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March 16, 1995

Ex Parte

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

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

RE: CC Docket 94-1

Dear Mr. Caton:

The attached letter was sent to Chairman Hundt today and copies were sent to Commissioners Barrett, Quello, Ness and Chong. Please include this correspondence in the record in the above referenced proceeding.

If you have any questions, please call me.

Sincerely,



W.W. Jordan  
Executive Director-Federal Regulatory

Attachment

cc: Chairman Hundt  
Commissioner Barrett  
Commissioner Quello  
Commissioner Ness  
Commissioner Chong  
Kathy Wallman

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# BELLSOUTH

David J. Markey  
Vice President-  
Governmental Affairs

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Washington, D.C. 20036  
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March 16, 1995

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The Honorable Reed E. Hundt  
Chairman  
Federal Communications Commission  
1919 M. Street, N.W., Rm. 814  
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

Dear Chairman Hundt,

In an ex parte filing in this proceeding, NYNEX has abandoned its prior positions regarding the elimination of the sharing and low end adjustment mechanisms in the LEC price cap plan. NYNEX now advocates criteria for the elimination of sharing that would delay the removal of this vestige of rate of return regulation indefinitely for most LECs. BellSouth strongly opposes the new NYNEX proposal. As demonstrated below, the NYNEX proposal is illogical and contrary to public policy.

Throughout this docket, NYNEX has stated unequivocal support for the elimination of the sharing and low end adjustment mechanisms on sound economic and public policy grounds. In its initial comments, NYNEX noted that sharing has substantially lessened the efficiency incentives of the price cap plan. It stated that sharing dampens the incentives to invest in the domestic infrastructure, while encouraging investment in unregulated lines of business. NYNEX also noted that the existence of a sharing mechanism in the LEC price cap plan hinders the transition to a fully competitive marketplace by increasing the administrative difficulty of removing services from price cap regulation as they become competitive. NYNEX Comments (May 9, 1994) at 28-31.

On January 18, 1995, USTA proposed that the Commission include a no-sharing option in the LEC price cap plan that

would include a self-adjusting productivity offset, an initial one-time reduction of one percent in the price cap indices, a phase out of the Consumer Productivity Dividend, and a more restrictive definition of "exogenous" costs. NYNEX fully supported the USTA no-sharing option, reiterating the multiple public benefits that would accrue from the elimination of the sharing and LFAM mechanisms. NYNEX Comments on USTA Proposal (January 31, 1995) at 2-3. NYNEX also urged the Commission to adopt a second, separate option that would eliminate sharing for those LECs facing substantial competition. Id. at 4 et seq.

On March 3, 1995, NYNEX filed with the Commission an ex parte pleading entitled "A NYNEX Proposal for the LEC Price Cap Plan". In an abrupt and largely unexplained change of direction, NYNEX abandoned the positions taken in its prior pleadings, and its support for the USTA proposal, in favor of a plan that would tie the elimination of sharing in the interstate LEC price cap plan solely to the development of competition in intrastate markets, a linkage of dubious legality. The NYNEX ex parte does not even discuss the serious jurisdictional issues raised by its proposal.

The NYNEX proposal would initially move all of the LECs away from price regulation and towards rate of return regulation by significantly narrowing both the "dead zone" around the initial rate target and the 50/50 sharing zone. Only when an initial competitive trigger was reached in each company would the LEC price cap plan return to its present structure. Additional hurdles would be required to expand, and ultimately eliminate the sharing and LFAM mechanisms.

The NYNEX proposal is based on the following syllogism: competition increases efficiency incentives; sharing dulls efficiency incentives; therefore, the Commission should link the two and retain sharing until competition develops. The illogic of the NYNEX proposal is apparent on its face. The Commission has already moved forward to encourage competition in the interstate access market and now should eliminate sharing to maximize the efficiency incentives in the LEC price cap plan.

The Commission has previously found that price regulation is superior to rate of return regulation in emerging competitive markets. LEC Price Cap Order, 5 FCC Rcd 6786 (1990) at para. 33. By initially moving back towards rate of return regulation, the NYNEX proposal would dull the very efficiency incentives that the Commission has found to be in the public interest. NYNEX offers no logical basis for this aspect of its proposal.

The NYNEX proposal is illogical in another respect. NYNEX posits a series of triggers that would result in LECs being regulated under pure price regulation only when all legal and economic barriers to entry are removed and actual competition is well entrenched. However, once such a state is reached, the appropriate government response should be to eliminate regulation all together, not to impose price regulation. Price regulation is appropriate only during the transition to effective competition. It should not be permanent. The NYNEX proposal has everything out of step: hybrid price/cost regulation when price regulation is appropriate and price regulation when no regulation is appropriate.

A final lack of logic in the NYNEX proposal is its premise that the LECs can "accept" local exchange competition on their own initiative. As noted above, eliminating barriers to local exchange competition will require state regulatory action and, in many cases, state or federal legislation. It makes no sense to condition the adoption of a superior form of interstate regulation on the occurrence of events at the state level that the LECs cannot control.

In addition to being illogical, the NYNEX proposal is bad public policy. It would discourage investment by making interstate returns dependent upon the actions of state regulators and legislators, thereby compounding the regulatory risk inherent in investing in the infrastructure. It would discourage economic efficiency, both by reintroducing the perverse incentives of rate of return regulation and by making carrier earnings more dependent upon political and regulatory skills than on skills in meeting customer needs. It would discriminate among

carriers performing equally well in managing costs, improving productivity and serving the public by rewarding some with higher returns based on factors largely outside of the control of carrier management.

It also is clear that the NYNEX proposal was carefully crafted to ensure that NYNEX, and NYNEX alone, can meet the proposed criteria. For example, NYNEX does not propose a state by state approach to the application of its criteria, but rather a regional approach. Thus, NYNEX initial trigger is met when "30% of Access Lines in Operating Territory meet Criterion 1". Is it hardly coincidental that New York State represents more than 30% of NYNEX's access lines, so that NYNEX would satisfy the trigger in all of its states merely because of the agreements it has reached in New York. Indeed, it is apparent that each of the criteria proposed by NYNEX was specifically tailored to encompass something that it has already agreed to in New York.

The NYNEX proposal is also untimely. NYNEX waited until March 3, 1995 to propose an entirely new conceptual basis for the elimination of sharing. NYNEX's proposal is not set forth in sufficient detail for BellSouth to analyze the proposal in depth, but the issues raised herein demonstrate that the proposal is sufficiently questionable to warrant thorough debate before its adoption should be considered seriously by the Commission. By contrast, the January 18, 1995 USTA proposal consists largely of elements that have been thoroughly debated throughout this proceeding.

The Commission should not construe BellSouth's opposition to the NYNEX proposal as opposition to interstate access competition. BellSouth shares the Commission's goal of encouraging the development of interstate access competition. The Commission, however, must not be distracted from the urgent business of improving the LEC price cap plan by NYNEX's untimely proposal.

In conclusion, it is BellSouth's view that NYNEX's March 3, 1995 proposal lacks a logical framework, is of dubious legality, raises significant public interest issues, and comes far too late in this proceeding for the Commission

to give it serious consideration. USTA's January 18, 1995 proposal for a no sharing option in the LEC price cap plan rests on a much sounder economic, legal and public policy base, and should be adopted.

Sincerely,

A handwritten signature in black ink, appearing to read "David J. Markey", with a long, sweeping flourish extending to the right.

David J. Markey  
Vice President-  
Governmental Affairs

cc: Commissioner Andrew Barrett  
Commissioner James Quello  
Commissioner Susan Ness  
Commissioner Rachelle Chong