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EX PARTE

March 8, 1995

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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

RE: CC Docket No. 94-1

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

On March 7, 1995, Ray Smith - Chairman of Bell Atlantic, John Clendenin - Chairman of BellSouth and Phil Quigley - Chairman of Pacific Telesis had meetings with Chairman Hundt, Commissioner Barrett, Commissioner Ness and Commissioner Quello to discuss issues raised in connection with the above referenced proceeding. The attached material was handed out during these meetings. Due to the last meeting not concluding until after 5:30 p.m., this ex parte filing is being made on the following day.

Please call me if you have any questions.

Respectfully submitted,

WW Jordan

W.W. (Whit) Jordan
Executive Director - Federal Regulatory

Attachment

cc: Chairman Hundt
Commissioner Barrett
Commissioner Ness
Commissioner Quello

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List A B C D E

A Factual Assessment of the LECs' Price Cap Plan

- ***LEC Price Cap Plan Is Lowering Access Charges.*** Since LEC price cap plan was implemented in January 1991, interstate access charges have declined by nearly 13 percent, as compared to a 10 percent increase in the consumer price index and a 12 percent gain in the Bureau of Labor Statistics' price index for interstate MTS service. (Fig. 1)

- ***LEC Price Caps Have Spurred Investment In The Infrastructure.*** Since price caps were implemented, Bell operating companies have invested 52 percent of their cash flow from local telephone operations in network facilities versus 48 percent during the 1988-90 time frame. By contrast, the share of cash flow from long distance services that AT&T, MCI and Sprint reinvested in their respective networks declined from 57 percent during 1988-90, to 48 percent during 1991-93. (Fig. 2) Current investment rates imply that each dollar in cash shifted from the LECs (52% of cash invested) to IXCs (48%) will reduce investment by 4 cents.

- ***LECs Have Not Profiteered From Price Caps.*** Since 1991, total cumulative returns (i.e., dividend yield plus percentage change in price per share) to regional Bell company and GTE shareholders have remained below the S&P 500. (Fig. 1) Lackluster performance of these stocks indicates that true profitability of regulated local telephone services, including access services, are certainly not excessive. Economic returns on access services also tend to be well below accounting returns because regulated depreciation rates are too low and, thus, overstate reported earnings. In 1993, BellSouth's reported rate of return on interstate access services would have declined from 13.7% to 10.2% if the company had been permitted to use the same depreciation rates that currently apply to AT&T's network operations. (Fig. 3)

- ***LEC Shareholders Are Being Penalized For Investing In Upgraded Local Networks.*** Since 1988, cumulative returns to RHC shareholders have varied inversely with the portion of total cash flow from local telephone operations that each of the companies reinvested in their local networks. That the stock market has rewarded individual RHCs for investing less in new network facilities is further evidence that true rates of return on local telephone services are, if anything, too low. Given that local telephone operations of the RHCs necessarily compete with other investment opportunities, any FCC action that reduces economic returns on access services will very likely diminish investment and slow the deployment of new technologies. (Fig. 4)

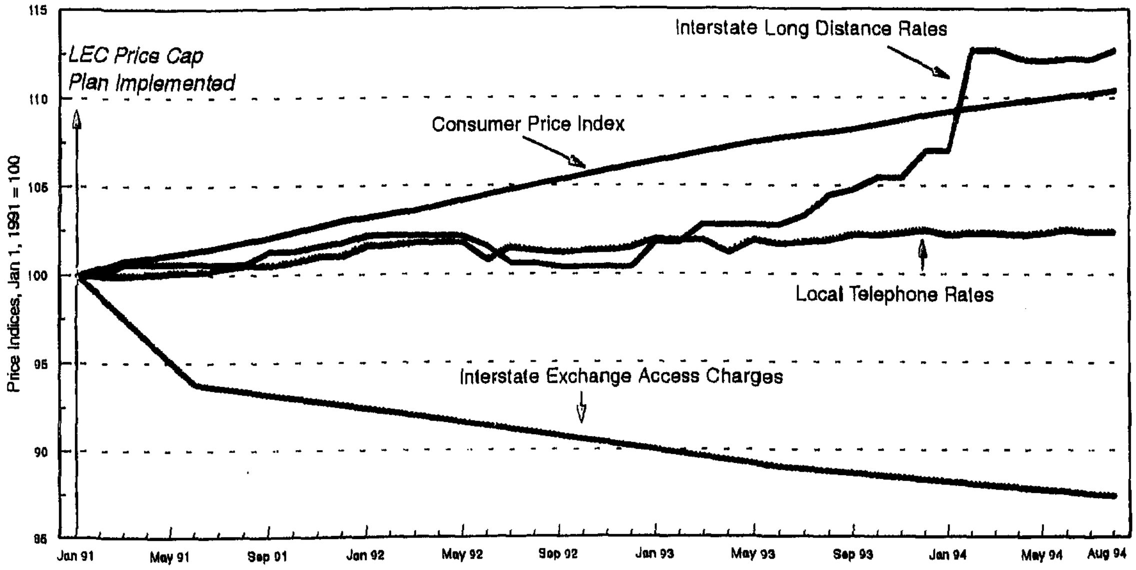
- **LEC Access Rate Cuts Are Being Flowed Through To IXC Shareholders.** Since 1991, MCI, Sprint and other long distance carriers have followed AT&T's lead in raising rates every six months or so, despite continuing reductions in interstate access charges. (Fig. 5) Subsequent improvements in IXC operating profit margins have resulted in even sharper increases in cumulative returns to IXC shareholders. (Table 1 and Fig. 1)

Modifying the LECs price cap plan in ways that further reduce earnings, therefore, will only further enrich IXC shareholders, while slowing investment in new network technology. At a time when the economy is becoming more and more information intensive and demanding an ever larger array of network services, consumers would be well served by eliminating the last vestiges of rate-of-return regulation (i.e., earnings sharing) and moving to a pure system of price regulation.

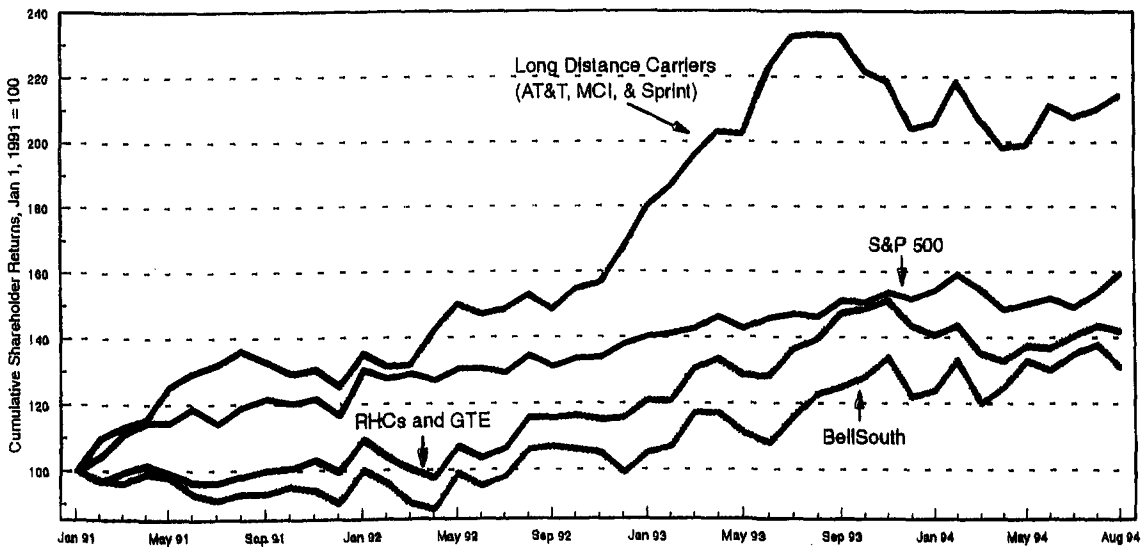
Figure 1

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.

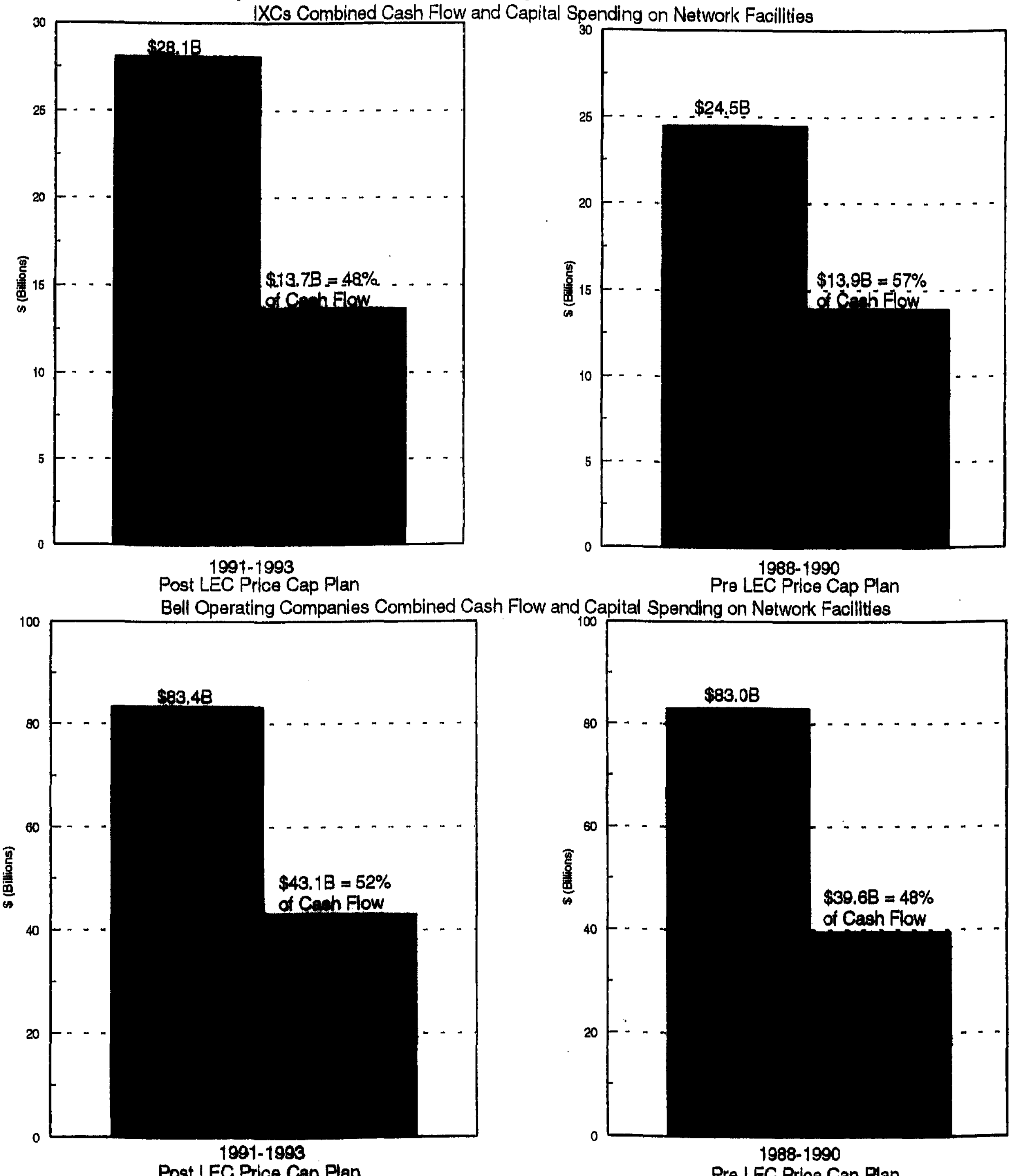


Note: Cumulative shareholder returns are based on market weighted monthly averages of total shareholder returns for individual companies.

Sources: Bureau of Labor Statistics, FCC, Compustat

Figure 2

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

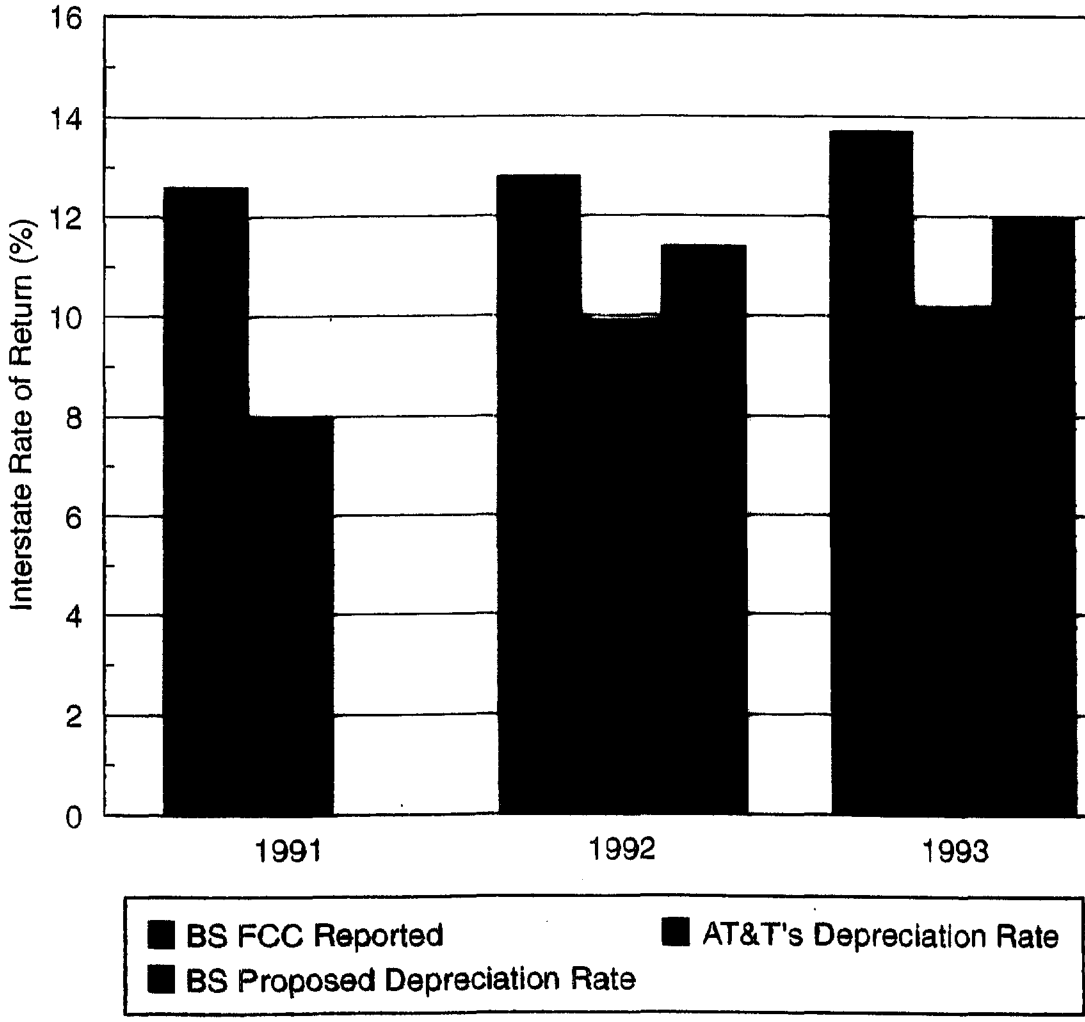


Note: Cash flow is earnings before interest, taxes, and drepreciation and amortization.
Sources: Compustat and FCC Form M

Figure 3

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

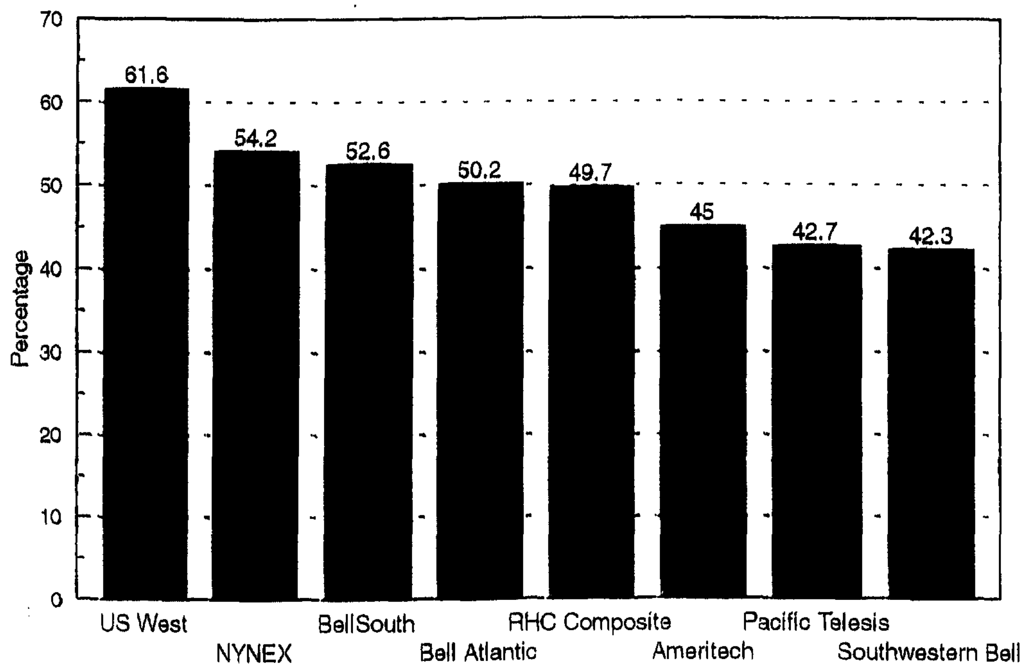
	BellSouth Reported Earnings	Earnings with AT&T Depreciation Rate	BellSouth Proposed Depreciation Rate
1991	12.6%	8.0%	N/A
1992	12.8%	9.9%	11.4%
1993	13.7%	10.2%	12.0%



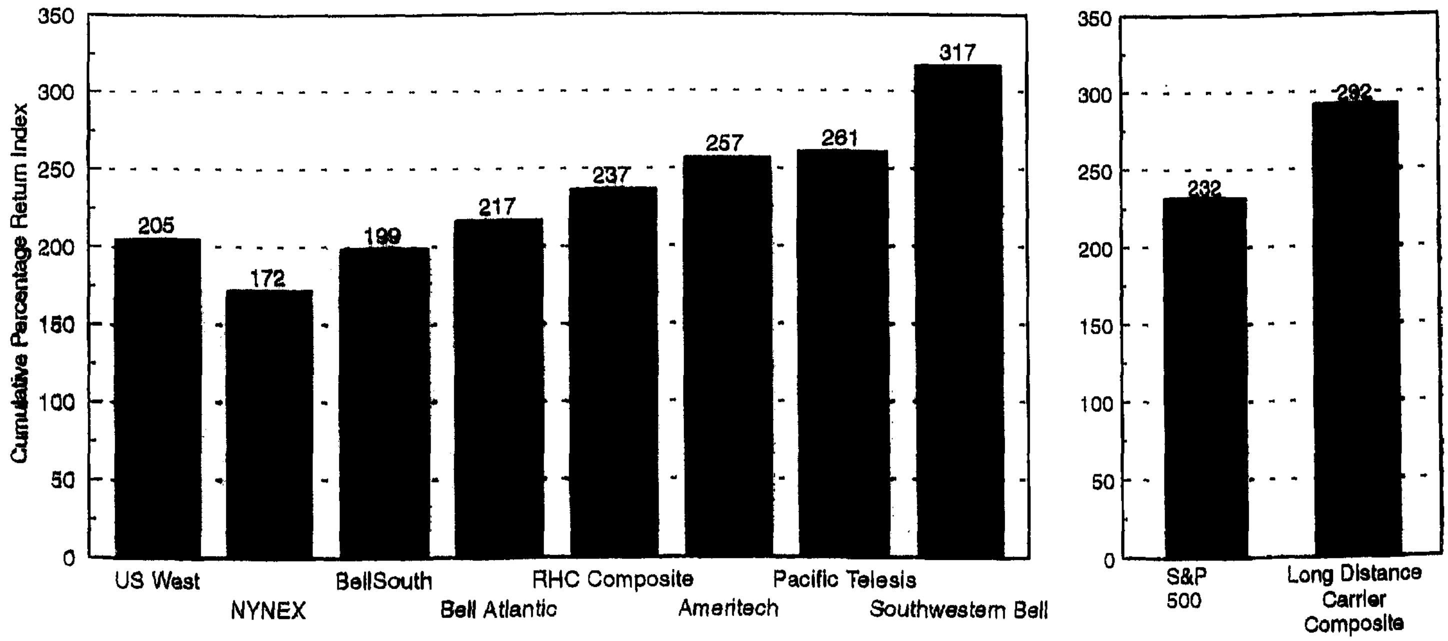
Note: BellSouth's depreciation rate not applicable in 1991

Figure 4

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.

Table 1

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%