313 states: "We will require that costs of converting to equal access be treated as endogenous." Id. at para. 180. The LEC Price Cap Order on Reconsideration released April 17, 1991, responded to MCI's challenge of the Commission's October 4, 1990, ruling: In the LEC Price Cap Order, we decided to treat all equal access costs endogenously, since the mandatory price cap LECs have converted most of their end offices to equal access, and have embedded most of these costs in their initial price cap rates." Id. At para. 64 and n.77.

C. The Commission Should Again Reject MCI's Suggestion to Require An Additional Exogenous Change In Conjunction With Sales and Swaps of Exchanges

MCI's other proposal, to require LECs to make an exogenous adjustment to reflect a "premium" contained in the sale price of an exchange sold to another LEC, would require excessive complexity and not yield any positive results for ratepayers. MCI challenges the Commission's decision not to require the LECs to take an exogenous change to reflect the increased Universal Service Fund (USF) or DEM weighting that the purchasing LEC would receive. MCI claims that these jurisdictional separations rules operate to provide a benefit to the purchasing LEC which is reflected in a premium contained in the selling price. MCI's arguments are without merit: MCI fundamentally misunderstands the operation of these jurisdictional separations rules and the Commission policies which limit the application of these high-cost support mechanisms. Moreover, in support of its proposition, MCI cites the wrong judicial authority; the correct authority in fact rejects the process MCI suggests.

As MCI partially explains, LECs whose loop costs exceed the nationwide average are allowed to assign a higher proportion of their costs to the interstate jurisdiction, and recover that increased allocation through the Universal Service Fund. Smaller companies are also allowed to allocate a higher proportion of their local switching investment to the interstate jurisdiction. See MCI Petition at 23, n. 48. MCI apparently believes that by selling properties in cases where the buyer is eligible for these separations mechanisms, LECs must not only make an exogenous adjustment to reflect the difference in their overall network costs, but also reflect the increase in subsidies received by purchasing carriers. MCI's proposal is fundamentally mistaken. Any changed circumstances for purchasing LECs have no relation to those of the price cap seller, because the purchasing LEC's eligibility for these separations rule mechanisms is unrelated to the selling price cap LEC's circumstances. See Price Cap Review Order, para. 331.

Many sales and swaps actually reduce the DEM subsidy effect to the purchasing carrier. As MCI itself notes, the level of DEM weighting is linked to the size of the carrier. See MCI Petition at 23, n. 48. For example, those carriers under 10,000 access lines are eligible for triple weighting, while those between 20,000 and 50,000 access lines are eligible only for double weighting. See 47 C.F.R. § 36.125(f). Accordingly, the purchase of additional exchanges, and the concomitant increase in the size of the purchasing carrier may in many cases actually reduce the amount allocated to the interstate jurisdiction under the DEM weighting rule. This provides further evidence that the Commission need not require selling carriers to make exogenous adjustments because a purchasing carrier expects additional subsidy from DEM weighting - in many cases no subsidy effect results.

Moreover, application of MCI's policy would discourage price cap LECs from entering into beneficial transactions with purchasing LECs who seek to further the purposes of the USF and DEM weighting separations policies: to promote service to high cost areas. Requiring exogenous cost reductions based on alleged "premiums" would encourage price cap LECs to avoid or forego sales where the purchasing LEC was eligible for these separations policies, even in cases where the purchasing LEC demonstrated that the proposed sale was not motivated by a desire to maximize its high-cost assistance, where it could otherwise demonstrate that a waiver of the "all-or-nothing rule" was warranted, and where the purchasing LEC would in fact advance the public interest by improving and/or expanding service in high-cost areas. Most importantly, this harm to the public interest would be completely unsupported by any actual economic change to the selling price cap LEC's actual costs due to the USF or DEM weighting. In fact, in many cases, where the purchasing LEC agrees to upgrade facilities, e.g. convert from multi-party to single-party service, the transaction actually increases the level of toll calling, and permits a reduction in access charges. Under MCI's proposal, both selling and purchasing LECs would be punished without any sound basis for doing so.

Lastly, MCI cites Democratic Cent. Comm. v. Metro. Wash. Transit Auth., 485 F.2d 847 (D.C. Cir. 1973), cert. denied sub. nom. D.C. Transit Sys. v. Democratic Cent. Comm., 415 U.S. 935 (1974), for the proposition that the alleged premiums must be captured for ratepayers. MCI Petition at 23. The case cited concerns an emergency provision for rate increases, it does not deal with "capture" of a "premium" for ratepayers. Presumably, MCI intended to refer to a case of a similar name: Democratic Cent. Comm. v. Wash.Metro.Area Transit Comm., 485 F.2d 786 (D.C. Cir. 1973), cert. denied, 415 U.S. 935 (1974). That case specifically rejected any automatic process whereby ratepayers are "entitled" to gains in the value of a public utility: "consumers do not succeed to such gains [in the value of operating utility properties] simply because they are users of the service furnished by the utility." 485 F.2d at 805. Rather, the benefits to be conferred to ratepayers depends on a careful equitable balancing between the interests of investors and consumers. 485 F.2d at 821. Thus, even if there was any "premium" contained in the price of an exchange sold to another LEC (which there is not), ratepayers would not be "automatically" entitled to that "premium."

V. The Commission Has Adequately Supported Increased LEC Pricing Flexibility.

Finally, MCI asks the Commission to reconsider the expanded downward pricing flexibility permitted in the Price Cap Review Order. MCI is concerned that increased downward flexibility may in fact have the effect of permitting some individual rates to increase. MCI therefore suggests that the Commission must develop specific criteria for determining what pricing flexibility is necessary to foster the development of competition, prior to implementing this policy decision. MCI Petition at 24. MCI's petition essentially asks the Commission to reconsider its fundamental policy decision that pricing flexibility for LECs is appropriate. The Commission's policy in favor of pricing flexibility is in fact correct.

Moreover, the minimal steps taken to permit increased flexibility in the switching and trunking baskets and for particular geographic zones is not likely to have the result MCI claims because these services are grouped into price cap baskets. See Price Cap Review Order, para. 409, n. 794. Additionally, the Commission correctly found that predatory pricing is quite uncommon. Id.; see also Revisions to Price Cap Rules for AT&T, Further

Notice of Proposed Rulemaking, CC Docket Nos. 87-313, 93-197 (released May 18, 1995), para. 45 ("[w]e believe that successful predation, defined as the ability to lower prices below a relevant measure of costs in order to drive competitors from the market, is an unlikely occurrence).

In any event, the Commission will review future pricing flexibility proposals, Price Cap Review Order at para. 412, and therefore no reconsideration of these interim pricing flexibility steps is needed. Developing general criteria for LEC pricing flexibility is likely to be accomplished through the process of evaluating these new proposals, some of which may be quite comprehensive. Accordingly, the Commission should retain these incremental steps toward greater pricing flexibility for LECs, and affirm its commitment to implement downward pricing flexibility in light of greater competition in LEC markets.

CONCLUSION

Petitioners have raised no arguments which warrant reconsideration of the Commission's Price Cap Review Order. Moreover, many of the petitioner's proposals would in fact disserve the public interest and should therefore be rejected. Petitioner's essentially ask the Commission to alter or reverse its fundamental policy decisions to promote efficiency incentives for LECs through pure price cap regulation, to adopt a productivity offset which permits LECs to retain the benefits of such efficiencies and thus create further incentives to further productivity, and to further promote the development of price cap regulations appropriate to an environment of increased competition for LEC services. The Commission should instead take further steps to implement these policy goals, including development of a

TFP-based productivity offset, elimination of sharing, and increased pricing flexibility.

Respectfully submitted,

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<u>CERTIFICATE OF SERVICE</u>

I, Robyn L.J. Davis, do certify that on June 29, 1995 copies of the Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

Robyn L.J. Davis