MCI Telecommunications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

March 16, 1995

William F. Caton
Acting Secretary
Federal Communications Commission
Washington, D.C. 20554

Re: Ex Parte Presentation
CC Docket No. 94-1
LEC Price Cap Performance Review

Dear Mr. Caton:

Copies of the attached written ex parte were today provided to Karen Brinkman and Richard Welch of the Commission at their request. Please associate this with the record in the above-captioned docket.

An original and two copies of this notice have been submitted to your office in conformance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Chris Frentrup

Chris Frentrup
MCI Telecommunications Corp.
Federal Regulatory Affairs

cc: Karen Brinkman
Richard Welch

MCI Communications Corporation
1801 Pennsylvania Ave NW
Washington, DC 20006
202 887 2048

Leonard S. Sawicki
Senior Manager
Regulatory Affairs

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

EX PARTE

March 10, 1995

Ms. Kathleen Wallman
Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street NW
Washington, D.C. 20554

Re: CC Docket No. 94-1

Dear Ms. Wallman,

In a recent meeting with the CARE coalition, you requested that we analyze certain matters related to the structure of price caps; in particular, how price cap companies might react to different X factors and the relationship between the X factors and sharing.

Attached to this letter is a spreadsheet model (Lotus 1-2-3, Version 3.1) that will allow the FCC to test different values for important price cap variables and observe the relationships among them. Because of the short time available, we tested only a few significant options. Some conclusions are clear from this work and we invite the FCC staff to confirm them using the model.

The analysis presented here must not be interpreted as a change in CARE's position. The conditions assessed here are those suggested by the FCC and the comments of other parties. Indeed, the analysis only reinforces our position.

One proposal that we have examined is a "two-tier" plan, offering the LECs a choice of a low productivity factor or a higher "X", with reduced sharing obligations. CARE believes that a single factor would do more to encourage past under-performing LECs to be more productive and allow the better performing companies to reap rewards of continued efficiency. Further, it will be difficult to structure a system that encourages companies to choose higher productivity goals.

A significant conclusion from the model is that differences in productivity factors between price cap plan options of more than one percentage point will result in none of the LECs choosing the higher standard at the outset of the plan. It is not until later years that some companies will move up to higher productivity. Any plan must have a "one way" rule. Once a company chooses the higher productivity goal, it must continue with that option. This would prevent period-to-period manipulation of earnings.

A second conclusion is that an extremely tight earnings range must be placed on the low option. This will move the LECs off the lower end as quickly as their earnings rise. We suggest 50 basis points. Not only does this have a basis in past Commission practice, but any greater amount merely extends the time that the companies stay with the lower standard.

As the FCC reviews possible two-tier approaches, it should consider that the average achieved "X" has been around 5.7%. If the FCC follows the lead of its last price cap plan, it would add one percent to the lower standard to offer a greater incentive to achieve above the historic trend. This would result in factors of 5.7% and 6.7% (analogous to today's 3.3% and 4.3%). In a lesson for the current review, few companies chose the higher level, yet all thrived through a recession and set earnings records.

Finally, if the FCC decides to allow a lower standard for some LECs, it should acknowledge that most of the "X" factors on the record are averages. Accommodating the lower achieving companies with an optional lower "X" means that the average for the remaining companies must rise. In its reply comments, AT&T illustrated that most of the price cap companies achieved productivity gains exceeding six percent and that the average was pulled down by just a few of the LECs. Degrading the standard by discounting the 5.7% average for the benefit of a few companies would unjustly enrich the others at the expense of consumers.

If you have any questions concerning this matter, please call Chris Frentrup at (202) 887-2731 or me.

In accordance with Section 1.1206 of the Commission's rules, two copies of this letter are being filed with the Secretary of the FCC.

Best regards,

Leonard S. Sawicki

Leonard S. Sawicki

cc: Alex Belinfante
Anna Gomez
Michael Katz
Richard Metzger
Mark Uretsky
Joannne Wall