Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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

AT&T COMMENTS

Pursuant to the Commission's Public Notice herein released January 24, 1995 (DA 95-102), AT&T Corp. ("AT&T") submits these comments on the written ex parte submission filed in this proceeding on January 18, 1995 by the United States Telephone Association ("USTA").[1]

There is little that is novel in USTA's self-described "comprehensive proposal." In the main, USTA simply presents a warmed-over version of the proposal first raised in its comments last May to replace the current productivity offset with a total factor productivity ("TFP") differential. AT&T and other parties have already demonstrated that the TFP methodology is seriously flawed and would undermine the efficiency goals of the LEC price cap plan. USTA's additional proposals to eliminate the sharing mechanism and the consumer productivity dividend ("CPD") are so

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1 "A USTA Proposal for the LEC Price Cap Plan," filed January 18, 1995 ("USTA ex parte").

antithetical to the legitimate interests of access ratepayers as to warrant summary rejection by the Commission.

USTA's _ex parte_ proposes (pp. 1-2 and Attachment 1) that LECs be permitted to elect a productivity offset based on a five year moving average, with a two-year lag, of the differential between the LEC industry TFP and the TFP of the U.S. economy.[2] As part of this proposal, the sharing and lower formula adjustment would be eliminated.[3] The CPD would also be phased down and then eliminated after 3 years, although USTA would allow an initial increase in that factor to 1 percent from the current .5 percent.[4] However, "to immediately share the benefits of this new option with customers," USTA proposes (p. 3) that the LECs electing this plan make a 1 percent reduction in their price cap indices ("PCIs").[5]

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2 Under USTA's plan, LECs could continue to elect treatment under the current 3.3 percent productivity factor, but the higher 4.3 percent optional productivity factor would be eliminated. USTA _ex parte_, p. 5.

3 _Id._, p. 2

4 _Id._, p. 3. In the second year of USTA's proposed phase down, the CPD would revert to .5 percent. The third year value of this factor would be set at .25 percent, and the CPD would be eliminated entirely. _Id._

5 Additionally, USTA proposes (p. 4) to "narrow" the types of costs that qualify for exogenous treatment,

(footnote continued on following page)

The premise of USTA's ex parte proposal is that the TFP differential developed by its economist in this proceeding[6] is a suitable basis for establishing the productivity factor for the LEC price cap plan -- a claim which has already been discredited in this proceeding. As shown in AT&T's Reply Comments, USTA's TFP analysis is both conceptually and methodologically flawed. In particular, the TFP differential dramatically understates the productivity (or "X") factor in the LEC price cap

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(footnote continued from previous page)

but provides little explanation of this suggestion. However, from USTA's statement (id.) that such changes should be confined to "government mandated changes that uniquely affect telecommunications companies," it appears that the principal objective of the proposal is to obviate reductions in the LECs' PCIs for exogenous changes that reduce those carriers' costs.

Finally, USTA submits various "adaptive" changes in LEC regulation, including a reprise of the proposal in its May 1994 comments for geographic market rules based on "initial," "transitional," and "competitive" market areas. AT&T has already shown that this proposal has no merit. See AT&T Reply Comments, filed June 29, 1994, pp. 4-21.

6 See L. Christensen, P. Schech and M. Meitzen "Productivity of the Local Operating Companies Subject to Price Cap Regulation," May 3, 1994 (USTA Comments, Attachment 6)("Christensen Study"). Following the filing of its ex parte submission, USTA filed revisions on the Christensen Study that further reduced the LEC TFP differential. See Letter dated January 20, 1995 from Mary McDermott, USTA, to William F. Caton, FCC. Although the purported purpose of that submission was to update the Christensen Study to incorporate 1993 data, in fact those new data have no impact on the study's results because the 1993 U.S. economy TFP is not available.

formula because TFP is computed relative to actual input prices, while the X variable is an offset to the GNP Fixed Weight Price Index ("GNP-PI"). Adjusting the TFP for the difference between GNP-PI and USTA's most recent computation of actual input price growth would result in almost doubling the annual productivity offset calculated using USTA's TFP methodology.[7]

Additionally, AT&T showed that USTA's TFP calculations fail to measure output in the same manner as the Commission's price cap formula. Specifically, USTA's study applied a revenue weighting to common lines, instead of the "Balanced 50/50" formula prescribed in the LEC price cap plan. This failure to follow the Commission-prescribed methodology results in an understatement in the productivity offset calculated by USTA's economist.[8] The study's weighting methodology is likewise at odds with the Commission's ratesetting practices under rate of return regulation. Accordingly, no valid comparison can be made between the results of the USTA study and the LECs' historical performance, either under incentive regulation or previously.[9]

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[7] AT&T Reply Comments, pp. 28-29 and Appendix C.

[8] Id., Appendix B, pp. B-7 to B-8.

[9] Id., p. 29.

Moreover, in developing his TFP figures USTA's economist used a significantly different depreciation methodology than the Commission's approved depreciation rates for price cap LECs.[10] Even apart from these serious conceptual discrepancies, AT&T demonstrated that the TFP calculations developed in USTA's study are misleading because they are developed from LEC data at the total company level rather than using the growth for interstate access services, which substantially exceeds the total company level data.[11] Indeed, USTA's own economist, in testimony before state public utility commissions, has acknowledged that LEC access services have exhibited significantly greater growth than other LEC services.[12]

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[10] Id., pp. 29-30.

[11] Id., p. 30.

[12] See Testimony of Laurits R. Christensen (Ohio Bell Exhibit 26.0) in Case No. 93-487-TP-ALT (Pub. Util. Comm'n Ohio), p. 13 and Table 1 (stating "interstate access output has grown much more rapidly that Total Output for the [LEC] industry," and showing average annual growth of 7.9 percent for interstate access compared to rates as low as minus 6.3 percent for other LEC services); Testimony of Laurits S. Christensen in Cause No. 39705 (Indiana PUC), p. 13 (conceding that the LEC's local service annual output "has grown . . . a full percentage point less than the [LEC's] Total Output").

Other commenters' filings in this proceeding confirm the invalidity of the USTA study's results.[13] Against this background, USTA's present claim (Attachment 1, p. 2) that "[n]o party to this proceeding has a fundamental disagreement with the [study's] methodology for developing the TFP differential" can only be described as disingenuous. USTA's further claim (Attachment 1, p. 2) that its TFP formula would be administratively simple to apply is also belied by the fact that much of the information required to calculate LEC industry TFP are not compiled in ARMIS or other Commission filings, and may not be readily obtainable. More fundamentally, even if all necessary data were readily available and verifiable, no generally agreed methods or standards now exist for calculating the LECs' TFP from such information.

Further, even if the Commission could compile those data and develop a calculation of the LEC TFP, its ability to reliably determine the TFP differential from the U.S. economy would be problematic. As USTA admits (Attachment 1, p. 1 n.3), the Bureau of Labor Statistics ("BLS") has implemented various changes over time in its methods for computing the U.S. economy TFP. These

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[13] See, e.g., Ad Hoc Reply Comments, pp. 27-30; MCI Reply Comments, pp. 30-31; Sprint Reply Comments, p. 2.

changes might well affect consistency between the BLS results and the LEC TFP figure calculated for the Commission's price cap plan. Indeed, the Commission could be precluded from calculating a TFP differential where the BLS' changes lead to substantial delay in releasing the U.S. economy TFP (as occurred for both 1991 and 1992, for which the BLS TFP data were not released until mid-1994).

The only significant change in USTA's TFP methodology provided in its ex parte filing is the proposal to establish and update the TFP-based productivity offset using a lagged moving average. USTA does not explain how such a procedure would obviate the serious deficiencies already shown in the TFP methodology, and in fact this change does nothing to remedy those defects. In fact, the proposed formula would only further damage ratepayers: in an era of rising productivity that characterizes the LECs' operations, the moving average and two-year lag in USTA's formula would merely further understate the productivity adjustment applied to the LECs' price caps. Thus, when compared to the Commission's current regulations the USTA proposal is systematically biased towards reducing the benefits to ratepayers of the LEC price cap plan.

It therefore comes as little surprise that the ex parte filing also renews USTA's previous proposal to eliminate entirely the sharing mechanism which the

Commission established as a backstop against the possibility that the LEC productivity offset might be established at too low a level. Without such protection, access ratepayers and their customers would be left with no assurance under USTA's plan that LEC access rates would be maintained at reasonable levels. The relief USTA seeks is therefore clearly unwarranted.

USTA's additional proposal to implement a one-time reduction in the LECs' PCIs is at best illusory. The record compiled in this proceeding overwhelmingly confirms that the current productivity offsets seriously understate the LECs' true efficiency.[14] Reflecting the long-term impact on the price cap indices of these understated productivity offsets, the LECs' current PCIs significantly exceed the actual price indices for those carriers; AT&T estimates the present aggregate "headroom" between the LECs' price indices and their price caps is more than $798 million.

Thus, even if USTA's one-time adjustment were implemented, many of these carriers would not be required to effect any rate reduction for at least some of their

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14 See, e.g., AT&T Comments, Appendix B ("Direct Model for Deriving LEC Productivity Under Price Cap Regulation"); id., Appendix C ("Simple Model for Estimating LEC Productivity"). As shown there, the LECs' achieved productivity for the first three years of price cap regulation was 5.97 percent.

baskets. Even where rate reductions in certain baskets might be required to satisfy price cap constraints, their amount would be modest. AT&T estimates that the total rate reductions produced by USTA's proposal would amount to less than $76 million. Moreover, after these changes the LECs would retain aggregate price cap headroom of more than $673 million -- an amount that is ample to absorb and deny any consumer benefit from the phased-down CPD.

In sum, USTA's "comprehensive proposal" is simply an example of the worst sort of one-sided special interest pleading. There is no basis or justification for the Commission to effectively dismantle its LEC price cap plan in the manner USTA requests.

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January 31, 1995

CERTIFICATE OF SERVICE

I, Ann Marie Abrahamson, do hereby certify that on this 31st day of January, 1995, a copy of the foregoing "AT&T Comments" was mailed by U.S. first class mail, postage prepaid, to the parties listed on the attached Service List.

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