

166. Where there is no evidence of local or intrastate competition, NYNEX's proposal would impose fairly stringent sharing requirements on LECs. LECs would share half their interstate earnings above 11.75 percent and all of its interstate earnings above 13.75 percent. The low-end adjustment mechanism would be set at 10.75 percent.<sup>248</sup>

167. NYNEX's proposal would widen the ranges within which LECs are permitted to retain some or all their earnings when 30 percent of a LEC's access lines were in states where the first four criteria on its proposed competitive checklist have been satisfied.<sup>249</sup> Under these circumstances, NYNEX's proposal would require the LEC to share half of its interstate earnings above 12.25 percent and all of its interstate earnings above 16.25 percent. The low-end adjustment mechanism would be set at 10.75 percent.<sup>250</sup>

168. The no-sharing ranges would be widened further under NYNEX's proposal when 80 percent of the LEC's access lines meet those criteria. The LEC would share half of its interstate earnings above 13.25 percent and all of its interstate earnings above 18.25 percent. The low-end adjustment mechanism would be set at 9.25 percent.<sup>251</sup>

169. Finally, NYNEX's proposal would eliminate sharing requirements and the low-end adjustment mechanism when 80 percent of the LEC's access lines meet all of the criteria on its proposed competitive checklist.<sup>252</sup>

170. We believe that if we were to retain sharing, it might be possible to rely on increased competition to replace one or possibly two of the purposes of the sharing mechanism, the "flow-through" purpose and the "backstop" purpose. In particular, if we find that carriers facing actual competition in fact earn lower returns, then it is unlikely that such carriers' earnings would be high enough to fall within the sharing range. We seek comment on NYNEX's proposal, whether we can rely on competition either for flowing through reductions in unit costs to access customers or as a "backstop" mechanism, and whether there are other implications to tying the elimination of sharing to the emergence of competition. For example, in the interim plan the no-sharing option acts as an incentive for a LEC to choose the highest X-Factor option.<sup>253</sup> If the elimination of sharing is tied to competition and the LECs continue to

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<sup>248</sup> NYNEX March 3 Letter at 4.

<sup>249</sup> NYNEX March 3 Letter at 4.

<sup>250</sup> NYNEX March 3 Letter at 4.

<sup>251</sup> NYNEX March 3 Letter at 4.

<sup>252</sup> NYNEX March 3 Letter at 4.

<sup>253</sup> First Report and Order, paras. 219-22.

have a choice of X-Factor, other changes to the price cap plan may be necessary to create incentives for LECs to choose an appropriately high X-Factor.

171. We invite parties to discuss whether the checklist discussed in Section IV.C. would be appropriate for determining whether the extent of competition faced by a LEC is sufficient to replace the flow-through function and the backstop function provided by sharing. We would expect any measure of competition we would adopt for this purpose to be a reasonably accurate guide for determining the extent of competition faced by a LEC. In other words, we would not expect this measure to enable a LEC to manipulate its sharing obligations without actually experiencing an increase in competition or without actually eliminating barriers to entry.

172. Accordingly, we seek comment on the following issues:

**Issue 20a:** Is NYNEX's proposal a reasonable one? Should we adopt it in some modified way? For example, if we were to retain sharing, should we adjust the specific sharing bands, change the number of levels of regulation, or include or exclude certain criteria from NYNEX's checklists?

**Issue 20b:** Under what circumstances could competition be used to replace the "flow-through" function of sharing? What incentives and disincentives are created by linking sharing and competition? Is it logical to establish wider sharing ranges as intermediate steps to the elimination of sharing? If so, how would such steps be reconciled with our policy of encouraging price cap companies to increase their productivity? If it is reasonable to link competition and the elimination of sharing, are other measures of competition more appropriate than those suggested by NYNEX? (Parties may refer to their discussion of the issues raised in Section IV.C. above.)

## **B. Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197: Changes to AT&T's Price Cap Plan**

173. Currently, changes in LEC access charges are treated exogenously in AT&T's price cap plan because we concluded that access charges were outside AT&T's control,<sup>254</sup> but changes in CAP charges are treated endogenously. One of the issues raised in the *First Report and Order* was whether this biases the market for access services in favor of the CAPs. We concluded in the *First Report and Order* that AT&T's demand for CAP services for the residential services that currently remain in the AT&T price cap plan is not sufficient to create any actual bias in AT&T's choice of access provider. We said that we might revisit this issue

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<sup>254</sup> See Section 61.44(b) of the Commission's Rules, 47 C.F.R. § 61.44(b).

in this proceeding, however, as competition in the provision of switched transport service develops.<sup>255</sup> Accordingly, we solicit comment on the following issue:

**Issue 21:** Under what circumstances would the treatment of access charges imposed by LECs and other access providers under AT&T's price cap plan create actual bias in the access services market? Is there any reason not to treat CAP and LEC charges the same under the AT&T price cap plan?

174. In the *First Report and Order*, and the *AT&T Performance Review*, we focused on AT&T's use of different access suppliers in AT&T's provision of its Basket 1 services, the services that remain under price cap regulation. Specifically, we used AT&T's demand for LEC access services relative to its demand for access services provided by others to determine the likelihood of actual bias in the access services market.<sup>256</sup> We also said that the development of expanded interconnection for switched access might cause the exogenous cost rules applied to AT&T to create actual bias in the access market, and so might require us to reexamine this issue.<sup>257</sup> Accordingly, we invite parties to comment on what competitive circumstances in the access market would warrant revision of AT&T's access charge exogenous cost rule.

### VIII. PROCEDURAL MATTERS

175. This review will be conducted as a non-restricted notice and comment rulemaking. See 47 C.F.R. Section 1.399 *et seq.*

176. Our decision in this phase of the LEC price cap performance review will be based on the comments received in response to this Second Further Notice. We will also consider relevant information that was submitted in the initial phase, either in the comments and reply comments or in the numerous *ex parte* filings, as well as in Phase II, provided that a party incorporates such information by reference in its pleadings in this phase of the proceeding. We will consider comments submitted in response to the *Operator Services NPRM* in this proceeding without any requirement that a party incorporate it by reference in a new pleading.

177. All relevant and timely comments and reply comments will be considered by this Commission. In reaching our decision, this Commission may take into account information and ideas not contained in the comments, provided that such information or a writing containing the nature and source of such information is placed in the public file, and provided that the fact of this Commission's reliance on such information is noted in the Order.

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<sup>255</sup> *First Report and Order*, paras. 343-44.

<sup>256</sup> *First Report and Order*, paras. 343-46; *AT&T Performance Review*, 8 FCC Rcd at 5169 (paras. 32-33).

<sup>257</sup> *AT&T Performance Review*, 8 FCC Rcd at 5169 (para. 33).

178. We direct all parties submitting studies to the Commission to provide all supporting data and workpapers on which those studies rely. This material must be provided both on paper and on computer disk. We require parties submitting spreadsheets to do so in Lotus 1-2-3 DOS format.

#### **A. Regulatory Flexibility Act**

179. We certify that the Regulatory Flexibility Act of 1980 does not apply to this rulemaking proceeding because if the proposed rule amendments are promulgated, there will not be a significant economic impact on a substantial number of small business entities, as defined by Section 601(3) of the Regulatory Flexibility Act. Carriers subject to price cap regulation for local exchange access services affected by the rule amendments under consideration generally are large corporations or affiliates of such corporations. The Secretary shall send a copy of this Further Notice of Proposed Rule Making, including the certification, to the Chief Counsel for Advocacy of the Small Business Administration in accordance with paragraph 603(a) of the Regulatory Flexibility Act, Pub. L. No. 96-354, 94 Stat. 1164, 5 U.S.C. Section 601 *et seq.* (1981).

#### **B. Ex Parte Rules - Non-Restricted Proceeding**

180. This is a non-restricted notice and comment rulemaking proceeding. *Ex Parte* presentations are permitted, except during the Sunshine Agenda period, provided they are disclosed as provided in Commission rules. *See generally* 47 C.F.R. Sections 1.1202, 1.1203, and 1.1206(a).

#### **C. Comment Filing Dates**

181. Pursuant to applicable procedures set forth in Section 1.399 and 1.411 *et seq.* of the Commission's Rules, 47 C.F.R. Sections 1.399, 1.411 *et seq.*, interested parties may file comments with the Secretary, Federal Communications Commission, Washington D.C. 20554 on or before November 20, 1995, and reply comments on or before December 20, 1995. To file formally in this proceeding, participants must file an original and four copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus nine copies must be filed. In addition, parties should file two copies of any such pleading with the Tariff Division, Common Carrier Bureau, Room 518, 1919 M Street, N.W., Washington, D.C. 20554, and one copy submitted on computer disk to the Industry Analysis Division, Common Carrier Bureau, Room 534, 1919 M Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington D.C. 20554.

**IX. ORDERING CLAUSE**

182. Accordingly, IT IS ORDERED that NOTICE IS HEREBY GIVEN OF the rulemaking described above and that COMMENT IS SOUGHT on these issues.

FEDERAL COMMUNICATIONS COMMISSION

*William F. Caton*  
William F. Caton  
Acting Secretary

**SEPARATE STATEMENT**  
**of**  
**COMMISSIONER ANDREW C. BARRETT**

RE: *Price Caps Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Phase III; Treatment of Operator Services Under Price Cap Regulation, CC Docket No. 93-124; Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197; Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197*

In the notices of proposed rulemaking adopted today, the Commission continues its inquiry into and explores various ways to revise interstate access price regulation. I generally support the Commission's efforts to refine the local exchange carrier (LEC) price cap plan and modify other related mechanisms, and note that, for some time, I have advocated improving our existing framework and establishing a permanent price cap plan.

In April, the Commission released the First Report and Order in CC Docket No. 94-1, which modified, on an interim basis, the LEC price cap plan.<sup>1</sup> Specifically, the Commission increased the productivity offset or "X-Factor" in the price cap formula and increased the number of X-Factor options available to LECs from two to three. The Commission also prudently eliminated the sharing obligations and the low-end adjustment feature for LECs that chose the highest X-Factor. The Commission expressed its intention to make additional long-term changes to the price cap plan expeditiously.

In the Second Further Notice of Proposed Rulemaking adopted today, the Commission considers several major modifications to interstate access price regulation to respond to changes in the market for these services and to rely more heavily on market forces to achieve our public policy goals. The notice proposes a three-level regulatory framework of increasingly less stringent price regulation. At the first level, the Commission requests comment on, and in certain cases, proposes a number of modifications within the existing LEC price cap plan. The goal of these changes would be to facilitate the introduction of new services and the alignment of rates with costs without posing any threat to competition or consumers. At the second level, for price cap LECs that are able to demonstrate substantial competition for particular services within a geographic market, the Commission proposes to remove those services from price cap regulation in that market and place them under streamlined regulation. At the third level, the Commission proposes that a price cap LEC that demonstrates that it no longer exercises market power for particular services in a geographic market would qualify for non-dominant regulation as to those services in that market.

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1 Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd 8962 (1995) (First Report and Order).

The notice also asks for comment on other issues relating to the existence and level of competition, including whether competitive considerations should influence the X-Factor used by or sharing obligations imposed on price cap LECs, and whether changes in competitive access providers' rates should be treated as exogenous costs in AT&T's price cap plan.

As early as 1992, I advocated changing the existing LEC price cap plan, and supported establishing a plan that would let the market assume more of the burden of regulating the LECs and that would more realistically reflect the telecommunications industry's unique and rapidly changing structure, costs, and investment needs.<sup>2</sup> Although the landscape of this industry is changing profoundly, the Commission, as the federal telecommunications regulatory body, needs to adopt a permanent price cap plan to provide the industry, the financial and investment communities, and consumers with a greater degree of certainty. While I supported the specific interim modifications to the LEC price cap plan made in the First Report and Order, I urged continued effort to establish a permanent price cap plan.<sup>3</sup> I am concerned that the interim plan could, because of delay, become a long-term regulatory mechanism. I do not believe that, in adopting the First Report and Order, that this was the Commission's intent.

The notices adopted today address a myriad of important issues and ask detailed questions concerning the long-term regulation of interstate access services. Notwithstanding the issues raised in the notices, I wish to reiterate certain policies upon which we should base long-term interstate access price regulation. A permanent regulatory structure should decouple the prices of services and earnings on a rate base, and moreover, should allow market forces to regulate those prices it is capable of efficiently regulating.<sup>4</sup> Furthermore, any new price cap mechanism should be based on two fundamental assumptions: (1) the individual LECs are less alike due to unique market circumstances and resulting strategies and (2) the telecommunications industry is very dynamic.<sup>5</sup>

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2 Commissioner Andrew C. Barrett, "Beyond Price Caps: Escaping the Traditional Regulatory Framework," Address at the Florida Economic Club (August 27, 1992); see Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, 9 FCC Rcd 1687 (1994) (Separate Statement of Commissioner Andrew C. Barrett); First Report and Order, 10 FCC Rcd 8962 (Separate Statement of Commissioner Andrew C. Barrett).

3 First Report and Order, 10 FCC Rcd 8962 (Separate Statement of Commissioner Andrew C. Barrett).

4 Commissioner Andrew C. Barrett, "Beyond Price Caps: Escaping the Traditional Regulatory Framework," Address at the Florida Economic Club (August 27, 1992).

5 First Report and Order, 10 FCC Rcd 8962 (Separate Statement of Commissioner Andrew C. Barrett). This latter assumption may be even more accurate today because of pending federal legislation that would permit the regional Bell Operating Companies (BOCs) to enter the interexchange telecommunications market.

In April, I stated that I did not believe that we were at a point where consumers can totally rely on market forces to set prices for all services, especially with respect to services provided to residential customers.<sup>6</sup> Although several states have taken steps to introduce local exchange competition and legislation is pending in Congress that would further encourage competition in the provision of local exchange, exchange access, and interexchange services, circumstances have not significantly changed since April to persuade me to change my position. Therefore, I maintain that the Commission should proceed expeditiously toward establishing a long-term regulatory mechanism, not only to provide all parties concerned with greater certainty, but to acknowledge and respond, where appropriate, to new competitive forces in relevant markets. The Commission should endeavor to formulate a framework that will provide adequate flexibility to LECs so that new services will be introduced and consumers will benefit. I look forward to carefully examining the comments submitted, and personally encourage interested parties to participate in this process in a timely and complete manner.

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6 Id.