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May 9, 1994

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FEDERAL COMMUNICATIONS COMMISSION
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William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1; Price Cap Regulation of Local Exchange Carriers: Rate-of-Return Sharing and Lower Formula Adjustment, CC Docket No. 93-179

Dear Mr. Caton:

Enclosed are an original and fourteen copies of Bell Atlantic's and Southwestern Bell Telephone Company's Joint Petition for a Partial Stay and for Imposition of an Escrow or Accounting Mechanism Pending Judicial Review in the above-captioned proceedings. Please return a date-stamped copy to the person delivering them. Copies have been served on all parties to the proceedings.

Sincerely,

Mark L. Evans

Enclosures

No. of Copies rec'd 0+14
List ABCDE

cc: Chairman Hundt
Commissioner Quello
Commissioner Barrett
Commissioner Chong
Commissioner Ness
William E. Kennard
Christopher J. Wright
John E. Ingle

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

In the Matter of Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1
In the Matter of Price Cap Regulation of Local Exchange Carriers Rate-of-Return Sharing and Lower Formula Adjustment	CC Docket No. 93-179

DOCKET FILE COPY ORIGINAL

JOINT PETITION FOR A PARTIAL STAY AND FOR IMPOSITION OF AN ESCROW OR ACCOUNTING MECHANISM PENDING JUDICIAL REVIEW

Relief Requested

Bell Atlantic and Southwestern Bell Telephone Company ("Petitioners") request that the Commission stay in part its First Report and Order, Price Cap Performance Review for Local Exchange Carriers (released April 7, 1995) (the "LEC Price Cap Order") and its First Report and Order, Price Cap Regulation of Local Exchange Carriers: Rate-of-Return Sharing and Lower Formula Adjustment (released April 14, 1995) (the "Add-back Order") pending judicial review. Specifically, petitioners ask the Commission to stay the portions of those orders that require them to (a) reduce their price-cap indices (PCIs) by .7 percent for each year they elected the lower X-Factor of 3.3 percent, (b) reduce their PCIs by the amount of any exogenous cost increases made pursuant to SFAS-106, SFAS 112, and the Court of Appeals' decision in Southwestern Bell Tel. Co. v. FCC, 28 F.3d 165 (D.C. Cir. 1994), and (c) "add back" into revenues the amount of any sharing obligation incurred in the previous year.

To ensure that the stay does not impose harm on other parties, the Commission may wish to require petitioners to either account for or place into escrow any funds collected as a result of the stay. Any funds identified by the accounting or placed into escrow, plus interest, can be delivered to petitioners' customers in the event that the Commission's orders are affirmed on review. In the event that petitioners prevail in whole or part, as they expect, the funds can be distributed in accordance with the Court's decision.

Petitioners have filed their petitions for review in the D.C. Circuit[1] and anticipate seeking a stay from that Court if this petition is denied. To ensure that the Court has sufficient time to act on such a motion before petitioners' 1995 annual access filings become effective on August 1, 1995, petitioners respectfully request that the Commission rule on this request no later than June 15, 1995.

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[1] See Petition for Review, Bell Atlantic v. FCC, No. 95-1217 (D.C. Cir. Apr. 19, 1995); Petition for Review, Bell Atlantic v. FCC, No. 95-1219 (D.C. Cir. Apr. 20, 1995); Petition for Review, Southwestern Bell Tel. Co. v. FCC, No. 95-1234 (D.C. Cir. Apr. 27, 1995); Bell Atlantic v. FCC, No. 95-1245 (D.C. Cir. May 2, 1995).

Introduction and Summary

In the LEC Price Cap Order, the Commission embarked on a new, aggressive, and legally dubious course. In this "fourth year review" of the LEC price cap plan, the Commission was supposed to examine "the effects of price cap regulation using *all available data and information.*" Notice of Proposed Rulemaking, Price Cap Performance Review for Local Exchange Carriers, 9 FCC Rcd 1687, 1688, ¶ 9 (1994) (emphasis added) ("Price Cap Notice"). But the Commission undertook no such task. Rather than supplementing its studies with new information concerning LEC performance under price caps as promised, the Commission revised its old data instead.

Most important here, the Commission decided to increase the minimum X-Factor from 3.3 percent to 4.0 percent. This decision was not based on new data concerning actual LEC productivity since the original price cap order (during 1990, 1991, 1992, or 1993). Instead, it was reached by disregarding both data used in the study that produced the 3.3 percent X-Factor and new data for 1990-93 that confirmed the correctness of that result. Indeed, the Commission was able to derive a "corrected" 4.0 percent X-Factor only by using a numerical gerrymander that would have done any political machine proud. With surgical precision -- but without remedial justification -- the Commission excised from its analysis years in which productivity was relatively low (1984, 1990-1993) while including years in which productivity was relatively higher (1985-1989). Then, on top of the already inflated result, the Commission added a .5 percent "consumer productivity dividend" that is nowhere justified in the order or supported in the record. In light of what the Commission put into the new calculation -- and what it left out -- it is hardly surprising that the Commission's new minimum X-Factor is substantially larger than the one it had employed before.

Rather than giving this numerical gerrymander purely prospective effect, the Commission then took the additional step of applying it retroactively. As a result of the LEC Price Cap Order, LECs must take a one-time downward adjustment to their PCIs of up to 2.8 percent -- .7 percent for each year in which they chose the 3.3 percent X-factor rather than the now "correct" figure of 4.0 percent. This retroactive readjustment simply cannot be justified. If the Commission had properly included relevant data, the .7 percent difference between the new X-Factor and the old one would not exist at all. Moreover, the Commission's decision to impose this one-time reduction offends the rule against retroactive ratemaking.

Continuing its practice of gerrymandering the data and then giving the results retroactive effect, the Commission also decided to reverse the effect of a judicial decision favorable to the LECs while leaving in place otherwise indistinguishable requirements that operate to the LECs' detriment. In 1993, the Commission decided that accounting changes for certain post-employment benefits or "OPEBs" would not be given exogenous cost treatment. In Southwestern Bell Tel. Co. v. FCC, 28 F.3d 165

(D.C. Cir. 1994), the Court of Appeals reversed, holding that the Commission's rules could not support the result. In this proceeding, the Commission continued the see-saw cycle by revising its rules to make OPEB accounting adjustments non-exogenous once again.

Rather than applying the new rule prospectively, however, the Commission opted for retroactivity yet again. Not only are future OPEB-based adjustments barred as "non-economic costs," but also the LECs are required to strip past OPEB adjustments out of existing PCIs. This retroactive application of a new rule not only violates the prohibition on retroactive rulemaking but is entirely arbitrary. The FCC has on a number of occasions required the LECs to adjust their PCIs to reflect "non-economic" accounting changes, most often to the LECs' detriment. Yet the Commission offers no justification for retroactively stripping out OPEB accounting costs but not the rest.

Finally, in the Add-back Order, the Commission once again made retroactive that which should be prospective only. Rather than applying its new add-back rule to sharing obligations incurred in the future, the Commission required add-back of sharing obligations incurred two years past. The Commission lacks authority to alter retroactively the consequences of sharing obligations that were incurred long ago.

The cumulative effect of these Commission errors is to inflict certain and irreparable injury on petitioners. As explained in the accompanying declaration of Howard Zuckerman

("Zuckerman Decl."), the up-front PCI reduction will cost Bell Atlantic $78.8 million in the first year alone; the removal of exogenous treatment for OPEB accounting changes will cost another $19.98 million; and the add-back order will cost $17.4 million more. Dale R. Kaeshoefer points out in his declaration ("Kaeshoefer Decl.") that Southwestern Bell will suffer similar harm: $55.7 million will be lost in the first year as a result of the one-time reduction, and $40.5 million will disappear because of the changed treatment of OPEBs. While financial injury is not irreparable where adequate corrective relief is available in the ordinary course of litigation, it *is* irreparable where there is little prospect for making the injured party whole at the end of the day. Absent an order granting the requested relief, that will be the case here.

If the PCI reductions are stayed and either an accounting order or an escrow mechanism is imposed, calculating the harm and delivering appropriate compensation to the adversely affected parties will be straightforward. The difference between the price actually paid and the price that would have been paid absent a stay will be fully accounted for in the LECs' books or placed in an interest-bearing escrow account. If the Commission's decision is affirmed on appeal, that amount can be turned over to the LECs' customers; if it is reversed, it can be turned over to the LECs. In contrast, if no stay is imposed, calculating the harm and offering appropriate compensation through the other possible remedy -- prospective rate increases designed to recoup lost revenue -- will be difficult if not impossible to achieve. Because competition in access services grows with each passing day, there is little reason to think that a prospective rate increase, even if authorized by the Commission, would make the LECs whole. To the contrary, any future increase in price sufficient to compensate petitioners for the magnitude of loss occasioned by this order is more likely to push petitioners' customers into the arms of competitors than to produce any real recovery.

Argument

When deciding whether to grant a stay pending appeal, both the courts and the Commission traditionally consider: (1) the probability that petitioners will prevail on the merits on appeal; (2) whether petitioners will suffer irreparable injury absent a stay; (3) whether a stay will substantially harm other parties; and (4) whether the public interest favors preserving the status quo pending appeal.[2]

The courts have recognized that an agency considering a request to stay its own order need not confess error to grant the

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[2]The governing standards were first set forth in Virginia Petroleum Jobbers Ass'n v. FPC, 259 F.2d 921 (D.C. Cir. 1958), and were modified in Washington Metropolitan Area Transit Comm'n v. Holiday Tours, Inc., 559 F.2d 841 (D.C. Cir. 1977); see also Cuomo v. United States Nuclear Regulatory Comm'n, 772 F.2d 972, 974 (D.C. Cir. 1985) (applying the four factors identified in Holiday Tours). The Commission follows Holiday Tours. E.g., Order Granting Stay, Amendment of Parts 15 and 76 Relating to Terminal Devices Connected to Cable Television Systems, Gen. Docket No. 85-301 (FCC No. 87-323), 2 FCC Rcd 6488 (1987); Memorandum Opinion and Order, MM Docket No. 86-406 RM 5480 (FCC No. 87-248) (July 17, 1987).

requested relief. To the contrary, it is enough that the agency recognize that it has ruled on concededly difficult issues and that the equities favor relief. As the D.C. Circuit explained in Holiday Tours, 559 F.2d at 844-45:

> Prior recourse to the initial decision maker would hardly be required as a general matter if it could properly grant interim relief only on a prediction that it has rendered an erroneous decision. What is fairly contemplated is that tribunals may properly stay their own orders when they have ruled on an admittedly difficult legal question and when the equities of the case suggest that the status quo should be maintained.

For the reasons set forth below, petitioners are entitled to a stay under either standard.

I. Petitioners Are Likely to Prevail on the Merits

A. The One-Time Downward Adjustment Is Based on a Wholly Arbitrary Retroactive Recalculation

Rather than treating its new decision as an interim order for the new price cap regime, the Commission instead seems to have treated it as a reconsideration order from the last one. Without bothering to examine new evidence of actual LEC performance under price caps, the Commission announced that it made a mistake calculating the minimum X-Factor last time around. Specifically, the Commission decided that it should not have included the 1984-1985 data point in its short-term productivity study (the "Frentup-Uretsky study"). Accordingly, the Commission excluded that data point from its new, revised Frentup-Uretsky study and determined that the appropriate X-Factor is 4.0 percent, not the 3.3 percent X-Factor applied in the past.

In addition to requiring LECs to use this 4.0 percent minimum X-Factor in the future, the Commission has decided to "correct" the effect of using the 3.3 percent X-Factor for the prior 4 years. This was accomplished by forcing the LECs to reduce their PCIs by .7 percent for each year they employed the 3.3 percent offset.

The problems with the Commission's approach are both numerous and fatal. First, the Commission's decision that the 3.3 percent minimum X-Factor was too small -- and its corresponding selection of a new 4.0 percent X-Factor -- is unsupported by the evidence and contradicted by the very studies on which the Commission relies. Second, the .5 percent consumer productivity dividend is unsupported by the record. Third, even if one assumes that the 4.0 percent X-Factor was correctly selected -- and it was not -- requiring the LECs to adjust their PCIs as if 4.0 percent had been the X-Factor all along constitutes prohibited retroactive ratemaking.

1. <u>The Commission's Decision That the 3.3 Percent X-Factor Was "Too Low" is the Result of an Arbitrary Numerical Gerrymander</u>

The critical element in these proceedings, according to the Commission, is actual LEC performance under price caps. Price Cap Notice, 9 FCC Rcd at 1288, ¶ 9. As the Commission explained in the Price Cap Order itself, the best indication of <u>potential</u> LEC productivity gains is <u>actual</u> LEC productivity under incentive regulation:

> [The Commission] believe[s] that the performance of the LECs over the past four

> years of price cap regulation provides us with *more reliable and accurate information* with respect to efficiency gains that LECs reasonably can be expected to achieve annually. [A]nnual updates to the X-Factor . . . ensure that the X-Factor reflects the actual performance of LECs on a more timely basis.

LEC Price Cap Order at 87, ¶ 191 (emphasis added).[3] Yet, when the Commission examined the propriety of the 3.3 percent productivity factor and selected the 4.0 percent factor to replace it, this more "reliable and accurate information" was nowhere to be found.

There is a reason for this: Actual evidence of LEC productivity gains under price caps directly contradicts the Commission's chosen results. One need look no further than the Commission's decision to re-examine the inclusion of the so-called 1984 data point to discover that this is so.

In support of its decision to reverse course from 1990 and disregard the 1984 data point, the Commission relied on but one piece of new evidence -- the Commission's economists' revised version of a USTA "Total Factor Productivity" Study. Price Cap Order at 93, ¶ 208 (referencing Bush and Uretsky, Input Prices and Total Factor Productivity, Appendix F to the LEC Price Cap

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[3]The LECs have provided substantial information concerning their actual performance under price caps. See, e.g., Christensen, et al., Productivity of the Local Operating Companies Subject to Price Cap Regulation: 1993 Update (Jan. 16, 1995, ex parte); Christensen, et al., Productivity of the Local Telephone Operating Companies Subject to Price Cap Regulation, attachment 6 to Comments of the United States Telephone Association (May 9, 1994); National Economic Research Associates, Inc., An Update of the FCC Short-Term Productivity Study for Local Exchange Carriers: 1984-1992 (Sept. 1994).

Order).[4] According to the Commission, its economists' revised version of the USTA study supported elimination of the 1984 data point because: (1) it showed that LEC productivity during 1984-1990 was higher than the Commission had previously thought; (2) elimination of the 1984 data point brings the Frentup-Uretsky study for 1985-1989 into line with the revised USTA study for the same period; and (3) the revised USTA study indicated that productivity for 1984-1985 was not so low as previously thought. Price Cap Order at 93, ¶ 208.[5]

This might be persuasive reasoning except that it omits a critical fact: If consideration of the revised USTA study is not arbitrarily limited to the years 1984-1990, the study shows that, if anything, the Commission's choice of a 3.3 percent X-Factor was overly aggressive. Indeed, if one looks to actual LEC performance under price caps -- the most important factor in the Commission's own judgment -- it turns out that the 3.3 percent X-Factor was too high. Even after adjusting the USTA study to their satisfaction, the Commission's own economists calculated

[4]The Commission relied on a different study -- Belinfante & Uretsky, Recalculation of the Frentup-Uretsky Study Excluding the 1984/85 Data Point, Appendix D to the Price Cap Order -- to perform the actual recalculation of the minimum X-Factor. To some extent the Appendix D study attempts to *justify* the decision to recalculate the X-Factor, see id. at 2, but it does so only by referring to the revised USTA study contained in Appendix F.

[5]The Commission added one additional justification: The critique, raised in an earlier proceeding, that the 1984 data point was an "outlier." Price Cap Order at 93, ¶ 208. But that precise argument was rejected by the Commission before; the only new consideration was the USTA study the Commission relied upon for the other three rationales.

that, between 1991 and 1992, the X-Factor averaged 3.1 percent. And if one includes the X-Factor calculated from actual 1990 data -- which indicates a productivity *loss* and a corresponding X-Factor of negative 2.69 percent -- the average X-Factor for 1990 to 1992 falls to a mere 1.7 percent. See Bush and Uretsky, Input Prices and Total Factor Productivity, Appendix F to the LEC Price Cap Order, at Attachment A, cols. G & H.[6] How the Commission could conclude that it erred in selecting 3.3 percent as the X-Factor despite such clear after-the-fact evidence that 3.3 percent was actually too high is simply baffling.

Rather than explain why it chose to disregard this evidence, the Commission attempted to bury it. But placing inconvenient facts in the final column of a microtype attachment to an appendix does not make them go away; it just makes them hard to read. Here, the very study on which the Commission relied for the conclusion that the original 3.3 percent X-Factor was too low -- and which the Commission tentatively selected as the model for calculating X-Factors in the future, see Price Cap Order, at 66-67, ¶ 145 -- clearly suggests that the opposite is true. More important, the study does so using the very type of information

[6]Moreover, at the same time the Commission arbitrarily excluded this most recent data from consideration, it included such aberrational X-Factors such as 10 percent for 1989 and 9 percent for 1988. Bush and Uretsky, Input Prices and Total Factor Productivity, Appendix F to the LEC Price Cap Order at Attachment A, col. H. Thus, the Commission judgment that the USTA study supports an X-Factor of 4.8 percent or so is the product of a numerical gerrymander; aberrationally high data points are included while more recent data that is in no way aberrational is, without any justification whatsoever, excluded.

the Commission itself has decreed to be most persuasive. Confronted by this, the Commission was not "free to disregard those facts" simply because they "prove[d] difficult or inconvenient." Tenneco Gas v. FERC, 969 F.2d 1187, 1214 (D.C. Cir. 1992).[7] Instead, the Commission was required to explain why its analysis was nonetheless valid. Because the Commission failed to do so, its decision is not likely to survive judicial review.

Having ignored actual LEC productivity under price caps in its determination that the initial 3.3 percent minimum X-Factor was erroneous, the Commission then proceeded to compound its error by ignoring the same evidence when it calculated the X-Factor anew. The Commission calculated the new X-Factor simply by running the 1990 Frentup-Uretsky study without the 1984 data point. See Belinfante & Uretsky, Recalculation of the Frentup-Uretsky Study Excluding the 1984/85 Data Point, Appendix D to the Price Cap Order. Actual data from 1990, 1991, and 1992 -- both available to the Commission and easily verified -- were simply ignored. Id. at 1 ("No attempt is made here to update the data used in the study").

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[7]See also Office of Consumers' Counsel v. FERC, 783 F.2d 206, 227 (D.C. Cir. 1986) (decision not based on substantial evidence where it neglects pertinent facts on the record); see Eagle-Picher Indus. v. EPA, 759 F.2d 905, 921 (D.C. Cir. 1985) ("under the arbitrary and capricious standard, [the Court] look[s] to see if the agency has examined the relevant data"); Mt. Diablo Hosp. v. Shalala, 3 F.3d 1226, 1232 (9th Cir. 1993) ("an action will not be upheld where the agency has intentionally omitted evidence from consideration"); see also General Motors v. FERC, 613 F.2d 939, 944 (D.C. Cir. 1979) (decision that ignores issues relevant to public interest will be reversed).

The Commission's disregard of this evidence substantially skewed its results. The Commission's own economists admit that, if actual LEC performance for the years 1990-1992 were taken into account, the new productivity offset would not have been 3.5 percent; it would have been 3.3 percent instead. Belinfante, Evaluation of the USTA Update of the Frentup-Uretsky Study, App. E to the Price Cap Order, at 1. This .2 percent difference will cost Bell Atlantic alone on the order of $5.4 million, while the decision to jack-up the minimum X-Factor to 4.0 percent from the 3.3 percent validated by the Commission's own study will cost Bell Atlantic $18.9 million each year. Moreover, because the Commission's decision requires a one-time adjustment for each of the four years petitioners chose the 3.3 percent X-Factor, it quintuples the first-year impact of changing the minimum X-Factor to 4.0. Because of this one-time adjustment, Bell Atlantic stands to lose $78.8 million, and Southwestern Bell $55.7 million, in the first year alone.[8] See Zuckerman Decl. ¶ 5; Kaeshoefer Decl. ¶ 5. It is wholly unacceptable for the

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[8]Under the assumption that the Commission had miscalculated LEC productivity by .7 percent (the difference between 4.0 percent and 3.3 percent), the Commission required the LECs to reduce their PCIs by .7 percent for each year in which they used the 3.3 percent X-Factor. For some LECs (including petitioner Bell Atlantic), this means a one-time adjustment of 2.8 percent. If the truly updated X-Factor of 3.8 percent had been used, however, the difference would only have been .5 percent per year and the total one-time reduction would only have been 2.0 percent -- a difference of .8 percent. For Bell Atlantic, that difference translates into $21 million per year, and for Southwestern Bell it is $16 million. Zuckerman Decl. ¶ 5; Kaehoefer Decl. ¶ 5.

Commission to offer so little justification when so much is at stake.

2. The Commission Failed to Offer an Adequate Justification for Retroactive Application of the .5 Percent Consumer Productivity Dividend

The Commission erred not only by excluding relevant data when calculating the new minimum X-Factor, but also by including factors that simply did not belong. Specifically, the Commission added a .5 percent "consumer productivity dividend" to the 3.5 percent productivity offset, yielding a minimum X-Factor of 4.0 percent. The Commission, however, never explained what the consumer productivity dividend is, why it has been set at .5 percent (as opposed to any other number), or why it should be included in both prospective adjustments and the retroactive one-time adjustment.

Presumably, the Commission included a consumer productivity dividend here for the same reason it included one in the last price cap order: (1) to give LECs an incentive to exceed historical productivity levels during the transition from rate-of-return regulation, and (2) to ensure that consumers share in the benefits of the LECs' ability to do so. Further Notice of Proposed Rulemaking, Policy and Rules Concerning Rates for Dominant Carriers, 3 FCC Rcd 3195, 3407-08, ¶¶ 386-89 (1987). Even if one accepts these justifications as correct -- and they clearly are not[9] -- it makes no sense at all to apply the

[9]As Bell Atlantic has pointed out, it no longer makes sense to include a consumer productivity dividend *above* historical productivity levels. Any supra-normal productivity gains

consumer productivity dividend in the one-time retroactive correction. The consumer productivity dividend was designed to induce LECs to "stretch" to exceed historical productivity levels. Id. at 3407-08, ¶¶ 386-89 (1987). There is no apparent justification for including a "stretch" factor as part of a retrospective adjustment, when the behavior to be affected has already occurred. Indeed, including a "stretch factor" retrospectively is particularly pointless where actual performance data demonstrates that even the base productivity goals were too high for the LECs to achieve.

Finally, even if a consumer productivity dividend of some variety could legitimately be included, the Commission offered no justification for making it .5 percent instead of .1 percent, .2 percent, or 5 percent. The number instead seems to have been plucked from thin air. The Commission's authority to establish just and reasonable rates must be exercised on the basis of a record and evidence; it cannot be exercised by conjuring figures from ether.

3. The One-Time Adjustment Constitutes Prohibited Retroactive Rulemaking

At bottom, the Commission's decision to force LEC prices downward was not based on valid, economically-sound predictive judgments about future LEC productivity but on a value-laden

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resulting from the imposition of price caps have already been made. See Comments of Bell Atlantic at 13-15 (FCC May 9, 1994). This argument is supported by historical data, which shows declining productivity gains between 1990 and 1992. Once again, the Commission did not even mention or address this argument.

decision that LECs had earned too much in the past. The Commission expresses concern that LECs achieved a rate of return large enough to require "sharing." Price Cap Order at 91-92, ¶ 203. But the question for the Commission is not whether the LECs earned too much in the past -- and the Commission concedes that the LECs did not -- but how to set appropriate rates for the future. Despite its protestations to the contrary, id. at 111-13, ¶¶ 252-54, the Commission confused those goals.

Confronted with this argument, the Commission offered only one response. The one-time adjustment, the Commission argued, does not require LECs to "return" excess monies earned in past years. Instead, it "reinitializes" LEC PCIs to ensure that future rates are reasonable. Price Cap Order at 112, ¶ 253. The problem is that there is no economic substance to this semantic distinction. Under price caps, the way the Commission requires LECs to "return" excess earnings and the way it "reinitializes" LEC PCIs are one and the same -- by lowering the LECs' PCIs. See 47 C.F.R. § 64.45(d)(2) (sharing enforced by requiring temporary reduction to LEC PCIs). Surely the Commission cannot convert a "refund" of .7 percent for each year the 3.3 percent productivity factor was employed into a "reinitialization" simply by selecting the "reinitialization" label.

Moreover, the Commission entirely ignored the effect of its decision on the calculus that led LECs to choose the 3.3 percent factor in the first place. The LECs were led to believe that, if they selected the lower X-Factor, they would suffer lower sharing thresholds but would benefit by avoiding a full percentage point of downward adjustment to their PCIs each year. Now that turns out not to have been the case. The benefit of choosing the 3.3 percent option for 4 years is not the addition of 4.0 percent to PCI but the addition of a mere 1.2 percent. Before retroactively altering the effects of the choices it provided the LECs, the Commission should have considered the impact of its decision on their justifiable reliance interests.

B. The Commission's Treatment of OPEBs Constituted Prohibited -- and Arbitrary -- Retroactive Rulemaking

In addition to forcing the LECs to reduce their PCIs to overcome the Commission's earlier use of a supposedly erroneous X-Factor, the Commission required LECs to reduce their PCIs to overcome the effect of a Court of Appeals decision with which the Commission happens to disagree.

In what is now known as the OPEBs Order,[10] the Commission addressed the price-cap treatment of accounting changes required by SFAS-106, SFAS-112, and corresponding Commission rules. Those changes required the LECs to recognize the costs of certain "other post-employment retirement benefits" (or OPEBs) on an accrual rather than cash-flow basis. The Commission initially determined that the ongoing "cost increases" traceable to those

[10]Memorandum Opinion and Order, Treatment of Local Exchange Carrier Tariffs Implementing Statement of Financial Accounting Standards, "Employers Accounting for Postretirement Benefits Other than Pensions," 8 FCC Rcd 1024 (1993).

accounting changes could not be treated exogenously.[11] But in Southwestern Bell Tel. Co. v. FCC, the Court of Appeals reversed, holding that the Commission's rules did not preclude exogenous cost treatment. "[W]hatever the intrinsic merits of" the Commission's rationale, the Court explained, "the Commission is free to consider [it] as a basis for *amending* its current rule, not for concocting a new rule in the guise of applying the old." 28 F.3d at 173.

In an effort to circumvent the effect of the Court's ruling, the Commission amended its rule in this proceeding. Specifically, it decided that accounting changes will not be given exogenous treatment unless they impose an "economic" (or cash-flow) cost. But rather than applying the new rule prospectively, the Commission made its decision retroactive as well. Not only did the Commission bar future OPEB-based adjustments as "non-economic costs," but it also required that past OPEB-based adjustments be stripped out of the LECs' existing PCIs. Price Cap Order at 136, ¶ 309. But, as the D.C. Circuit explained in Georgetown Univ. Hosp. v. Bowen, 821 F.2d 750 (1987), aff'd on other grounds, 488 U.S. 204 (1988), it is a fundamental premise of the APA that legislative rules promulgated through notice and comment rulemaking can only be applied prospectively. To hold otherwise would render the Court's reversal of agency rulemakings utterly meaningless; the agency

[11]The order did not decide whether the historic portion of those costs (i.e., the Transitional Benefit Obligation) qualified for exogenous treatment.

could simply reissue invalidated rules on a retroactive basis. Id. at 758. That is what the Commission attempted here. Having lost in the Court of Appeals on how OPEBs may be treated, the Commission now seeks to nullify the effect of that decision. Whether or not the Commission has authority to deny exogenous treatment to non-economic costs not yet recognized by the LECs, the Commission has no authority to deny such treatment to non-economic costs already incorporated in LEC PCIs under authority of Southwestern Bell.

In any event, even if the Commission had authority to require this retroactive readjustment, it clearly abused that authority. There are many non-economic "accounting" effects embedded in current LEC PCIs. The Commission repeatedly has required LECs to *reduce* their PCIs on account of non-economic accounting changes, including the treatment of inside wiring amortization and amortization of depreciation reserve deficiencies. See Price Cap Order at 137, ¶ 313 & n.586. But the Commission nowhere considers whether these non-economic changes should now be retroactively stripped out of current LEC PCIs. If the Commission is going to pick-and-choose among the "non-economic" cost changes that must be stripped out of LEC PCIs, it must articulate some basis for its decisions. This the Commission has not done.

A pattern does appear, however. The Commission's treatment of non-economic costs, it turns out, is the product of precisely the type of gerrymander the Commission employed when calculating the new X-Factor. Non-economic cost changes that favor the LECs, like OPEBs, end up on one side of the line; they not only are barred from being considered exogenous in the future but also must be stripped out of LEC PCIs to the extent they were considered exogenous under the Commission's prior rules. In contrast, non-economic changes that work to the LECs' detriment, like the treatment of inside wiring amortization and amortization of depreciation reserve deficiencies, are left in place or relegated to consideration at some indefinite future date.

The fact that one adjustment favors the LEC and the others do not explains the Commission's decision but does not justify it. The Commission's mandate, after all, is to ensure that rates are just and reasonable -- not that they disfavor the LECs whenever possible. In accord with that mandate, the Commission must articulate a justification as to why certain non-economic costs must be stripped out from LEC PCIs retroactively while others need not. Because the Commission failed to articulate or apply such a standard here, its order is arbitrary and capricious on its face.

C. The Commission's Add-Back Order Constituted Prohibited Retroactive Ratemaking

The Commission's Add-back Order suffers from a very similar defect. Although the Commission conceded that its Add-back Order only can be applied prospectively, Add-back Order at 22, ¶ 49, in fact the Commission gave the order retrospective effect. As a result of the Commission's decision, sharing obligations that were incurred two years ago must now be treated as earnings for last year. See ibid. Whether or not the Commission has authority to alter the legal implications of sharing obligations that are incurred in the future, it cannot by rulemaking alter the legal implications of sharing obligations incurred in the past. Georgetown Univ. Hosp. v. Bowen, 821 F.2d 750 (D.C. Cir. 1987). The impact of this error is measured not in thousands but in millions of dollars. Zuckerman Decl. ¶ 8; Kaeshoefer Decl. ¶ 5.[12]

II. The Equities Favor Granting the Stay

A. Absent Interim Relief, the Commission's Order Will Deprive LECs of Substantial Revenue Without Offering Any Prospect for Recovery

The cumulative effect on petitioners is staggering. For each petitioner, over one hundred million dollars in revenues will disappear in a single year. Zuckerman Decl. ¶¶ 5, 8; Kaeshoefer Decl. ¶¶ 5, 7. The effect on the industry as a whole will be a multiple of that number.

It is true, of course, that monetary loss generally does not constitute irreparable injury. See Wisconsin Gas Co. v. FERC, 758 F.2d 669, 674 (D.C. Cir. 1985). But that general rule only applies where "adequate compensatory or other corrective relief" is available "in the ordinary course of litigation." Id. (quoting Virginia Petroleum Jobbers Ass'n v. FPC, 259 F.2d 921, 925 (D.C. Cir. 1958)). Where, in contrast, monetary loss cannot

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[12]Petitioners recognize that Ameritech has already sought a stay of the Commission's Add-back Order. See Emergency Motion for Stay Pending Judicial Review (FCC Apr. 28, 1995). Should Ameritech's Motion be granted, petitioners' request for a partial stay of the Add-back Order, of course, will be moot.

be recovered, irreparable harm is present and a stay may be appropriate.

That is precisely the case here. Although the Commission is empowered to permit LECs to increase their rates to recoup losses incurred as a result of Commission decisions that are invalidated on appeal,[13] it is unlikely that the Commission could successfully exercise that authority here. Ever-expanding competition in LEC interstate access service markets already limits the ability of LECs to raise their prices and will have an even larger effect in the future. As Mr. Zuckerman explains in his affidavit:

> [T]he scope and intensity of . . . competition is increasing rapidly, and will continue to do so as . . . existing competitors provide an expanding array of competing telephone services, and as new competitors such as wireless personal communications services begin operation. The effect of this increasing competition will be to put increased pressure on price levels.
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> [G]iven these market conditions, obtaining permission from regulators to increase prices in an effort to recoup the lost revenues described above would be a largely illusory remedy. Assuming the Orders were in effect for only a single year, the lost revenues would total well over $100 million. In order to recoup losses of this magnitude, prices would have to be increased

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[13]Usually, any attempt to allow LECs to raise future rates to make up for past losses would violate the prohibition on retroactive ratemaking. However, both the Supreme Court and the D.C. Circuit have recognized that agencies have substantial latitude to adjust future rates to make up for the effect of reversal on appeal. See United Gas Improvement Co. v. Callery Properties, Inc., 382 U.S. 223, 229-30 (1965); Public Utils. Comm'n of California v. FERC, 988 F.2d 154, 162 (D.C. Cir. 1993). As the D.C. Circuit recently noted, "[t]his Court has previously recognized [an agency's] authority to order retroactive rate adjustments when its earlier order disallowing a rate is reversed on appeal." 988 F.2d at 162.

> significantly above those in effect today. The notion that the marketplace would permit price increases of this magnitude in the future is simply not realistic. As a result, Bell Atlantic would be unable to recover these losses, and would be irreparably harmed.

Zuckerman Decl. ¶¶ 9-10; accord Kaeshoefer Decl. ¶ 7.

The grant of a stay and imposition of an escrow or accounting order, in contrast, will avoid irreparable injury for all. The difference between the new rates and the old ones will be held in a separate interest-bearing escrow account or otherwise accounted for by the LECs. When judicial review is terminated, the funds so identified or segregated, plus interest, can be distributed in accord with the Court's decision.[14] The Commission has recognized the obvious advantages of this approach and has applied it in the past. See, e.g., Virgin Islands Tel. Corp., 7 FCC Rcd 4235, 4236-37, ¶ 13 (1992).

Moreover, even if the Commission were able to compensate petitioners for interim losses by allowing them to increase their future rates -- although competitive forces make it singularly unlikely that the attempt would succeed -- such an after-the-fact rate increase is an inferior method of providing compensation. In essence, raising future rates to make up for past losses forces tomorrow's customers to pay for the unjustified benefit

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[14]In the event an escrow account is established, all of the interest paid by the escrow agent (selected at the Commission's discretion) will be included in the distribution. In the event that an accounting order is used instead, petitioners will pay the statutory interest rate on any funds remitted to their customers.