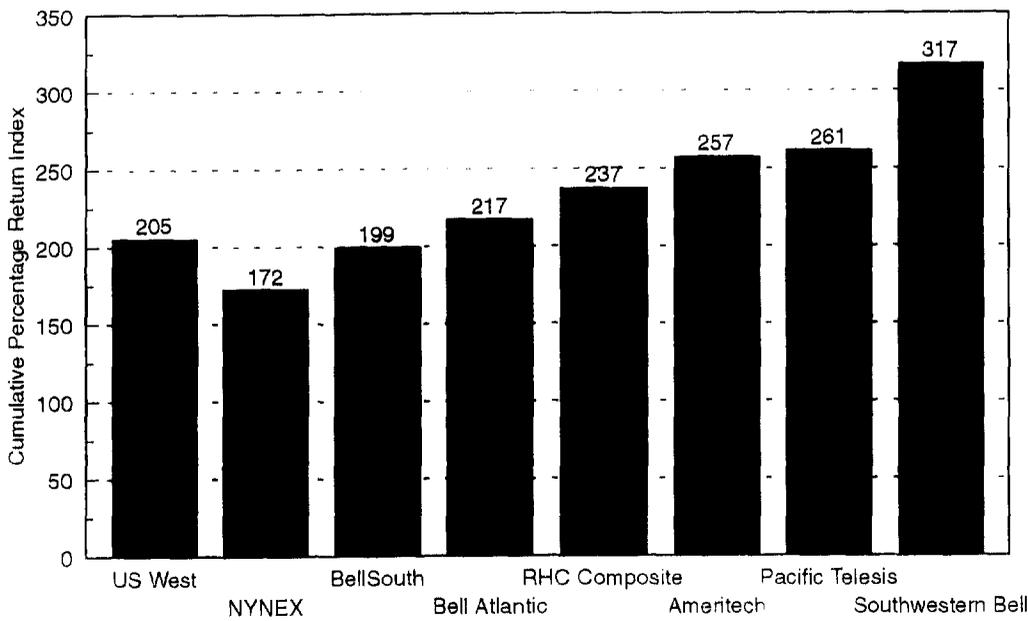
CONCLUSION

- REDUCING EARNINGS WILL REDUCE INVESTMENT
- INCREASING INCENTIVES WILL INCREASE INFRASTRUCTURE INVESTMENT

**Bell Operating Company's Capital Spending as Percent of Cash Flow
1988-1993**



**RHC Cumulative Shareholder Return
1988-Present**



Source: One Source and Compustat

Note: Cash flow on earnings before interest, taxes and depreciation, and amortization. Cumulative shareholder return includes dividend yield and price appreciation of RHC stocks since January 1, 1988.

BELLSOUTH PRICE CAP PROPOSALS
EX PARTE PRESENTATION
CC DOCKET 94-1
NOVEMBER 22, 1994

- I. REGULATORY REFORM AND INFRASTRUCTURE DEVELOPMENT ARE INSEPARABLE**
- A. Price Cap Reform Provides Commission Opportunity To Promote Development of NII**
 - B. Price Caps Plan Impacts LEC Investment Decisions**
 - C. Current Price Cap Plan Damages Incentives to Invest in the Core Network**
 - D. Commission's Current Rules Bias Market Outcomes by Handicapping LECs**
- II. PRICE REGULATION IS SUPERIOR TO COST OF SERVICE REGULATION**
- A. Price Regulation Emulates Economic Incentives of a Fully Competitive Marketplace**
 - B. Interstate Access Market Is Increasingly Competitive**
 - C. LECs Need Ability To Respond To Competition Through Pricing Flexibility and Introduction of New Services**
- III. SPECIFIC PRICE CAP CHANGES PROPOSED BY BELLSOUTH**
- A. Eliminate sharing and low end adjustment mechanisms**
 - 1. These mechanisms are no longer required as a "backstop" because of possible error in the level of the LEC productivity offset.
 - 2. They retain the perverse incentives associated with cost of service regulation.
 - 3. No sharing was required in either AT&T or Cable TV price regulation plans.
 - 4. Reported LEC earnings are inflated due to FCC prescribed uneconomic depreciation rates.
 - 5. Existence of sharing has been used to justify the continuance of burdensome depreciation regulations that are otherwise unnecessary.
 - B. Adopt reasonable productivity target**
 - 1. Credible record evidence shows current productivity target is set too high.
 - 2. Christensen study commissioned by USTA shows current productivity offset before CPD should be 2.3%. Updated average of Commission studies is 2.4%.
 - 3. Increasing competition will slow growth in access minutes of use, a principal source of historical LEC productivity growth.
 - 4. Productivity gains resulting from force reductions and other "one time" events cannot be repeated, making it difficult to replicate historical performance.
 - 5. Cable TV companies have a 0% productivity offset.

C. Extend Depreciation Price Cap Carrier Option to Price Cap LECs

1. Commission's current depreciation procedures for price cap LECs do not permit timely recovery of invested capital.
2. Depreciation is not exogenous and will not impact rates at all once sharing is eliminated.
3. BellSouth has identified a multi-billion dollar reserve deficiency in major technology accounts because of Commission's inappropriately prescribed depreciation rates.
4. Other carriers have already announced multi-billion dollar write downs of inadequately depreciated plant for financial reporting purposes.
5. Commission chose not to regulate depreciation rates of Cable TV companies.
6. Commission extended depreciation price cap carrier option to AT&T. Commission does not regulate depreciation rates of other long distance carriers.
7. Commission should address this issue on reconsideration in CC Docket No. 92-296.

D. Simplify Present Price Cap Pricing Structure

1. Present procedures are extremely burdensome and cumbersome and inhibit introduction of new services.
2. Reform the current cost support, rate structure, and tariff requirements to facilitate the introduction of new services.
3. Modify baskets and bands to replicate the outcome of a fully competitive marketplace.
4. Reduce number of categories and subcategories, expand zone pricing to switching, and increase downward pricing flexibility to encourage competitive response by price cap LECs.
5. Streamline regulation as markets become competitive.
6. Effective competition is demonstrated when a significant percentage of customers (e.g. 25%) in a defined geographic area can be addressed by competitor.
7. Address transition issues now. If transition issues must be deferred, a new phase of this proceeding should be initiated without delay.

IV. ADOPTING BELLSOUTH'S PRICE CAP PROPOSALS WILL BENEFIT CUSTOMERS

A. Improved incentives for infrastructure investment will result in more jobs and more investment in infrastructure for education and health care.

1. WEFA study indicates that a proper price regulation plan for LECs would spur 5 to 15 percent increase in infrastructure investment.
2. The WEFA study also concludes that 510,000 new jobs will be created in the domestic economy. A \$47.9 billion increase in the Gross Domestic Product by 2004 is also forecast.
3. Consistent and positive signals will be given to capital markets.

B. Enhanced deployment of new services in response to consumer and market demand will be encouraged.

C. Greater efficiency by carriers will result in enhanced competition and lower prices to consumers. The WEFA study concludes that consumer price inflation will be 1.4% less by the year 2004 due to the efficiencies and cost reductions that would occur throughout the economy.