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December 12, 1994

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DEC 12 1994

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY**

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

**RE: Ex Parte Material
CC Docket No. 94-1**

Dear Mr. Caton:

Attached are copies of the cover letters and materials that were delivered today to Michael Katz and Kathy Levitz. These materials are a follow up to an ex parte meeting that USTA representatives had on November 15, 1994 with Mr. Katz and Ms. Levitz. Because of the bulk of the material in Attachment C, I am supplying only the cover sheet for that attachment. The cover sheet contains the citations for the court opinions that were attached to the letters. Copies of those opinions are publicly available from several sources.

The original and a copy of this ex parte notice are being filed in the Office of the Secretary. Please include it in the public record of this proceeding.

Respectfully submitted,

Mary McDermott
Vice President & General Counsel

Attachments

No. of Copies rec'd 0+1
List A B C D E



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**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY**

December 12, 1994

Mr. Michael Katz, Chief Economist
Federal Communications Commission
1919 M Street, N.W. - Room 822
Washington, D.C. 20554

Re: CC Docket No. 94-1

Dear Mr. Katz,

Enclosed is the follow-up material from the discussion we had a couple weeks ago on the legal aspects of a price cap plan with no sharing or lower formula adjustment mechanism (LFAM).

First, I am attaching excerpts from past FCC orders on the AT&T and LEC price cap plans that discuss the workings of plans without sharing and LFAM. Those excerpts are contained in Attachment A. Although Ed Shakin and I mentioned these cites during our meeting, I thought it might be helpful to supply copies.

Second, I asked the local exchange carriers regulated under the price cap plan to review their filings in this docket to compile examples of how the LECs themselves have characterized the risk and reward balance under a "pure" price cap plan. Attachment B is a sampling from the LEC comments and replies. Where I thought specific material was particularly relevant, I marked it in the margins.

Finally, I have included copies of the court decisions that I think are most relevant to the legal inquiry on the "confiscation" issue. A list of these cases, as well as the text, is Attachment C. Included among them are the Bluefield Water Works and Hope Natural Gas decisions because these two invariably come up in discussions about confiscation and still provide useful guidance. More recent, however, are cases like

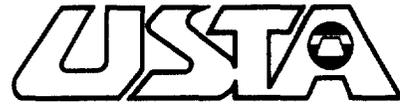
Wisconsin v. Federal Power Commission in which the Supreme Court stated "... no single method need be followed by the [Federal Power] Commission in considering the justness and reasonableness of rates..." and the Duquesne Light Co. case where that same court observed "the designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors." The final three cases that I have included in Attachment C are from the healthcare field and involve regulation of charges under Medicare and Medicaid programs. I thought they might be of interest to you because these cases discuss "confiscation" in the context of voluntary plans, essentially holding that if a regulatory plan is not compelled, there is no taking.

I hope this material is helpful and ask you to contact me if you have any questions or want any additional information on this issue.

Sincerely,

A handwritten signature in black ink that reads "Mary McDermott". The signature is written in a cursive, flowing style with a large initial "M".

Mary McDermott
Vice President and General Counsel



United States Telephone Association

1401 H Street, N.W., Suite 600
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December 12, 1994

Ms. Kathy Levitz, Deputy Chief
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W. - Room 500
Washington, D.C. 20554

Re: CC Docket No. 94-1

Dear Ms. Levitz,

Enclosed is the follow-up material from the discussion we had a couple weeks ago on the legal aspects of a price cap plan with no sharing or lower formula adjustment mechanism (LFAM).

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Court stated "... no single method need be followed by the [Federal Power] Commission in considering the justness and reasonableness of rates..." and the Duquesne Light Co. case where that same court observed "the designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors." The final three cases that I have included in Attachment C are from the healthcare field and involve regulation of charges under Medicare and Medicaid programs. I thought they might be of interest to you because these cases discuss "confiscation" in the context of voluntary plans, essentially holding that if a regulatory plan is not compelled, there is no taking.

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Mary McDermott
Vice President and General Counsel

Policy and Rules Concerning Rates for Dominant Carriers 4 FCC Rcd 2873 (1989)
(AT&T Price Cap Order)

Pages 3107-3111 (Paragraphs 479 to 491) Description of process for "above-cap" rates in the AT&T price cap plan.

Pages 3135-3136 (Paragraph 545) Complaint procedure under the AT&T price cap plan.

Policy and Rules Concerning Rates for Dominant Carriers 5 FCC Rcd 6786 (1990)
(LEC Price Cap Order)

Pages 6823-6824 (Paragraphs 303-304) Description of process for "above-cap" rates (outside of the lower formula adjustment) in the LEC price cap plan.

Page 6836 (Paragraphs 405-406) Relationship between price regulation and carrier costs and profits; Complaint procedure under the LEC price cap plan.

that, in some instances, this necessarily involves case-by-case adjudication to flesh out a general standard.

d. Above-Cap Rates

i. Summary of Further Notice

479. In the Further Notice we tentatively found that tariffs proposing above-cap rates would be filed on 90 days' notice, would generally be suspended, and would be required to be accompanied by cost support demonstrating that the rates were just and reasonable. We stated that the cost showing would include cost data for each element in the relevant basket for the most recent four years under price cap regulation, as well as a detailed explanation of the carriers' method of allocating costs among the rate elements. We deemed this extensive showing necessary to allow a determination that the costs driving the increase had been prudently incurred and that the increase was just and reasonable.¹⁰¹³ We considered using the substantial cause standard, but tentatively determined that that standard would not allow us to scrutinize above-cap filings sufficiently to insure maximim protection of consumer interests within the price cap system.

ii. Pleadings

480. AT&T objects strenuously to our proposal regarding above-cap filings on the grounds that it allows less flexibility and causes more cost and delay than current regulation. AT&T argues that it is not only difficult and expensive, but in some cases impossible, to defend "the necessarily arbitrary allocation of costs on such a minutely disaggregated basis."¹⁰¹⁴ AT&T notes that price and cost may not be related at the rate element level, citing as an example PRO America, in which, AT&T claims, there is no way to identify separately the costs of the fixed monthly charge and the usage-based charges.¹⁰¹⁵ AT&T also asserts that cost data may have little to do with the reason for an above-cap filing if, for example, an "across-the-basket" increase were proposed.¹⁰¹⁶

481. As an alternative, AT&T advocates a case-by-case approach, much as under the substantial cause standard for above-band filings. According to

¹⁰¹³ E.g., that the increase is necessary to avoid confiscation or to ensure acceptable service quality. Further Notice, 3 FCC Rod at 3375 (para. 319).

¹⁰¹⁴ AT&T Comments at 30-31.

¹⁰¹⁵ Id. at 31.

¹⁰¹⁶ Id. at 31 n.**.

AT&T, this Commission should assess the justification for a rate change in light of the particular circumstances, giving due consideration to carriers' costs, customers' expectations, and other relevant factors. Under AT&T's approach, the data needed to assess an above-cap filing would be determined on a case-by-case basis, depending on the type of change and the reason for it. AT&T also believes that 45 days' notice would be sufficient for an above-cap filing.¹⁰¹⁷

482. Ameritech concurs with AT&T, arguing that the specified cost showing is irrelevant and unreasonable when a rate package is filed in which total revenues for a basket exceed the cap. Ameritech proposes that the showing in such a case be based on total interstate cost and revenue data and that the rates be allowed if justified by extraordinary circumstances.¹⁰¹⁸

483. By contrast, Ad Hoc views our proposed showing as so similar to what the carriers file today that it invites them to make above-cap filings whenever they do not like the rates that they would need to charge to conform to the cap. Ad Hoc sees the above-cap filing as somehow less demanding than the substantial cause showing we proposed for above-band rates.¹⁰¹⁹ According to Ad Hoc, the "substantive bottom line" is unacceptable: carriers would be subject only to the traditional standard for carrier-initiated rates, that is, rates would be permitted as long as they were just and reasonable.¹⁰²⁰ Ad Hoc argues that, as a proper balance to the freedom carriers will be gaining to price below the caps, carriers seeking above-cap rates should have to show that such rates are, not merely just and reasonable, but actually necessary to avoid confiscation.¹⁰²¹

484. Colorado OCC believes that our proposal merely allows carriers to switch at will from price caps to cost-based regulation and back again.¹⁰²² Colorado OCC also interprets our discussion in the Further Notice as establishing three distinct standards for allowing above-cap rates: 1) the rates are necessary to avoid unlawful confiscation; 2) the rates are necessary to assure acceptable service quality; 3) the rates are necessary to cover costs prudently incurred. Colorado OCC asks whether we will ascertain a

1017 Id. at 31-32.

1018 Ameritech Comments at 39-40.

1019 Ad Hoc Comments at 15-16.

1020 Id. at 16.

1021 Id. at 20.

1022 Colorado OCC Comments at 21.

linkage between the service bearing a rate increase and the standard for justification which the carrier invokes. Finally, Colorado OCC asserts that the protection offered against confiscation is more exteme than under rate of return regulation, since rate of return gives investors the opportunity, not the right, to earn a fair return.¹⁰²³

485. Michigan PSC contends that 90 days is too short a time to review the thousands of pieces of paper that would be needed to make an above-cap filing, and suggests that a notice period of a year might be needed.¹⁰²⁴ Ohio proposes that above-cap rates be automatically suspended or even forbidden to take effect without regulatory approval.¹⁰²⁵

iii. Discussion

486. With minor modifications, we adopt our proposal to require a full cost-based showing for filings proposing above-cap rates.

487. We agree with AT&T that the showing we are adopting is less flexible and more difficult than the showings currently required of AT&T under rate of return. We fully intend it to be. Our price caps scheme grants AT&T significant new flexibility below the cap. Our determination that below-cap rates are presumptively just and reasonable requires us to look closely at all above-cap filings. Furthermore, because the purpose of price caps is to create incentives to reduce costs, consistent with rates falling within the zone of reasonableness, we must choose a method of handling tariffs proposing above-cap rates that preserves those incentives. If we did not examine the cost/price relationships for all services in the basket for which the carrier proposes to exceed the cap, and if we did not inquire into the investment and marketing decisions that led to the above-cap filing, then we would indeed be vulnerable to the criticisms put forth by Ad Hoc and others.

488. We disagree with the parties who contend that the required showing for above-cap rates is insufficiently stringent to restrain AT&T from exceeding the cap at will. While AT&T will be permitted to file above-cap tariffs when it sees fit to do so, and to have such tariffs reviewed on their merits, the showing we are requiring will be extensive and complex. It would take AT&T some time to develop such a showing.¹⁰²⁶ Once filed, it would be

¹⁰²³ Id. at 22.

¹⁰²⁴ Michigan PSC Comments at 21-22.

¹⁰²⁵ Ohio PUC Comments at 13.

¹⁰²⁶ Michigan PSC probably underestimates the scope of this showing at several thousand pages. We note, as we did earlier, that we cannot adopt the suggestion of Michigan PSC that we require longer notice periods for these

virtually certain to be suspended for five months, the maximum time allowed by the Act. Such a filing would be evaluated extremely carefully, in the light of a strong presumption that within-cap rates would be just and reasonable.¹⁰²⁷ We would not anticipate that above-cap rates would be routinely filed or granted, as the burden on AT&T would be greater than under existing procedures or under the substantial cause test. In any event, under our procedures, considerable time would elapse between the time AT&T decided it wanted an above-cap rate and the time such a rate went into effect, if at all. AT&T would not be able simply to switch from price caps back to rate of return regulation. A rational assessment of the possibilities should lead AT&T to the conclusion that an above-cap filing, while permissible, will only be permitted to take effect after suspension, where the justification is compelling, and that the best way to assure continuous profitability is to wholeheartedly pursue the efficiency incentives held out by the price caps program.

489. While AT&T will be given a fair opportunity to justify any above-cap rates, the difficult showing that AT&T must make is reasonable in light of the flexibility given to AT&T with respect to below-cap rates. Moreover, it is quite unlikely that, within the next four years, our formula will stray so far from actual costs that the cap will produce unreasonably low rates. We are beginning with existing, carrier-initiated rates; if those rates were not currently high enough, AT&T has had an opportunity to propose rate increases. We are allowing those rates to move with inflation and with changes in access charges and other exogenous costs. The flow-through of

filings. The Communications Act does not allow notice periods greater than 90 days. Likewise, we must reject Ohio PUC's suggestion that an above-cap rate be forbidden to take effect until approved; the Act does not allow suspensions longer than five months.

1027 Colorado OCC is incorrect in distilling from the Further Notice three distinct standards for approving an above-cap rate. Its first perceived standard, that the rate is necessary to avoid confiscation, was not a new or extended guarantee against confiscatory rates. The constitutional protection against confiscation is neither limited nor expanded by price caps regulation. Likewise, we mentioned the possibility that a rate increase might be justified on service quality grounds only to make clear that we will not force a carrier to degrade service quality to meet price cap constraints. We did not intend to hold out the promise that rates could routinely go above the cap as long as the carrier claimed the added revenues were needed to maintain service quality. The third standard mentioned by Colorado OCC, prudence of costs, was not mentioned as a reason for allowing above-cap rates but as a limitation upon purported justifications of such rates. In other words, AT&T will not be permitted to raise rates above the cap based on a cost showing unless the costs it shows were prudently incurred.

access charges alone means that AT&T is guaranteed rates reflecting all increases in its single largest expense. The productivity adjustment is well within the various estimates of the long term productivity of the industry; with the addition of the CPD, it represents a productivity goal we believe AT&T can and will exceed, given improved incentives.

490. We do recognize that not every rate element can be assigned a cost. As AT&T notes, one cannot assign costs as between the fixed and usage-based elements of the charges for a service like PRO America. On the other hand, when AT&T originally filed the tariffs for its services it had to demonstrate that the rate structures it proposed would recover the costs of the service. It may not be possible to assign discrete costs to each rate element of each service, but it should be possible to demonstrate how the pricing of each rate element is related to the cost of the service. In making a showing for an above-cap tariff, therefore, we will require AT&T to assign costs down to the lowest possible level, and to make a detailed explanation of the reasons for the prices of all rate elements to which it does not assign costs.

491. One further modification to our proposal is needed. We said in the Further Notice that the allocation of costs within the basket would have to be explained. Upon further consideration, however, it is apparent that we will also need an explanation of the manner in which AT&T has allocated all costs, not just exogenous costs, among baskets if we are to properly evaluate an above-cap filing. Otherwise, if we consider an above-cap filing for one basket without looking at the other baskets, the baskets will not perform their intended function of reducing the likelihood of cross-subsidy between less- and more-competitive services.

e. Below-Band Rates

1. Summary of Further Notice

492. In the Further Notice we proposed that tariffs which would decrease rates by more than 5 percent be filed on 45 days' notice and be accompanied by a showing that the rates cover the costs of providing service and are otherwise just, reasonable, and nondiscriminatory. We did not propose a particular economic standard by which to evaluate cost showings for below-band rates, but we solicited comment on the advantages of adopting a standard, such as average variable cost, for determining whether below-band prices are predatory for tariff review purposes.

ii. Pleadings

493. Parties' positions regarding procedures for reviewing tariff filings proposing below-band rates tend to mirror their positions on the likelihood of predatory pricing under the scheme set forth in the Further Notice and on the necessity of lower price bands. AT&T argues that all price decreases should be presumed lawful, that competitors should bear the burden

to pay for features they do not want.¹¹⁵² Arkansas PSC argues that the separations manual, USOA, and joint cost rules are all designed for rate of return regulation. In addition, Arkansas PSC requests additional explanation of the effect of price cap regulation on ONA.¹¹⁵³

c. Discussion

544. We conclude that the implementation of price cap regulation will be enhanced by the continuation of existing market rules, implementing regulations such as ONA and the joint cost rules, and the USOA and separations rules. We believe that the introduction of both ONA and price caps will benefit all ratepayers, and we do not believe that it is necessary to take steps in this proceeding to "stagger" the implementation, as the New Hampshire PUC suggests. Indeed, we believe that price cap regulation, by fostering innovation and efficiency, may contribute to the rapid and salutary implementation of AT&T's ONA plan. Furthermore, our decision to implement incentive regulation for AT&T does not require overhaul of the separations rules, the USOA, or the joint cost rules. While these regulations were all initiated during a time when this Commission was regulating AT&T by means of rate of return regulation, the purposes they serve remain just as important and necessary under price caps. In fact, retention of these rules ensures that the implementation of price caps on the federal level does not disrupt state regulatory systems, since all of the foundational regulatory activities leading up to jurisdictional separations remain in place.

3. Complaint Procedures

545. In the Further Notice, we tentatively decided to retain our existing complaint procedures.¹¹⁵⁴ Ohio PUC supports the retention of existing procedures in order to guard against abuse under price cap regulation.¹¹⁵⁵ API, however, contends that existing complaint procedures involve considerable delays.¹¹⁵⁶ In addition, IDCMA states that the statutory provisions for complaints do not specify the standards by which this Commission will judge complaints. IDCMA inquires whether a complainant will be required to show that AT&T's return on aggregate services exceeds its

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- 1152 New Hampshire PUC Comments at 16-17.
1153 Arkansas PSC Comments at 2.
1154 3 FCC Rod at 3380-81 (para. 332).
1155 Ohio PUC Comments at 17-18.
1156 API Comments at 28-29.

current rate of return.¹¹⁵⁷ We affirm our tentative conclusion to retain existing complaint procedures. Prompt resolution of complaints will be assisted by the recent adoption of legislation requiring this Commission to resolve complaints within one year or, in certain cases, 15 months.¹¹⁵⁸ The ultimate burden of proof continues to rest on the complainant.¹¹⁵⁹ However, to the extent that facts reside exclusively within the knowledge of the defendant carrier, the carrier has the burden of going forward with that evidence.¹¹⁶⁰ Once the carrier-defendant has met its burden of proving the facts within its knowledge, the ultimate burden of persuasion, as at present, must be carried by the complainant.

4. Interim Cost Allocation Manual

546. In the Further Notice, this Commission tentatively concluded that the Interim Cost Allocation Manual (ICAM) would be retained unless AT&T elects price cap regulation, in which case we proposed its use be discontinued.¹¹⁶¹ AT&T supports this Commission's tentative decision to discontinue use of the ICAM, and argues that the ICAM should be discontinued regardless of whether AT&T elects price caps. AT&T contends that the fully distributed cost methodology of the ICAM is arbitrary, wholly inconsistent with efficient pricing, and cannot measure earnings in any meaningful way.¹¹⁶² Ad Hoc and ICA contend that elimination of the ICAM will reduce reporting, and therefore reduce the data available to customers wishing to challenge AT&T's rates.¹¹⁶³ Comptel argues that the ICAM is intended to prevent AT&T from abusing its market power, and should not be eliminated, because there is no proven substitute in price cap regulation.¹¹⁶⁴

547. We conclude that the ICAM should be discontinued. Since the ICAM requires fully distributed costing between broad service categories, its

1157 IDCHA Comments at 51-52.

1158 See Federal Communications Commission Authorization Act of 1987, P.L. 100-594 (signed Nov. 3, 1988).

1159 MCI Telecommunications Corp. v. AT&T, 85 FCC 2d 994, 999 (1981).

1160 Hughes Sports Network v. AT&T, 25 FCC 2d 550, 553 (1970).

1161 3 FCC Rod at 3464 (para. 503).

1162 AT&T Comments at 49.

1163 Ad Hoc Reply at 19; ICA Comments, App. B (BRI Report) at 75-76.

1164 Comptel Comments at 26.

296. The Commission's proposal to require 90 days' notice for any tariff filing which proposes to raise rates above the 5 percent price band similarly stimulated much comment.³⁸¹ Some LECs contend that the 90 day notice period is excessive,³⁸² or that the whole proposal is burdensome and could result in unconstitutional confiscation.³⁸³ They also assert that the proposal in fact would afford ratepayers ample protection from cross-subsidization and large price increases.³⁸⁴ USTA generally supports our proposal as balancing the needs for limited pricing flexibility and additional customer safeguards.³⁸⁵

297. The Commission's conclusion that such tariffs would face a high probability of suspension and that, to become effective, they would have to be supported by a showing of substantial cause, did not assuage the concerns of some commenters. Some opponents assert that "substantial cause" is too light a burden,³⁸⁶ and that carriers filing such rates should be required to show that they will suffer "unconstitutional confiscation" of their property if their requested above-band rate increase is not allowed to take effect.³⁸⁷ Several other parties attack our proposed above-band standards as too vague or too weak.³⁸⁸

298. We conclude that we will require 90 days' notice for any tariff filing which would raise rates above the 5 percent price band. We have chosen a 90 day notice period because above-band rates raise questions about the distribution of rate increase burdens that require the fullest possible consideration by this Commission. Furthermore, a 90 day period will enable interested parties to conduct the type of analysis necessary to submit meaningful, substantive comments. Above-band, within-cap rate level changes will also face a high probability of suspension.

299. We expect LECs to present a compelling argument that the above-band increase was due to unexpected, unforeseeable, and unusual circumstances. We are satisfied that substantial cause is the proper standard for evaluating these filings. In the *AT & T Price Cap Order* the Commission defined the test and stated how it will be applied.³⁸⁹ The Commission specifically designed the substantial cause test to aid in the evaluation of tariff changes in circumstances in which customers have a legitimate expectation that change will not occur.³⁹⁰ Above-band rate increases fit this mold. Our price cap plan crosses in ratepayers the legitimate expectation that no individual rate will rise more than 5 percent each year, adjusted for changes in the price cap. Above-band increases act to undermine this expectation. While LECs may, in their discretion, file above-band rates, we consider it appropriate, as part of our carefully calibrated balance of ratepayer and shareholder interests, to impose the higher burden of substantial cause when carriers choose to exceed our pricing bands.³⁹¹

4. Above-cap filings

300. The *Second Further Notice* suggested a higher standard for tariffs proposing above-cap rates,³⁹² and we adopt that proposal here. In response to the *Second Further Notice* proposal, two LECs argue that the standards for above-cap filings are too strenuous,³⁹³ and a third asserts that this policy violates the doctrine of "carrier-initiated" rates.³⁹⁴ Ad Hoc reasserts its position that the Commission should permit above-cap filings only if the carrier demonstrates that it will suffer unconstitutional confiscation of its property without the above-cap rate increase.³⁹⁵

301. We do not find these arguments persuasive. We believe our standards for above-cap filings are appropriate in light of the overall degree of pricing flexibility we are affording the LECs. We find it unlikely that within the next four years our price cap formula will stray so far from actual costs that the cap will produce unreasonably low rates. We are initializing price caps based on existing rates. We are also allowing rates to move with inflation and changes in other exogenous costs. Thus, we conclude that it is only fair, from a ratepayer perspective, to set high hurdles for above-cap increases.

302. US West claims that we risk violating the doctrine of carrier-initiated rates if we require a LEC subject to mandatory price cap regulation, to meet a high standard for an above-cap rate filing. We understand the doctrine of carrier-initiated rates to limit our ability to bar the filing of tariff revisions by a carrier in such a way as to require that current tariffs be retained without change.³⁹⁶ The regulatory regime we are adopting for LECs does not disturb this doctrine. With our above-cap filing requirement, we impose no bar on tariff filings by LECs subject to mandatory price cap regulation. Instead, we simply clarify, in accordance with our authority to set standards for tariff review and pursuant to our obligation to assure that rates remain just and reasonable, that when above-cap rates are filed, a different and higher review standard will be applied than when the rates filed are within the cap. We are not prescribing any particular rates, nor are we requiring or forbidding any particular tariff revisions—carriers remain free to decide when tariff revisions are to be filed and the nature and extent of those revisions.³⁹⁷

303. We conclude that we will permit LECs to file tariffs proposing above-cap rate increases on 90 days' notice. Our review of these filings will be thorough and exacting.³⁹⁸ LECs should be prepared to submit extensive support materials in defense of their above-cap rate proposals.³⁹⁹ We have chosen stringent review standards in order to preserve the price cap incentive to reduce costs and keep rates within a zone of reasonableness. In support of an above-cap rate increase, LECs shall include with their proposals: (1) cost support data broken down to the lowest possible level for each relevant basket for each of the most recent four years under price cap regulation; (2) a detailed explanation of the reasons for the prices of all rate elements to which the LEC does not assign costs; (3) a comprehensive explanation of how the carrier allocated costs among rate elements in the relevant basket; and (4) an explanation of the manner in which the LEC has allocated all costs, not just exogenous costs, among all baskets. This last element is particularly important if we are to guard against any cross-subsidy between less- and more-competitive services.

304. Above-cap filings will be found lawful only in the unlikely event that these rules have the effect of denying a LEC the opportunity to attract capital and continue to operate, despite the low end adjustment mechanism and the opportunity provided the LEC to increase its earnings through greater efficiency.⁴⁰⁰ A LEC may request an above-cap rate increase by filing a tariff transmittal that complies with specific rules for such filings, a showing that includes but is not limited to the cost support information normally required in annual access tariff filings for LECs subject to rate of return regulation, and other information sufficient to establish that the increase is needed if the LEC is to have an opportunity to attract capital. We anticipate that any such increase will present

issues requiring an investigation and, as a protection for ratepayers, suspension of the increases until that investigation is completed or for the statutory period of five months.

5. Below-band filings

305. The *Second Further Notice* proposed that tariffs decreasing rates by more than 5 percent adjusted for changes in the PCI would be filed on 45 days' notice, and would be accompanied by a showing that the rates cover the costs of providing service and are otherwise just, reasonable, and nondiscriminatory.⁴⁰¹ The Commission suggested that the average variable cost standard adopted for AT&T should also be used as the standard by which to determine whether LEC proposed rates were predatorily low.⁴⁰² This proposal stimulated much comment, with views ranging from those opposing any restriction on rate decreases to those asserting that additional restrictions are necessary, or that below-band filings should face traditional rate of return regulation.

306. The LECs are divided in opinion on this proposal. Some offer qualified support.⁴⁰³ LEC opponents of our below-band proposal assert that no restrictions on downward price movements are necessary. They state that if there were an increase in the PCI, our proposed below-band standards would effectively raise the limit of the lower band, thereby driving rates which were previously just inside the lower limit down below it.⁴⁰⁴ Two LECs argue that there should be no lower band restriction at all.⁴⁰⁵

307. Other opponents of the proposed treatment of below-band tariffs state that it is based on the erroneous assumption that keeping prices above average variable cost will eliminate the possibility of predatory pricing.⁴⁰⁶ This may be true in a competitive market, these commenters suggest, but given LEC monopoly power, a more conservative approach is warranted.⁴⁰⁷

308. Other parties assert that the LECs are in effect demanding streamlined review for all rate reductions, regardless of magnitude, for the purpose of engaging in predatory pricing. They believe that the adoption of an average variable cost standard as the basis for permitting below-band rates will remove the last vestiges of protection against anticompetitive behavior by the LECs.⁴⁰⁸ One commenter concludes that we should continue to subject below-band rate reductions to traditional tariff review, including the cost support requirements of Section 61.38 of our Rules.⁴⁰⁹

309. We believe that rate reductions are generally beneficial to consumers and, more often than not, are undertaken for competitive reasons. Predatory pricing, though often alleged, is fairly uncommon, and proven cases are rare.⁴¹⁰ Further, our LEC service basket structure lessens the already unlikely occurrence of predation. We are convinced that below-band reductions introduced under our price cap system will be more pro-competitive than predatory; nonetheless, we have decided to err on the side of caution and not accord below-band filings streamlined tariff review. Therefore, we seek a standard which requires suspension only of those rates which are so low that they can be presumed to be anticompetitive.

310. We believe that average variable cost provides just such a standard. While disagreement exists on the point at which prices can be presumed legal, and on the role of intent in finding antitrust violations,⁴¹¹ the question

whether prices are below marginal cost, or its surrogate, average variable cost, is central to the determination of whether prices are predatory. In adopting average variable cost as a tariff review standard, we do not find that all rates which cover average variable cost are necessarily just, reasonable, and non-discriminatory. Petitioners may be able to show that there is reason to investigate a rate decrease which we permit to go into effect after 45 days. Competitors can also file complaints alleging predatory pricing. In either case, it might be possible to show that the resulting rate is above average variable cost but nonetheless predatory using relevant antitrust analysis and precedent.

311. We accordingly direct all LECs seeking to introduce below-band rate reductions to file their transmittals on 45 days' notice. Below-band rate filings must be accompanied by a showing that the rates cover the cost of service and are otherwise just, reasonable, and non-discriminatory. In reviewing these tariffs, we will employ the average variable cost standard to determine whether a below-band reduction should be suspended pending investigation.

6. New and restructured services

312. In the *Second Further Notice* the Commission proposed to distinguish between new and restructured services and to treat them as they are treated under AT&T's price cap plan.⁴¹² Some parts of the proposal drew little comment (e.g., definitions) while others stimulated a large response. Below, we define new services as any that enlarge the range of service offerings available to customers (i.e., all existing offerings remain available). We define restructured services as any that modify a method of charging or provisioning a service that does not result in a net increase of service options available to customers. We also decide that new services will not be incorporated into the price cap system immediately, but will be included in the LEC's cap in the first annual price cap tariff filing after the completion of the base year in which the new service becomes effective. Finally, we conclude that restructured services will be filed on 45 days' notice and must demonstrate compliance with the price cap and banding limits of the basket to which they belong.

a. Definitions

313. The proposal to distinguish between new and restructured services in a manner identical to the treatment of new and restructured services offered by AT&T under price caps drew little comment.⁴¹³ Some of the comments relating to the proposed definitions concern matters not directly related to price cap regulation.⁴¹⁴

314. New and restructured services, because they present different issues, must undergo separate forms of regulatory analysis. It is important, therefore, to set a standard for distinguishing these services from one another. We will consider as new, services which add to the range of options already available to customers. A new service may, but need not, include a new technology or functional capability. Many new services are, in essence, re-priced versions of already-existing services. It is indeed rare for a carrier to offer a wholly different form of telecommunications service. As long as the pre-existing service is still offered, and the range of alternatives available to consumers is increased, we will classify the service as new. Restructured services, on the other hand, involve the rearrangement of existing services. Carriers can

Atlantic's suggestion that we defer consideration of this rule to our pending Part 65 proceeding. The termination of rate of return regulation for price cap carriers requires that we make provision for possible overearnings in the final enforcement period leading to price cap regulation. We also reject US West's suggestion regarding cash refunds because we believe that prospective PCI adjustments are simpler for us to monitor, easier for the affected LECs to implement, and considerably limit the potential for discrimination among ratepayers.⁵⁶⁴ In addition, we reject the suggestion of US West that this Commission lacks authority to order refunds except where a carrier has proposed a rate increase and an accounting order has been entered.⁵⁶⁷ We wish to make clear, as we have in earlier proceedings, that our refund authority under Section 204 is not limited to such cases,⁵⁶⁸ and that our refund authority extends beyond Section 204.⁵⁶⁹

V. LEGAL AUTHORITY

401. In adopting price cap regulation for AT&T, the Commission explained in detail the legal basis for its action.⁵⁷⁰ We concluded, *inter alia*, that: (1) substitution of price cap regulation for traditional rate of return regulation was within our authority under the Communications Act; (2) price cap regulation would comply with the Act's requirement that rates be just, reasonable, and non-discriminatory; (3) our no-suspension zone approach to price cap regulation was consistent with the Act and relevant judicial authority; (4) a rate prescription was not required in connection with our use of existing rates; and (5) a *de facto* rate prescription had not been undertaken in connection with or no suspension zone approach to price caps. Consistent with our tentative conclusion in the *Second Further Notice* that price cap regulation of local exchange carriers is lawful,⁵⁷¹ we conclude, for the reasons set forth there and supplemented below, that the LEC price cap plan adopted today is within our legal authority under the Act, and that it will assure that LEC interstate rates remain just, reasonable, and non-discriminatory.

402. The primary basis for this conclusion is that our price cap plan for the LECs largely tracks our AT&T price cap plan. Both plans feature a streamlined tariff review process with suspension and no-suspension zones, baskets, service categories, and bands to guard against precipitous price changes for particular services, as well as a price cap formula that is based on existing rates,⁵⁷² reflects cost changes and includes a Consumer Productivity Dividend that requires carriers to increase their productivity above historical levels to take advantage of the increased flexibility provided by the price cap system. Several parties repeat legal arguments previously rejected in the context of the AT&T plan, but they do not explain why our legal conclusions in that context were wrong or are not directly applicable to price caps for LECs.⁵⁷³ Accordingly, we again reject those arguments for the reasons set forth in the *AT&T Price Cap Order*.

403. Compared with the price cap plan we adopted for AT&T, we have added one additional safeguard to our LEC plan to respond to the concern that, as discussed previously,⁵⁷⁴ we may not be able to select a productivity figure for the LECs in which we have precisely the same high degree of confidence as we have in the productivity figure chosen for AT&T. As a result of this concern, there is some risk that relying solely on the approach taken in

the AT&T plan could result in a particular LEC earning increased profits that are not necessarily tied to increases in productivity. Accordingly, we have adopted a sharing mechanism, described in detail above, for carriers that comply with price cap ceilings.⁵⁷⁵ By setting an upper limit on LEC profits and adding an additional mechanism to ensure that ratepayers directly benefit from any increases in profits,⁵⁷⁸ we are further ensuring that LEC rates will remain within a zone of reasonableness.

404. We adopt the sharing mechanism pursuant to our general Rule Making authority contained in Sections 4(i) and 201-203 of the Act as well as our prescription authority contained in Section 205 of the Act.⁵⁷⁷ In addition to the sharing mechanism, and under the same authority, we have included in our LEC price cap plan a lower end adjustment mechanism consistent with our obligation to ensure that LEC rates are not confiscatory.⁵⁷⁸

405. We disagree with those who argue that our price cap plan fails to assure just and reasonable rates because it does not adequately take carrier costs and profits into account.⁵⁷⁹ As we have explained, price cap rates do reflect costs and take profits into account, albeit in a different manner than do rate of return rates.⁵⁸⁰ Our decision to modify the manner in which we take costs and profits into account is based on our analysis that the price cap cost benchmark will produce efficiencies unattainable in the prior regulatory system, and is fully supported by relevant precedent.⁵⁸¹ Furthermore, the relative absence of competition compared to the interexchange market is not a legal basis to block price cap reform for LECs, as some have claimed.⁵⁸² Price cap regulation for AT&T was not predicated on the existence of competition, and nothing in the design of LEC price cap regulation is predicated on the existence of competition for interstate access services. In fact, the absence of competition is one reason we decided to employ the backstop of a sharing mechanism to prevent even the possibility of excessive monopoly earnings.⁵⁸³

406. With respect to costs and profits, we will continue to rely, as we do with AT&T, on the Section 204 investigation and Section 208 complaint processes as part of our plan to ensure just, reasonable, and non-discriminatory rates.⁵⁸⁴ In light of our selection of the sharing and adjustment mechanisms, complaints claiming that overall company earnings that comply with the sharing mechanism are excessive in view of costs will not lie. Since our sharing mechanism does not relate to specific rates, however, complaints that particular rates are unjust and unreasonable in light of the relevant costs and profits, or that they are discriminatory, may continue to be filed. In addition, if a LEC does not appear to be in compliance with the sharing mechanism, its tariffs would be subject to investigation and suspension pending an inquiry into the extent to which its price cap indexes had been sufficiently reduced to properly account for its historical earnings. Complaints could also be filed in this case. Similarly, if a LEC has been permitted to charge above-cap rates, the sharing mechanisms would no longer apply, and the LEC's rates would be subject to complaint on the basis that they are unjust and unreasonable in light of the current rate of return prescription. Thus, our investigation and complaint processes will remain important tools in ensuring just, reasonable, and non-discriminatory rates, and in monitoring carrier costs and profits.

Policy and Rules Concerning Rates for Dominant Carriers 4 FCC Rcd 2873 (1989)
(AT&T Price Cap Order)

Pages 3107-3111 (Paragraphs 479 to 491) Description of process for "above-cap" rates in the AT&T price cap plan.

Pages 3135-3136 (Paragraph 545) Complaint procedure under the AT&T price cap plan.

Policy and Rules Concerning Rates for Dominant Carriers 5 FCC Rcd 6786 (1990)
(LEC Price Cap Order)

Pages 6823-6824 (Paragraphs 303-304) Description of process for "above-cap" rates (outside of the lower formula adjustment) in the LEC price cap plan.

Page 6836 (Paragraphs 405-406) Relationship between price regulation and carrier costs and profits; Complaint procedure under the LEC price cap plan.

that, in some instances, this necessarily involves case-by-case adjudication to flesh out a general standard.

d. Above-Cap Rates

i. Summary of Further Notice

479. In the Further Notice we tentatively found that tariffs proposing above-cap rates would be filed on 90 days' notice, would generally be suspended, and would be required to be accompanied by cost support demonstrating that the rates were just and reasonable. We stated that the cost showing would include cost data for each element in the relevant basket for the most recent four years under price cap regulation, as well as a detailed explanation of the carriers' method of allocating costs among the rate elements. We deemed this extensive showing necessary to allow a determination that the costs driving the increase had been prudently incurred and that the increase was just and reasonable.¹⁰¹³ We considered using the substantial cause standard, but tentatively determined that that standard would not allow us to scrutinize above-cap filings sufficiently to insure maximum protection of consumer interests within the price cap system.

ii. Pleadings

480. AT&T objects strenuously to our proposal regarding above-cap filings on the grounds that it allows less flexibility and causes more cost and delay than current regulation. AT&T argues that it is not only difficult and expensive, but in some cases impossible, to defend "the necessarily arbitrary allocation of costs on such a minutely disaggregated basis."¹⁰¹⁴ AT&T notes that price and cost may not be related at the rate element level, citing as an example PRO America, in which, AT&T claims, there is no way to identify separately the costs of the fixed monthly charge and the usage-based charges.¹⁰¹⁵ AT&T also asserts that cost data may have little to do with the reason for an above-cap filing if, for example, an "across-the-basket" increase were proposed.¹⁰¹⁶

481. As an alternative, AT&T advocates a case-by-case approach, much as under the substantial cause standard for above-band filings. According to

1013 E.g., that the increase is necessary to avoid confiscation or to ensure acceptable service quality. Further Notice, 3 FCC Rod at 3375 (para. 319).

1014 AT&T Comments at 30-31.

1015 Id. at 31.

1016 Id. at 31 n.**.

AT&T, this Commission should assess the justification for a rate change in light of the particular circumstances, giving due consideration to carriers' costs, customers' expectations, and other relevant factors. Under AT&T's approach, the data needed to assess an above-cap filing would be determined on a case-by-case basis, depending on the type of change and the reason for it. AT&T also believes that 45 days' notice would be sufficient for an above-cap filing.¹⁰¹⁷

482. Ameritech concurs with AT&T, arguing that the specified cost showing is irrelevant and unreasonable when a rate package is filed in which total revenues for a basket exceed the cap. Ameritech proposes that the showing in such a case be based on total interstate cost and revenue data and that the rates be allowed if justified by extraordinary circumstances.¹⁰¹⁸

483. By contrast, Ad Hoc views our proposed showing as so similar to what the carriers file today that it invites them to make above-cap filings whenever they do not like the rates that they would need to charge to conform to the cap. Ad Hoc sees the above-cap filing as somehow less demanding than the substantial cause showing we proposed for above-band rates.¹⁰¹⁹ According to Ad Hoc, the "substantive bottom line" is unacceptable: carriers would be subject only to the traditional standard for carrier-initiated rates, that is, rates would be permitted as long as they were just and reasonable.¹⁰²⁰ Ad Hoc argues that, as a proper balance to the freedom carriers will be gaining to price below the caps, carriers seeking above-cap rates should have to show that such rates are, not merely just and reasonable, but actually necessary to avoid confiscation.¹⁰²¹

484. Colorado OCC believes that our proposal merely allows carriers to switch at will from price caps to cost-based regulation and back again.¹⁰²² Colorado OCC also interprets our discussion in the Further Notice as establishing three distinct standards for allowing above-cap rates: 1) the rates are necessary to avoid unlawful confiscation; 2) the rates are necessary to assure acceptable service quality; 3) the rates are necessary to cover costs prudently incurred. Colorado OCC asks whether we will ascertain a

1017 Id. at 31-32.

1018 Ameritech Comments at 39-40.

1019 Ad Hoc Comments at 15-16.

1020 Id. at 16.

1021 Id. at 20.

1022 Colorado OCC Comments at 21.

linkage between the service bearing a rate increase and the standard for justification which the carrier invokes. Finally, Colorado OCC asserts that the protection offered against confiscation is more exteme than under rate of return regulation, since rate of return gives investors the opportunity, not the right, to earn a fair return.¹⁰²³

485. Michigan PSC contends that 90 days is too short a time to review the thousands of pieces of paper that would be needed to make an above-cap filing, and suggests that a notice period of a year might be needed.¹⁰²⁴ Ohio proposes that above-cap rates be automatically suspended or even forbidden to take effect without regulatory approval.¹⁰²⁵

iii. Discussion

486. With minor modifications, we adopt our proposal to require a full cost-based showing for filings proposing above-cap rates.

487. We agree with AT&T that the showing we are adopting is less flexible and more difficult than the showings currently required of AT&T under rate of return. We fully intend it to be. Our price caps scheme grants AT&T significant new flexibility below the cap. Our determination that below-cap rates are presumptively just and reasonable requires us to look closely at all above-cap filings. Furthermore, because the purpose of price caps is to create incentives to reduce costs, consistent with rates falling within the zone of reasonableness, we must choose a method of handling tariffs proposing above-cap rates that preserves those incentives. If we did not examine the cost/price relationships for all services in the basket for which the carrier proposes to exceed the cap, and if we did not inquire into the investment and marketing decisions that led to the above-cap filing, then we would indeed be vulnerable to the criticisms put forth by Ad Hoc and others.

488. We disagree with the parties who contend that the required showing for above-cap rates is insufficiently stringent to restrain AT&T from exceeding the cap at will. While AT&T will be permitted to file above-cap tariffs when it sees fit to do so, and to have such tariffs reviewed on their merits, the showing we are requiring will be extensive and complex. It would take AT&T some time to develop such a showing.¹⁰²⁶ Once filed, it would be

¹⁰²³ Id. at 22.

¹⁰²⁴ Michigan PSC Comments at 21-22.

¹⁰²⁵ Ohio PUC Comments at 13.

¹⁰²⁶ Michigan PSC probably underestimates the scope of this showing at several thousand pages. We note, as we did earlier, that we cannot adopt the suggestion of Michigan PSC that we require longer notice periods for these

virtually certain to be suspended for five months, the maximum time allowed by the Act. Such a filing would be evaluated extremely carefully, in the light of a strong presumption that within-cap rates would be just and reasonable.¹⁰²⁷ We would not anticipate that above-cap rates would be routinely filed or granted, as the burden on AT&T would be greater than under existing procedures or under the substantial cause test. In any event, under our procedures, considerable time would elapse between the time AT&T decided it wanted an above-cap rate and the time such a rate went into effect, if at all. AT&T would not be able simply to switch from price caps back to rate of return regulation. A rational assessment of the possibilities should lead AT&T to the conclusion that an above-cap filing, while permissible, will only be permitted to take effect after suspension, where the justification is compelling, and that the best way to assure continuous profitability is to wholeheartedly pursue the efficiency incentives held out by the price caps program.

489. While AT&T will be given a fair opportunity to justify any above-cap rates, the difficult showing that AT&T must make is reasonable in light of the flexibility given to AT&T with respect to below-cap rates. Moreover, it is quite unlikely that, within the next four years, our formula will stray so far from actual costs that the cap will produce unreasonably low rates. We are beginning with existing, carrier-initiated rates; if those rates were not currently high enough, AT&T has had an opportunity to propose rate increases. We are allowing those rates to move with inflation and with changes in access charges and other exogenous costs. The flow-through of

filings. The Communications Act does not allow notice periods greater than 90 days. Likewise, we must reject Ohio PUC's suggestion that an above-cap rate be forbidden to take effect until approved; the Act does not allow suspensions longer than five months.

1027 Colorado OCC is incorrect in distilling from the Further Notice three distinct standards for approving an above-cap rate. Its first perceived standard, that the rate is necessary to avoid confiscation, was not a new or extended guarantee against confiscatory rates. The constitutional protection against confiscation is neither limited nor expanded by price caps regulation. Likewise, we mentioned the possibility that a rate increase might be justified on service quality grounds only to make clear that we will not force a carrier to degrade service quality to meet price cap constraints. We did not intend to hold out the promise that rates could routinely go above the cap as long as the carrier claimed the added revenues were needed to maintain service quality. The third standard mentioned by Colorado OCC, prudence of costs, was not mentioned as a reason for allowing above-cap rates but as a limitation upon purported justifications of such rates. In other words, AT&T will not be permitted to raise rates above the cap based on a cost showing unless the costs it shows were prudently incurred.

access charges alone means that AT&T is guaranteed rates reflecting all increases in its single largest expense. The productivity adjustment is well within the various estimates of the long term productivity of the industry; with the addition of the CPD, it represents a productivity goal we believe AT&T can and will exceed, given improved incentives.

490. We do recognize that not every rate element can be assigned a cost. As AT&T notes, one cannot assign costs as between the fixed and usage-based elements of the charges for a service like PRO America. On the other hand, when AT&T originally filed the tariffs for its services it had to demonstrate that the rate structures it proposed would recover the costs of the service. It may not be possible to assign discrete costs to each rate element of each service, but it should be possible to demonstrate how the pricing of each rate element is related to the cost of the service. In making a showing for an above-cap tariff, therefore, we will require AT&T to assign costs down to the lowest possible level, and to make a detailed explanation of the reasons for the prices of all rate elements to which it does not assign costs.

491. One further modification to our proposal is needed. We said in the Further Notice that the allocation of costs within the basket would have to be explained. Upon further consideration, however, it is apparent that we will also need an explanation of the manner in which AT&T has allocated all costs, not just exogenous costs, among baskets if we are to properly evaluate an above-cap filing. Otherwise, if we consider an above-cap filing for one basket without looking at the other baskets, the baskets will not perform their intended function of reducing the likelihood of cross-subsidy between less- and more-competitive services.

e. Below-Band Rates

i. Summary of Further Notice

492. In the Further Notice we proposed that tariffs which would decrease rates by more than 5 percent be filed on 45 days' notice and be accompanied by a showing that the rates cover the costs of providing service and are otherwise just, reasonable, and nondiscriminatory. We did not propose a particular economic standard by which to evaluate cost showings for below-band rates, but we solicited comment on the advantages of adopting a standard, such as average variable cost, for determining whether below-band prices are predatory for tariff review purposes.

ii. Pleadings

493. Parties' positions regarding procedures for reviewing tariff filings proposing below-band rates tend to mirror their positions on the likelihood of predatory pricing under the scheme set forth in the Further Notice and on the necessity of lower price bands. AT&T argues that all price decreases should be presumed lawful, that competitors should bear the burden

to pay for features they do not want.¹¹⁵² Arkansas PSC argues that the separations manual, USOA, and joint cost rules are all designed for rate of return regulation. In addition, Arkansas PSC requests additional explanation of the effect of price cap regulation on ONA.¹¹⁵³

c. Discussion

544. We conclude that the implementation of price cap regulation will be enhanced by the continuation of existing market rules, implementing regulations such as ONA and the joint cost rules, and the USOA and separations rules. We believe that the introduction of both ONA and price caps will benefit all ratepayers, and we do not believe that it is necessary to take steps in this proceeding to "stagger" the implementation, as the New Hampshire PUC suggests. Indeed, we believe that price cap regulation, by fostering innovation and efficiency, may contribute to the rapid and salutary implementation of AT&T's ONA plan. Furthermore, our decision to implement incentive regulation for AT&T does not require overhaul of the separations rules, the USOA, or the joint cost rules. While these regulations were all initiated during a time when this Commission was regulating AT&T by means of rate of return regulation, the purposes they serve remain just as important and necessary under price caps. In fact, retention of these rules ensures that the implementation of price caps on the federal level does not disrupt state regulatory systems, since all of the foundational regulatory activities leading up to jurisdictional separations remain in place.

3. Complaint Procedures

545. In the Further Notice, we tentatively decided to retain our existing complaint procedures.¹¹⁵⁴ Ohio PUC supports the retention of existing procedures in order to guard against abuse under price cap regulation.¹¹⁵⁵ API, however, contends that existing complaint procedures involve considerable delays.¹¹⁵⁶ In addition, IDCMA states that the statutory provisions for complaints do not specify the standards by which this Commission will judge complaints. IDCMA inquires whether a complainant will be required to show that AT&T's return on aggregate services exceeds its

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- 1152 New Hampshire PUC Comments at 16-17.
1153 Arkansas PSC Comments at 2.
1154 3 FCC Rod at 3380-81 (para. 332).
1155 Ohio PUC Comments at 17-18.
1156 API Comments at 28-29.

current rate of return.¹¹⁵⁷ We affirm our tentative conclusion to retain existing complaint procedures. Prompt resolution of complaints will be assisted by the recent adoption of legislation requiring this Commission to resolve complaints within one year or, in certain cases, 15 months.¹¹⁵⁸ The ultimate burden of proof continues to rest on the complainant.¹¹⁵⁹ However, to the extent that facts reside exclusively within the knowledge of the defendant carrier, the carrier has the burden of going forward with that evidence.¹¹⁶⁰ Once the carrier-defendant has met its burden of proving the facts within its knowledge, the ultimate burden of persuasion, as at present, must be carried by the complainant.

4. Interim Cost Allocation Manual

546. In the Further Notice, this Commission tentatively concluded that the Interim Cost Allocation Manual (ICAM) would be retained unless AT&T elects price cap regulation, in which case we proposed its use be discontinued.¹¹⁶¹ AT&T supports this Commission's tentative decision to discontinue use of the ICAM, and argues that the ICAM should be discontinued regardless of whether AT&T elects price caps. AT&T contends that the fully distributed cost methodology of the ICAM is arbitrary, wholly inconsistent with efficient pricing, and cannot measure earnings in any meaningful way.¹¹⁶² Ad Hoc and ICA contend that elimination of the ICAM will reduce reporting, and therefore reduce the data available to customers wishing to challenge AT&T's rates.¹¹⁶³ Comptel argues that the ICAM is intended to prevent AT&T from abusing its market power, and should not be eliminated, because there is no proven substitute in price cap regulation.¹¹⁶⁴

547. We conclude that the ICAM should be discontinued. Since the ICAM requires fully distributed costing between broad service categories, its

1157 IDCMA Comments at 51-52.

1158 See Federal Communications Commission Authorization Act of 1987, P.L. 100-594 (signed Nov. 3, 1988).

1159 MCI Telecommunications Corp. v. AT&T, 85 FCC 2d 994, 999 (1981).

1160 Hughes Sports Network v. AT&T, 25 FCC 2d 550, 553 (1970).

1161 3 FCC Rod at 3464 (para. 503).

1162 AT&T Comments at 49.

1163 Ad Hoc Reply at 19; ICA Comments, App. B (BRI Report) at 75-76.

1164 Comptel Comments at 26.

296. The Commission's proposal to require 90 days' notice for any tariff filing which proposes to raise rates above the 5 percent price band similarly stimulated much comment.³⁸¹ Some LECs contend that the 90 day notice period is excessive,³⁸² or that the whole proposal is burdensome and could result in unconstitutional confiscation.³⁸³ They also assert that the proposal in fact would afford ratepayers ample protection from cross-subsidization and large price increases.³⁸⁴ USTA generally supports our proposal as balancing the needs for limited pricing flexibility and additional customer safeguards.³⁸⁵

297. The Commission's conclusion that such tariffs would face a high probability of suspension and that, to become effective, they would have to be supported by a showing of substantial cause, did not assuage the concerns of some commenters. Some opponents assert that "substantial cause" is too light a burden,³⁸⁶ and that carriers filing such rates should be required to show that they will suffer "unconstitutional confiscation" of their property if their requested above-band rate increase is not allowed to take effect.³⁸⁷ Several other parties attack our proposed above-band standards as too vague or too weak.³⁸⁸

298. We conclude that we will require 90 days' notice for any tariff filing which would raise rates above the 5 percent price band. We have chosen a 90 day notice period because above-band rates raise questions about the distribution of rate increase burdens that require the fullest possible consideration by this Commission. Furthermore, a 90 day period will enable interested parties to conduct the type of analysis necessary to submit meaningful, substantive comments. Above-band, within-cap rate level changes will also face a high probability of suspension.

299. We expect LECs to present a compelling argument that the above-band increase was due to unexpected, unforeseeable, and unusual circumstances. We are satisfied that substantial cause is the proper standard for evaluating these filings. In the *AT & T Price Cap Order* the Commission defined the test and stated how it will be applied.³⁸⁹ The Commission specifically designed the substantial cause test to aid in the evaluation of tariff changes in circumstances in which customers have a legitimate expectation that change will not occur.³⁹⁰ Above-band rate increases fit this mold. Our price cap plan creates in ratepayers the legitimate expectation that no individual rate will rise more than 5 percent each year, adjusted for changes in the price cap. Above-band increases act to undermine this expectation. While LECs may, in their discretion, file above-band rates, we consider it appropriate, as part of our carefully calibrated balance of ratepayer and shareholder interests, to impose the higher burden of substantial cause when carriers choose to exceed our pricing bands.³⁹¹

4. Above-cap filings

300. The *Second Further Notice* suggested a higher standard for tariffs proposing above-cap rates,³⁹² and we adopt that proposal here. In response to the *Second Further Notice* proposal, two LECs argue that the standards for above-cap filings are too strenuous,³⁹³ and a third asserts that this policy violates the doctrine of "carrier-initiated" rates.³⁹⁴ Ad Hoc reasserts its position that the Commission should permit above-cap filings only if the carrier demonstrates that it will suffer unconstitutional confiscation of its property without the above-cap rate increase.³⁹⁵

301. We do not find these arguments persuasive. We believe our standards for above-cap filings are appropriate in light of the overall degree of pricing flexibility we are affording the LECs. We find it unlikely that within the next four years our price cap formula will stray so far from actual costs that the cap will produce unreasonably low rates. We are initializing price caps based on existing rates. We are also allowing rates to move with inflation and changes in other exogenous costs. Thus, we conclude that it is only fair, from a ratepayer perspective, to set high hurdles for above-cap increases.

302. US West claims that we risk violating the doctrine of carrier-initiated rates if we require a LEC subject to mandatory price cap regulation, to meet a high standard for an above-cap rate filing. We understand the doctrine of carrier-initiated rates to limit our ability to bar the filing of tariff revisions by a carrier in such a way as to require that current tariffs be retained without change.³⁹⁶ The regulatory regime we are adopting for LECs does not disturb this doctrine. With our above-cap filing requirement, we impose no bar on tariff filings by LECs subject to mandatory price cap regulation. Instead, we simply clarify, in accordance with our authority to set standards for tariff review and pursuant to our obligation to assure that rates remain just and reasonable, that when above-cap rates are filed, a different and higher review standard will be applied than when the rates filed are within the cap. We are not prescribing any particular rates, nor are we requiring or forbidding any particular tariff revisions—carriers remain free to decide when tariff revisions are to be filed and the nature and extent of those revisions.³⁹⁷

303. We conclude that we will permit LECs to file tariffs proposing above-cap rate increases on 90 days' notice. Our review of these filings will be thorough and exacting.³⁹⁸ LECs should be prepared to submit extensive support materials in defense of their above-cap rate proposals.³⁹⁹ We have chosen stringent review standards in order to preserve the price cap incentive to reduce costs and keep rates within a zone of reasonableness. In support of an above-cap rate increase, LECs shall include with their proposals: (1) cost support data broken down to the lowest possible level for each relevant basket for each of the most recent four years under price cap regulation; (2) a detailed explanation of the reasons for the prices of all rate elements to which the LEC does not assign costs; (3) a comprehensive explanation of how the carrier allocated costs among rate elements in the relevant basket; and (4) an explanation of the manner in which the LEC has allocated all costs, not just exogenous costs, among all baskets. This last element is particularly important if we are to guard against any cross-subsidy between less- and more-competitive services.

304. Above-cap filings will be found lawful only in the unlikely event that these rules have the effect of denying a LEC the opportunity to attract capital and continue to operate, despite the low end adjustment mechanism and the opportunity provided the LEC to increase its earnings through greater efficiency.⁴⁰⁰ A LEC may request an above-cap rate increase by filing a tariff transmittal that complies with specific rules for such filings, a showing that includes but is not limited to the cost support information normally required in annual access tariff filings for LECs subject to rate of return regulation, and other information sufficient to establish that the increase is needed if the LEC is to have an opportunity to attract capital. We anticipate that any such increase will present