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May 19, 1995

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

DOCKET FILE COPY ORIGINAL

Re: CC Docket No. 94-1; Price Cap Performance Review for Local Exchange Carriers

Dear Mr. Caton:

Enclosed herewith for filing are the original and four (4) copies of MCI Telecommunications Corporation's Petition for Reconsideration in the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI comments furnished for such purpose and remit same to the bearer.

Sincerely yours,

Chris Frentrup

Chris Frentrup
Senior Regulatory Analyst
Federal Regulatory

Enclosure
CF

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20054

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

PETITION FOR RECONSIDERATION

MCI TELECOMMUNICATIONS CORPORATION

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May 19, 1995

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SUMMARY

Although MCI applauds the Commission's decision that the fundamental objective of price caps should continue to be to ensure that rates for interstate telecommunications services are just, reasonable, and non-discriminatory, MCI believes that the Commission, in several significant respects, has failed to provide a reasoned analysis for its decision, or has failed to articulate a rational connection between the facts it adopts and its holding. MCI argues that the key decisions made by the Commission in promulgating its "interim" plan are either not explained, not supported by record evidence, or are inconsistent with specific findings the Commission made in the Order. MCI urges the Commission to reconsider its decisions regarding the productivity factor (both its level and the number of choices), the sharing and low-end adjustment mechanisms, re-initializations, the Carrier Common Line Formula, treatment of exogenous costs, sales and swaps of exchanges, and pricing flexibility.

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PETITION FOR RECONSIDERATION

I. INTRODUCTION

Pursuant to Section 1.106 of the Commission's rules, MCI hereby submits its petition for reconsideration of the Performance Review Order in the above-captioned docket.[1] Although MCI applauds the Commission's decision that the fundamental objective of price caps should continue to be to ensure that rates for interstate telecommunications services are just, reasonable, and non-discriminatory, MCI believes that the Commission, in several significant respects, has failed to provide a reasoned analysis for its decision, or has failed to articulate a rational connection between the facts it adopts and its holding.[2] MCI argues that the key decisions made by the Commission in promulgating its "interim" plan are either not explained, not supported by record evidence, or are inconsistent with specific findings the Commission made in the Order. For the

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[1] In the Matter of Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, FCC 95-132, released April 7, 1995 (Performance Review Order).

[2] Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983): California v. FCC, 39 F 3d 919 (9th Cir. 1994). See also 5 U.S.C. § 706 (2)(A).

reasons set out below, MCI urges the Commission to reconsider its decision.

II. PRODUCTIVITY FACTORS

The Commission found that, even though the record was insufficient to choose a methodology for computing the productivity factor, there was still consensus on the concept of basing the factor on an industry-wide measure of performance during the post-price cap period.[3] The Commission determined that the record indicated that its initial selection of productivity factors for the LECs had indeed been too low, and that for an interim period, until it can determine a future methodology for updating the productivity factor, the Commission should revise its productivity estimate based on a revision to its original short-term productivity study. After making this revision, and combining the revised short-term study with the long-term study, the Commission found that its range of productivity factors should have been 4.0 and 5.0 percent, rather than its original selections of 3.3 and 4.3 percent.[4] The Commission explicitly rejected, for the interim plan, MCI's suggestion that it rely only on the short-term productivity study to set the minimum productivity factor.[5]

A. Selection of 4.0 percent as a minimum factor is inconsistent with findings that productivity increased

MCI believes that selection of a minimum productivity factor of 4.0

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[3] Performance Review Order at paras. 144-5.

[4] Id. at para. 201.

[5] Id. at para. 216.

percent is inconsistent with the Commission's specific finding that local exchange carrier (LEC) productivity increased in the first four years of the price cap plan. The Commission's 4.0 percent productivity factor is the result of the Commission's correction of its initial short-term productivity study to delete a previously-disputed data point. In addition, the 4.0 percent factor results from a long-term study of telephone industry prices.[6] Both these studies examined data from only the pre-price cap period. Thus, the correction made by the Commission adjusts the productivity factor only to the level where it should have been set.[7] To then select a 4.0 percent productivity offset as the minimum therefore implies that LEC productivity is no different in 1995 than it was in 1990. However, the Commission has found that LEC productivity increased during the first four years under price caps.[8] Indeed, the Commission determined that the productivity factor should "incorporate productivity changes that have occurred since the institution of price cap regulation."[9]

There is simply no way for these two findings to be reconciled. Either productivity growth has increased -- as the Commission explicitly found and as a broad array of parties (including MCI) argued -- or it has not. Moreover, as

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[6] Id. at para. 209.

[7] Id. at paras. 18-19.

[8] Id. at para. 221.

[9] Id. at para. 145.

the Commission recognized, the increasing pace of productivity growth must be reflected in the choice of the minimum offset. MCI argues that the Commission must increase the productivity factor above the level implied by its pre-price cap studies.

B. Record evidence amply supports a factor of 5.7 percent

Ample record evidence supports a minimum productivity factor of 5.7 percent, as advocated by the CARE coalition.[10] AT&T's study of LEC performance since price caps began found that their productivity had been 5.97 percent. Ad Hoc's study of LEC total factor productivity found a productivity of 5.7 percent. MCI's estimate of pre-price cap LEC productivity was 5.9 percent. These parties and other intervenors joined in the CARE coalition and based on these different studies, advocated a minimum productivity factor of 5.7 percent. Even the United States Telephone Association's (USTA's) own study, properly performed to include an input price differential, supports a productivity factor of 5.7 percent.

In light of these facts, Commissioner Ness in her dissenting statement concluded that "the record contains substantial evidence that the productivity gains of LECs in the post-divestiture, pre-price cap era were above the lower X-factor" the Commission prescribed.[11] Commissioner Ness also argued that

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[10] See e.g., CARE November 3, 1994 ex parte filing.

[11] See Performance Review Order, Dissenting Statement of Commissioner Susan Ness at 3. (Emphasis in the original.) "X-factor" is another term for productivity factor.

the Commission should give more weight to its short-term study than to its long-term study, which would indicate that the productivity achieved by the LECs before price caps was about 5 percent.

MCI believes that Commissioner Ness was right on both counts. The Commission has adopted a productivity factor which is below the levels achieved by the LECs before price caps, and which is certainly too low given the LECs increased incentives to achieve productivity gains under price caps. The Commission should have relied more heavily on the short-term pre-price cap studies and the evidence regarding LEC productivity achievements since price caps. Had it done so, it would have adopted a productivity factor of at least 5.7 percent.

Any further evidence necessary to prove that the Commission's productivity factors were too low was provided by the LEC's behavior in the annual access filing. Most LECs chose the Commission's highest option; no LEC chose the Commission's middle option.[12] This indicates that the LECs could easily achieve a productivity factor of 5.7 percent. MCI urges the Commission to adopt this higher productivity factor on reconsideration.

C. There is no record evidence to support a three-tiered productivity factor

In the Performance Review Order, the Commission set three productivity

[12] Only NYNEX, US West, Southern New England Telephone, and some GTE study areas chose the 4.0 percent productivity factor. MCI asserts that these carriers' selection of 4.0 percent in no way indicates that these LECs are incapable of achieving a 5.3 percent productivity growth.

factor options from which the LECs could choose: 4.0 percent, 4.7 percent, or 5.3 percent. The Commission stated that three options better reflect LEC heterogeneity, and provide carriers greater flexibility. It also argued that the middle option provides LECs an additional opportunity to move away from the minimum productivity factor to a higher step.[13] The Commission' s decision to offer the LEC three productivity factor options is fraught with short-comings and is not supported by evidence on the record.

The Commission baldly asserts that three options better reflect the heterogeneity of past performance and choices among the LECs. The first shortcoming with this assertion is that no evidence exists on the public record to demonstrate the heterogeneity of past performance and choices among the LECs. In fact, the evidence demonstrates just the opposite. For example, as is illustrated in Table 1 of MCI's Comments, LECs have all increased their productivity levels as evidenced by the increases in their rates of return. Furthermore, as the Commission pointed out:

> LEC earnings have risen rapidly during the initial price caps period, to the point where, in 1993, all seven BOCs, Contel, Lincoln, and a number of Sprint operating companies were in the 50-50 sharing zone.[14]

Any variance in their earnings is not due to heterogeneous performance, but is due to specific one-time, up-front charges taken by the LECs. The Commission

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[13] Performance Review Order at para. 215.

[14] Id. at para. 203.

has no basis to suggest that the LECs' past performance and choices are heterogeneous.

The Commission's remaining reasons for providing three options are equally deficient. First, the Commission argues that the LECs would benefit from three options. However, the Commission has failed to consider the adverse public policy effects that could result from LECs being offered three options. The LECs will have greater scope to game the system, tailoring their productivity choice in a way that maximizes their return, rather than rate decreases to ratepayers. Consequently, the Commission's analysis, at best, is incomplete, and therefore, not valid.

Second, the Commission has failed to adequately explain or demonstrate the logic behind its third reason. The Commission states that the three productivity factors provide the LECs with an option that is higher than one level, and below another. This is not reasoning, analysis, nor an explanation. This is merely an observation. Consequently, it fails to add any support to the Commission decision.

As Commissioner Ness correctly observed, offering LECs three productivity factor options, rather than two, will:

> reduce consumer benefits, increase uncertainty in the marketplace, and add unnecessary complexity to the framework. A far better approach would have been to change the structure less and the numbers more.[15]

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[15] Performance Review Order, Dissenting Statement of Commissioner Susan Ness at 2.

MCI concurs with Commissioner Ness' assessment of the Commission's three-option model.

> The drawbacks of this approach have not been adequately considered. A three-option model adds needless complexity and "churn"....[16]

The Commission based its decision to offer three options to the LECs on its "expertise and informed judgment in balancing the interests of consumers and shareholders." This is a lawyerly way of stating that the Commission decision to offer the LECs three options was based on no more than a wild guess. MCI urges the Commission, on reconsideration, to drop the three-tiered productivity option as adding unnecessary complexity and churn.

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[16] Id.

III. SHARING AND LOW-END ADJUSTMENT MECHANISM

In conjunction with the revised productivity factors discussed supra, the Commission adopted revised sharing limits.[17] Those sharing requirements are as follows:

Productivity Selection	Achieved Earnings	Sharing Obligation
4.0%	11.25% - 12.24%	None
	12.25% - 13.24%	50% sharing
	over 13.25%	100% sharing
4.7%	11.15% - 12.24%	None
	12.25% - 16.24%	50% sharing
	over 16.25%	100% sharing
5.3%	10.25% and up	None

MCI believes that there are several critical flaws with respect to the Commission's decision to adopt this sharing structure. In particular, MCI argues that there is no record evidence to support removal of sharing when a carrier elects a 5.3% productivity offset. In addition, removal of sharing obligations for the 5.3% LECs is inconsistent with the Commission's findings that the LECs retain substantial market power. MCI also disagrees with the Commission's apparent finding that Section 201 of the Communications Act has no bearing on the decision to structure sharing/no sharing incentives.

[17]Id. at para. 200.

Finally, MCI believes that the cost of capital showing it made in its filing, together with other record evidence demonstrating a decline in the LECs' cost of capital, supports recalibration of sharing bands. MCI discusses each of the issues below.

A. There is no explanation in the Order and no basis in the record to remove sharing when carriers elect the 5.3% productivity offset

The Commission discourses at length on the topic of whether sharing introduces a element of incongruity into its incentive-based regulatory system, equating sharing to a "rate of return" mechanism that is fundamentally at odds with price caps.[18] Based on its concern that sharing erodes efficiency incentives, the Commission concludes that sharing is an undesirable addition to its price caps system, and decides to explore ways to eliminate sharing entirely in a Further Notice. So compelling does the Commission find its analysis on the alleged inefficiencies of a sharing mechanism, that the Commission decides -- in advance of the Further Notice that it has announced will discuss this topic -- to eliminate completely the sharing obligation on LECs who elect a 5.3% productivity offset.

The Commission's explanation for its action is virtually nonexistent. The Commission states only that a 5.3% productivity offset is "sufficiently challenging" to permit elimination of the sharing requirement.[19] Why the 5.3%

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[18] Id. at para. 188.

[19] Id. at paras. 19, 220.

productivity offset is sufficiently challenging is anybody's guess. There is no further explanation provided.

As discussed above, having once again mistakenly set the minimum productivity factor at a level that is too low, the Commission erroneously concludes that the 5.3% factor constitutes a major challenge. MCI submits that a productivity factor sufficiently challenging to permit the elimination of sharing would have to be set at a level that is substantially above the 5.7% productivity level that LECs have exhibited. The Commission need look no further than the 1995 annual access filings to determine that 5.3%, instead of being the steep challenge envisioned for the bold few, is in reality a cakewalk.

B. Removal of sharing is inconsistent with the Commission's findings that the LECs remain dominant carriers

That the Commission would have come to such a remarkable conclusion to eliminate sharing in the interim plan is surprising in light of the important role that sharing has played under the initial price cap plan in ensuring that rates remain reasonable. The Commission adopted the sharing mechanism because it was "difficult to determine a single, industry-wide productivity offset that [would] be perfectly accurate for the industry as a whole or for individual LECs or market conditions at a given time."[20] The Commission was concerned that its price cap system might work an unfairness on customers, causing rates to exceed costs by a substantial amount, and resulting in rates that were

[20] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786 (1990) (LEC Price Cap Order) at 6801.

unreasonable under Section 201 of the Communications Act.[21]

In its Performance Review Order, the Commission made several specific findings with respect to the LECs' monopoly power.

> Because the LECs appear to retain substantial market power in providing local exchange and access services, regulation continues to be needed to achieve the goals of the Communications Act, and to increase consumer welfare.[22]

In addition, in discussing whether to treat the changing cost of access from competitive access providers (CAPs) as exogenous for AT&T, the Commission specifically found that AT&T's use of CAP access is "de minimis".[23] Even in the presentation of the Performance Review item to the Commission, the LECs were described as dominant providers of access service.[24] There can be no question that the Commission made specific findings and conclusions that the LECs remain dominant and exercise market power that must be constrained by regulation.

Inexplicably, and without reference to this finding of market power, the Commission has completely eliminated sharing for any LEC electing a 5.3% productivity offset. Earnings in any amount that a 5.3% LEC can generate accrue solely to the benefit of the corporation and its stockholders. The market

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[21] 47 U.S.C. Section 201.

[22] Performance Review Order at para. 92.

[23] Id. at para. 344.

[24] Presentation of Geraldine Matise, Chief, Tariff Division, at the Commission's March 30, 1995 Agenda Meeting.

power that the LECs continue to exercise ensures that, for any LEC who is able to substantially outperform the 5.3% productivity goal embedded in the formula, rates can and will rise to unreasonable levels. So long as LECs continue to be dominant, the Commission must constrain their earnings.

C. Removal of the sharing mechanism violates Section 201 of the Act

The Commission concluded in its Performance Review Order that the Section 201 of the Communications Act does not require sharing.[25] While this observation is certainly true as a matter of statutory interpretation, MCI argues that it is completely incorrect to argue that the Commission can completely abdicate responsibility for limiting earnings of dominant LECs.[26] Since the Commission does not permit customers to file complaints based on a price cap LECs' earnings levels,[27] and because there is no performance review required in this allegedly "interim" plan,[28] a LEC electing 5.3% that can generate higher productivity gains can reap a windfall from the new price cap plan at the

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[25] Performance Review Order at para. 225.

[26] MCI finds completely unpersuasive the Commission's use of the AT&T Price Cap Plan as precedent for a sharing/no sharing decision for the LEC plan. The markets that are regulated in each case are substantially different, and exhibit dramatic differences in the level of competition and availability of competition.

[27] Performance Review Order at para. 224.

[28] While MCI is certain that the Commission fully intends to fulfill its commitment to complete work on a final price cap in one year, historically, intervening events often have a way of lessening an agency's resolve. For example, the commission adopted an "interim" cost allocation manual for AT&T that remained in place for eight years before it was abolished by the adoption of price cap regulation for AT&T. AT&T, 84 FCC 2d 384 (1981).

ratepayer's expense. In effect, the Commission has gutted the statutory requirements of Section 201 and its provision that rates be reasonable. It is, of course, axiomatic that the Commission cannot re-write the Communications Act -- only Congress can.[29]

If it is true, as the Commission found in the Performance Review Order, that LEC productivity gains are increasing under price caps, then the potential benefits accruing under price caps will quickly become skewed in favor of shareholders in the absence of some upper constraint on earnings. Until the Commission brings access rates much closer in line with their economic costs, sharing must continue as a feature of the price cap system.

D. Cost of capital decrease supports recalibration of sharing bands

In its Performance Review Order, the Commission declined to adjust the sharing bands based on changes since 1990 in LEC cost of capital, the starting point for creating sharing requirements.[30] The Commission found unpersuasive cost of capital showings made by MCI and AT&T, demonstrating a prolonged downward trend in cost of capital that the Commission itself found had yielded an "unanticipated benefit" to the LECs. The Commission instead cited some recent statistics indicating that the cost of debt has been increasing.

MCI argues that the Commission's decision not to recalibrate the sharing

[29] See MCI Telecommunications Corporation v. FCC, 765 F 2d 1186 (D.C. Cir.) 1985) (vacating the Sixth Report and Order in Competitive Carrier that prohibited tariff filings by non-dominant carriers.).

[30] Performance Review Order at paras. 229-33.

bands downward is not based on reasoned analysis. First, the Commission offered only evidence on the cost of debt, ignoring cost of equity evidence.[31] Second, since the cost of capital is based on a weighted average of cost of equity and cost of debt, the Commission did not consider how changes in the mix of equity and debt may have affected the reasonableness of the 11.25% cost of capital finding from 1990.[32] Finally, the Order is bereft of any analysis that would demonstrate that the more recent cost of debt statistics cited by the Commission represent anything more than a short-term increase in what otherwise would be a sustained downward trend.

MCI argues that these deficiencies in the Commission's decision must be corrected, and that the Commission must consider the overwhelming evidence that the sharing bands are set too high.[33]

E. The Commission should eliminate the low-end adjustment mechanism

The Commission has erroneously decided to retain for the interim period the low-end adjustment mechanism for LECs electing the 4.0 or 4.7 percent productivity factor. The Commission's rationale for retaining the low-end

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[31] MCI Comments at 29-30 and Appendix A.

[32] Id.

[33] MCI also disagrees that the Rate of Return Reform Order, cited by the Commission as precedent for the need not to evaluate the level of sharing, has any bearing on the LEC price cap plan. Performance Review Order at paras. 232-3. The Commission itself explicitly state that the Rate of Return Reform Order does not apply to price cap carriers. See Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Process, Report and Order, CC Docket No. 92-133, FCC 95-134, adopted March 30, 1995.

adjustment for these carriers is to provide for a measure of automatic relief for LECs experiencing low earnings, so that confiscatory rates and extended rate proceedings may be avoided. However, as MCI explained in its comments, filed May 9, 1994, LECs are already protected from confiscation by "belts and suspenders."

A low-end adjustment mechanism is unnecessarily redundant. The price cap plan already contains protections that more than adequately guard LECs against confiscatory rates. Not only do LECs retain the ability to file above-cap rate increases, but the LECs may seek a waiver of the price cap rules, as needed. The "safety nets" already are in place for the LECs. Therefore, elimination of the low-end adjustment mechanism would not materially add to the risks that price cap LECs face under incentive regulation.

Conversely, retaining the low-end-adjustment mechanism clearly is not in the public interest, as it allows the LECs to raise their rates for reasons other than those foreseen by the Commission in its original price cap order. For example, if a LEC decides to layoff employees to reduce their future costs, as NYNEX did in 1991, the low-end adjustment mechanism would allow the LEC to recover its one-time charge due to its depressed earnings level. The LEC would receive the productivity benefit of the lowered costs, while being reimbursed for the one-time charge. Thus, the incentive that the low-end adjustment mechanism provides the LECs is clearly not in the public interest, while it simultaneously provides the LECs another level of protection, which it clearly does not require.

IV. RE-INITIALIZATION OF PCI LEVELS

In light of its finding that the productivity factor had been initially set too low, the Commission decided that the LECs would have to make an up-front cut in the Price Cap Indexes (PCIs) of a maximum of 2.8 percent.[34] This cut was equal to the difference between the Commission's previous minimum productivity factor of 3.3 percent and its new minimum factor of 4.0 percent, multiplied by the number of years the LECs had chosen the 3.3 percent productivity factor.

MCI believes this re-initialization amount was too low. As argued supra, the productivity factor should have been 5.7 percent. Thus, even if the Commission were correct that the up-front cut should have been based on the difference between the correct productivity factor and the productivity factor the LECs chose over the last four years, the up-front rate cut would have been a maximum of 9.6 percent.[35]

However, MCI does not agree that the re-initialization should have been based solely on the difference between the correct productivity factor and the Commission's initially selected factor. In its Comments, MCI argued that the

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[34] Performance Review Order at para. 245.

[35] If the LEC chose 3.3 percent all four years, its up-front reduction would have been 9.6 percent, or 4 times the difference between 5.7 percent and 3.3 percent; if it chose 4.3 percent each year, its up-front cut would have been 5.6 percent, or 4 times the difference between 5.7 percent and 4.3 percent.

re-initialization should be based on the change in the LECs' cost of capital. The Commission declined to base its re-initialization on the change in the cost of capital, but provided no reasoned explanation for why a change in the cost of capital should not be a basis for re-initialization, stating only that it was doing so for the same reasons it was not adjusting the sharing levels for the change in the LECs' cost of capital.[36]

In deciding not to change the sharing bands for the change in the cost of capital, the Commission noted that the average yield on 10-year treasury notes had been 8.09 percent in January 1991 (when price caps began for the LECs), 5.75 percent in January 1994 (when the Commission began its performance review), and 7.62 percent in January 1995. Thus, the Commission concluded, because interest rates were approximately where they had been when price caps began, there was no need to adjust the sharing levels because the cost of capital had not changed.

As discussed supra, the Commission has made no determination that this apparent increase in interest costs is anything other than a temporary increase. The Commission also did not address MCI's argument that the other components of the cost of capital, i.e., the cost of equity and the mix of debt and equity had changed so as to lower the overall cost of capital.[37] Furthermore, the Commission did not address whether the "adders" that the

[36] Performance Review Order at para. 255.

[37] See MCI Comments at Appendix A.

Commission used when it initially set the 11.25 percent rate of return were still necessary.[38] As the Commission itself noted, carriers received an unintended windfall during the four years of price caps due to the apparent decline in the cost of capital during that period.[39] The Commission cannot fail to correct LEC rates for the decline in their cost of capital that is supported by the record, without explanation. MCI urges the Commission, on reconsideration, to re-initialize the LECs rates based on the change in their cost of capital, and to base the sharing bands on that revised cost of capital.

V. FINDING THAT LECS DO NOT INFLUENCE DEMAND GROWTH REQUIRES ADOPTION OF THE PER-LINE FORMULA

The Commission determined that LECs do not significantly effect carrier common line (CCL) demand growth,[40] but declined to adopt the per-line formula for the common line basket, which would have ensured that the LECs did not receive any of the benefits of that growth. Citing a concern that switching to the per-line formula would cause rate churn and confusion, and require the LECs to recompute their PCIs all the way back to the beginning of price caps, the Commission declined to adopt the per-line formula for its interim

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[38] These adders were for variation in the discounted cash flow results, the fact that the BOCs cost of equity reflected uncertainty about the effect of their cellular properties, and for increased infrastructure incentives. MCI argued that these adders were no longer necessary. See MCI Comments, Appendix A at 15-16.

[39] Performance Review Order at para. 231.

[40] Id. at paras. 266-9.

plan.[41]

Having made the finding that the LECs do not influence demand growth, the only resolution of this issue that Commission can achieve is to adopt the per-line formula. The Commission failed to do so, and gave no reasoned explanation for its decision. Its stated reason was to "avoid excessive rate churn and confusion."[42] This explanation makes no sense. Switching to the per-line formula could cause rate churn only if the Commission plans to adopt a substantially easier plan when it makes its final decision on the LEC price cap plan. The per-line formula is also no more complex a formula than the balanced 50/50 formula which the Commission adopted, and thus changing to a per-line formula should cause no additional confusion.[43]

The Commission's concern that the LECs would have to recompute their PCIs if it switched to the per-line formula is unfounded. The PCIs in the past were set using the 50/50 common line formula, and had a productivity factor tailored to that formula. If the Commission were to require the LECs to recompute their Common Line PCIs based on the per line formula, it would also have to reset the 3.3 percent productivity factor to its per line equivalent. However, these two formulas, with their necessarily different productivity factors, should yield the same result.

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[41] Id. at para. 272 and n. 507.

[42] Id.

[43] The only difference between the per-line formula and the balanced 50/50 formula is that in the former the factor for demand growth is not divided by 2.

It would be simpler, and equally accurate, to simply require the LECs to use the per line formula from this year forward. This would also be consistent with the Commission's treatment of the exogenous treatment of Other Post-Employment Benefits and the add-back of sharing, which it required the LECs to correct only on a going-forward basis. MCI urges the Commission to adopt the per-line formula on reconsideration.

VI. EXOGENOUS COSTS

The Commission revised its criteria for the exogenous treatment of changes in the Uniform System of Accounts (USOA). Previously, these changes were granted exogenous treatment if they were imposed by the regulator, or resulted from a change by the Financial Accounting Standards Board (FASB), and were outside the control of the carrier. The Commission added a third prong to such changes; these changes also must be economic cost changes, i.e., the LECs will have to show that their cash flows changed because of the USOA or FASB change.[44] Consistent with this finding, the Commission directed the LECs to remove the two FASB changes for which the LECs previously requested exogenous treatment.[45]

MCI believes that the Commission took the right step in attempting to

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[44] Performance Review Order at paras. 293-5.

[45] Financial Accounting Standard 106 required the LECs to adopt accrual accounting for their Other Post-Employment Benefits (OPEBs), primarily retiree health benefits, and FAS 112 required accrual accounting for employee long-term disability and workers' compensation expenses, severance packages, and other charges for employee lay-offs.