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

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| In the Matter of | ) | |
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| 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 |

# GTE's COMMENTS IN SUPPORT OF JOINT PETITION FOR PARTIAL STAY

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby submit the following comments in support of the Joint Petition (the "*Joint Petition*") for a Partial Stay and for Imposition of an Escrow or Accounting Mechanism Pending Judicial Review filed May 9 by the "*Petitioners*", *i.e.*, Bell Atlantic and Southwestern Bell Telephone Company. The *Joint Petition* addresses two interrelated FCC decisions: (i) the First Report and Order, FCC 95-132 (released April 7, 1995), in CC Docket 94-1 (the "*Price Cap Order*"), *appeal pending sub nom.* The Bell Atlantic Operating Companies v. FCC, No. 95-1217 (D.C. Cir. filed April 19, 1995); and (ii) the Report and Order in CC Docket 93-179, FCC 95-133 (released April 14, 1995) (the "*Add-Back Order*"), *appeal pending sub nom.* Ameritech Operating Companies v. FCC, No. 95-1239 (D.C. Cir., filed April 28, 1995), (collectively, the "*Orders*").

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## SUMMARY

GTE supports the *Joint Petition*. In particular, GTE here supports the argument of the *Joint Petition* (at 8-22) that in court *Petitioners* are likely to prevail on the merits. The *Joint Petition* (*id.*) correctly spells out the defects of the *Orders*, their opportunistic use of data, their creation of retroactive effects, their arbitrariness.

Further showing that *Petitioners* are likely to prevail on the merits, GTE maintains that the *Orders*, by producing arbitrary consequences directly opposite the intent of the program, will defeat the very purposes of price caps. GTE urges the Commission to grant the relief requested by the *Joint Petition*.

## DISCUSSION

### I. THE *ORDERS* WILL DO GRAVE HARM TO THE PUBLIC INTEREST.

The effect of the *Orders* is to require GTE to implement 1995 annual access tariff price decreases amounting to $110,733,000.[1] As large as this amount is, it is dwarfed by the counterpart figures for Southwestern Bell and Bell Atlantic. In light of special circumstances affecting GTE (*i.e.*, low-end adjustments), combined with GTE rate actions described *infra*, GTE cannot make assertions of near-term harm in the dimensions of the harms cited by Southwestern Bell and Bell Atlantic.

Nonetheless, in GTE's view, the *Orders* will create the gravest harm not only to Local Exchange Carriers ("LECs" or "exchange carriers") operating under price cap regulation but to the public interest, for the reasons discussed *infra*.

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[1] These prices go into effect August 1, 1995.

## II. ACTIONS VIRTUALLY DICTATED BY THE *ORDERS* INCLUDE (i) SELECTION OF PRODUCTIVITY OFFSET LEVELS GTE MAINTAINS ARE UNREALISTIC AND (ii) PRICE INCREASES INSTEAD OF DECREASES.

To reduce the near-term negative impact of the *Orders* on GTE, GTE has taken the following actions:

**First**: Even though GTE maintains that the overall productivity levels established by the *Price Cap Order* are not attainable on a continuing and company-wide basis, GTE selected for the coming eleven months a combination of options (the 4.0 percent option selected for areas comprising 54 percent of GTE rate base[2] -- which are generally GTE's largest operating areas; the 5.3 percent option selected for the areas comprising the remaining 46 percent) that produces the least unfavorable result for GTE.

In particular, the selection of 5.3 percent for areas comprising 46 percent of GTE rate base was driven by the fact that, in these areas, the 1.3 incremental difference between 5.3 and 4.0 had less near-term harmful impact on GTE's earnings than the exogenous or Z factor impact of sharing.

Thus, in selecting 5.3 percent, GTE is simply responding to the incentives dictated by the *Orders*, which attach favorable dollar consequences in very large amounts to accepting as a working parameter unrealistic productivity assumptions. This is a world apart from price caps as originally envisioned where a company would commit itself to achieving reasonably attainable objectives.

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[2] This includes GTE Florida, Texas, California, Washington, Hawaii and Michigan; as well as two smaller areas, Arkansas and California-West Coast.

**Second**: In its May 8 tariff filing,[3] GTE took action consistent with price cap parameters[4] to move GTE pricing toward the existing price cap level. This action results in price increases for customers in certain areas.[5] In taking this action, GTE -- acting rationally in response to the incentives established by the *Orders* -- is minimizing adverse impact of the *Orders* by implementing price increases driven by FCC policy that penalizes companies for doing just what the Commission desired, *i.e.*, for reducing rates below the price caps level. Here again, the *Orders* produce results -- price increases -- directly opposite their intended effect.

## III. BY IMPOSING HEAVY PENALTIES ON BELOW-CAP PRICING, THE *ORDERS* AGAIN DEFEAT THE OBJECTIVES OF PRICE CAPS.

A key to the price caps plan was that companies would set their prices below the price cap level, thereby demonstrating the unnecessary cost of detailed price regulation and ultimately justifying the elimination of rate regulation. As the Commission recently phrased it:

> Price cap regulation is designed to mirror the efficiency incentives found in competitive markets, thus acting as a transitional regulatory scheme until the advent of substantial competition makes price cap regulation unnecessary.[6]

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3 *See* The GTE Telephone Operating Companies and GTE System Telephone Companies, Transmittal Nos. 962, 968, 145, 149, Order, DA 95-1148 (released May 24, 1995) (by the Chief, Tariff Division, Common Carrier Bureau) (the "*GTE Tariff Order*").

4 "GTE maintains that its current and proposed rates are well within its current PCIs...." *GTE Tariff Order* at paragraph 4.

5 The *GTE Tariff Order* at paragraph 7 refused to reject GTE's tariff filing and concluded "an investigation is not warranted at this time."

6 Policy and Rules Concerning Rates for Dominant Carriers, Revisions to Price Cap Rules for AT&T, CC Docket Nos. 87-313 and 93-197, Further Notice of Proposed Rulemaking, FCC 95-198 (released May 18, 1995) at paragraph 3.

GTE has done exactly what the system sought to induce, *i.e.*, has consistently furnished service at prices below the price caps level. This demonstrates that GTE was responding not to the arbitrary incentives of rate of return but to the demands of the marketplace. But the effect of the *Orders* is to apply such heavy penalties to continued below-cap offerings as to virtually compel GTE to implement the price increases allowed to become effective by the *GTE Tariff Order* toward price cap levels.

This shows again that the *Orders* virtually mandate company behavior producing results exactly opposite the purpose of price caps. And it shows that the *Orders* have effects that preclude the intended benefits of price caps.

## IV. INSTEAD OF LIBERATING LECs TO MAKE ECONOMICALLY RATIONAL DECISIONS AS INTENDED BY PRICE CAPS, THE *ORDERS* IMPOSE A NEW SET OF ARBITRARY NEAR-TERM INCENTIVES THAT VIRTUALLY DICTATE COMPANY DECISIONS.

In GTE's view, the *Orders* reflect an evisceration of the price cap concept stage by stage to a point where any consistent grounding in logic disappears. Instead of liberating regulated companies to make economically rational decisions, the revised price cap plan imposes a new set of arbitrary near-term incentives that virtually dictate company decisions. Thus, even though GTE maintains productivity offsets of 4.0-5.3 percent are unrealistic, the *Orders*: (i) require a productivity offset of at least 4.0 percent and (ii) make it virtually mandatory for GTE to select the 5.3 percent offset for areas representing 46 percent of GTE rate base.

## V. THE *ORDERS* PRODUCE OUTCOMES AS ARBITRARY AS RATE OF RETURN REGULATION, OUTCOMES THAT THRUST SUBJECT COMPANIES TOWARD CONFISCATORY RATES, THEREBY DEFEATING THE PURPOSE OF PRICE CAPS.

For exchange carriers subject to price caps, the *Orders* create an outcome as arbitrary as rate of return regulation. Indeed, the *Orders* implement a price-reduction mechanism set at unrealistic productivity offset levels that will thrust the subject companies toward confiscatory rates. The perverse incentives created by the *Orders*, and the *Orders*' departures from the underlying logic of price caps, are so extreme and unfortunate that they will defeat the reform of regulation sought by the Commission in adopting price caps.

Respectfully submitted,

GTE Service Corporation and its affiliated domestic telephone operating companies

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## Certificate of Service

I, Judy R. Quinlan, hereby certify that copies of the foregoing "GTE's Comments in Support of Joint Petition for Partial Stay" have been mailed by first class United States mail, postage prepaid, on the 7th day of June, 1995 to all parties of record.

Judy R. Quinlan

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