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

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FEDERAL COMMUNICATIONS COMMISSION
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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

DOCKET FILE COPY ORIGINAL

COMMENTS OF AT&T

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TABLE OF CONTENTS

SUMMARY	i
INTRODUCTORY STATEMENT	1
I. THE METHODS FOR MEASURING THE LECS' PRODUCTIVITY OFFSET, OR "X-FACTOR," SHOULD BE REVISED	7
A. The USTA Model for Calculating the X-Factor Is Replete With Substantive Errors and Should Not Be Adopted	8
1. The USTA model does not meet the essential criterion that the calculation of the X-Factor should be based on accessible and verifiable data	9
2. A major defect in the USTA model is its omission of the input price differential	11
3. Another major defect in the USTA model is its reliance on total company, rather than on interstate only, data	13
4. The USTA model made erroneous capital input calculations	18
5. Other infirmities in the USTA model detract from its validity and reliability in calculating the LECS' X-Factor	23
6. Because of the pervasive deficiencies in the USTA model, its results substantially understate the LECS' X-Factor	24
B. The Appropriate TFP Method For Calculating the X-Factor Is The Performance-Based Model	27
C. The Commission Should Retain Multiple X-Factors And Should Not Adopt A Five-Year Moving Average	30
1. The Commission should permit a choice of two X-Factors	30
2. The Commission should not adopt moving average X-Factors	33

D.	The Commission Should Retain the Consumer Productivity Dividend	35
II.	THE COMMISSION SHOULD RETAIN THE SHARING REQUIREMENTS BUT SHOULD DISCONTINUE THE LOW-END ADJUSTMENT	36
A.	The Sharing Mechanism Should Be Retained As An Incentive For Each LEC To Choose An X-Factor Appropriate To Its Own Circumstances	36
B.	The Commission Should Discontinue The Low-End Adjustment	39
III.	THE COMMISSION SHOULD ADOPT A "PER-LINE" FORMULA FOR THE COMMON LINE BASKET	41
IV.	THE COMMISSION SHOULD NOT CHANGE ITS EXISTING RULES GOVERNING EXOGENOUS COST ADJUSTMENTS	44
V.	THE COMMISSION SHOULD CONDUCT ANNUAL PERFORMANCE REVIEWS, WITH MORE INTENSIVE PERFORMANCE REVIEWS SCHEDULED EVERY THREE YEARS	46
	CONCLUSION	48

SUMMARY

A primary purpose of this rulemaking proceeding is to establish a methodology for determining the productivity offset, "X-Factor," in the Commission's price cap formula for local exchange carriers (LECs). Recently, in the LEC price cap performance review proceeding, the United States Telephone Association (USTA) advocated a total factor productivity (TFP) approach for measuring the LECs' X-Factor, and the Commission has tentatively expressed a preference for the TFP method. USTA's proposed model, however, is replete with a number of serious methodological errors, and it substantially understates the LECs' actual rate of productivity. For this proceeding, Dr. John R. Norsworthy, a nationally recognized expert on productivity measurement, has developed, in collaboration with AT&T, a detailed model of the LECs' rate of total factor productivity growth for the period 1985-1994 (the Performance-Based Model). The model shows that the productivity for the LECs' interstate access services has grown at a rate of 7.3 percent per year.

The Commission should flatly reject USTA's version of a total factor productivity model for several reasons. First, contrary to the Commission's stated criteria, the USTA model relies on data that are non-public and non-verifiable. AT&T's Performance-Based Model, by contrast, relies solely on publicly available data and fully documented procedures. Second, the USTA model does not include the input price differential. As the

Commission has recognized, the input price differential for the LECs is substantial, and should be recognized in calculating the X-Factor. USTA has used a specious statistical analysis to conclude that the input price differential is zero. According to Dr. Norsworthy's analysis, USTA's failure to include an input price differential results in an understatement of the LECs' X-Factor in the amount of 2.54 percent.

Third, the USTA model improperly relies on total company data, rather than on only interstate data. As Dr. Norsworthy shows, changes in productivity for interstate services can be reliably separated from total company productivity changes. Indeed, the data conclusively demonstrate that productivity has grown at a considerably faster rate for the LECs' interstate services than for their other services, and therefore USTA's failure to account for this difference results in an additional substantial understatement of the LECs' interstate X-Factor. Furthermore, when the Commission has available a reasonable method for segregating interstate and intrastate data -- as it does here -- the Communications Act and an unbroken line of court decisions require the Commission to determine the interstate data separately and regulate interstate rates only on that basis.

The USTA model is riddled with numerous other errors, and is based on a number of faulty assumptions. For example, in

determining the LECs' long-term cost of capital, the USTA model erroneously assumes that the cost of equity is the same as the cost of debt, that the LECs have an all-equity capital structure, and that the LECs have a fixed and optimal cost of capital. The USTA model bases its depreciation on an outdated study that did not even involve telecommunication equipment. And the USTA model employs procedures that misallocate capital input to the LECs. As a result, adoption of the USTA model would severely undermine the LECs' incentives to invest in cost-minimizing technologies. For these and many other reasons explained both in the AT&T Comments and in Dr. Norsworthy's Statements, the Commission should reject USTA's proposed model and adopt the Performance-Based Model. This latter model corrects the serious errors in the USTA model, and utilizes economically valid procedures based on accessible and verifiable data.

The Commission should also continue to permit the LECs to choose between multiple X-Factors. It is recommended that two X-Factor options be allowed. As shown in the Performance-Based Model, the productivity growth over the period 1985-1994 for the LECs' interstate access services has averaged 7.3 percent. The Commission should establish an X-Factor that encourages the LECs to maintain that level of productivity growth, and it should also include a Consumer Productivity Dividend. The lower X-Factor should be set at 7.8 percent, with a sharing requirement. The higher X-Factor option should be set at 8.8 percent but would be

exempt from any sharing requirement. Moreover, these X-Factors should not be based on moving averages. Moving averages would simply punish ratepayers by making them wait for the benefits of productivity gains, while simultaneously creating pernicious incentives for the LECs to attempt to influence the X-Factor results through uneconomic investment.

As the Commission recognizes in its Fourth Further Notice of Proposed Rulemaking, a system of multiple X-Factors will work properly only if the Commission retains the sharing requirements. Without sharing, the LECs would simply choose the lower X-Factor, regardless of their actual productivity gains. Thus, the Commission should continue to require sharing for LECs that choose the lower X-Factor. On the other hand, sharing should be eliminated for the LECs selecting the higher X-Factor, as an incentive for those LECs to commit to higher productivity growth. Further, the Commission should discontinue the low-end adjustment for all X-Factors. The low-end adjustment has not served the purposes for which it was intended, and, in any event, a LEC could still seek a waiver of the price cap rules if its economic circumstances truly threaten its ability to provide service and attract capital.

As the Commission explicitly recognized in the First Report and Order in CC Docket No. 94-1, a per-line formula for the common line basket is "superior" to the current "Balanced

50/50" formula. The Commission should now formally adopt this acknowledged "superior" formula. Without a per-line formula, the common line charges would continue to bestow an unwarranted windfall on the LECs, in effect rewarding them for gains properly attributable to the interexchange carriers. In addition, the Commission should maintain the rules relating to the treatment of exogenous costs, as were adopted in the First Report and Order.

Finally, the Commission should conduct annual performance reviews of the price cap LECs to consider new issues relating to the system of incentive regulation, and it should conduct a major LEC performance review every three years to assess all aspects of the price cap system, including an analysis and valuation of the X-Factor. These more intensive triennial reviews should be coordinated with the LECs' tariff filing requirements.

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CC Docket No. 94-1

COMMENTS OF AT&T

Pursuant to the Commission's Fourth Further Notice of Proposed Rulemaking,¹ AT&T Corp. (AT&T) hereby submits its comments with respect to the designated issues concerning price cap regulation for the local exchange carriers (LECs).

INTRODUCTORY STATEMENT

The Commission's Fourth Further Notice instituted a rulemaking involving four basic topics regarding the methods for establishing the LECs' price caps, namely (1) the measurement of the productivity factor (i.e., "X-Factor") in the LEC price cap formula; (2) the sharing and low-end adjustment mechanisms to be applied in light of an individual LEC's level of experienced earnings; (3) the appropriate common line formula to be utilized in determining the price cap index for the LECs' common line

¹ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, released September 27, 1995, FCC 95-406 (Fourth Further Notice).

basket; and (4) the treatment of certain costs beyond the control of the LECs, known as "exogenous costs."

Although the original LEC price cap plan, adopted in 1990 and implemented at the beginning of 1991,² had formulated rules concerning the topics here under consideration, the Commission decided to consider in this proceeding further changes of these rules, based on its evaluation of the price cap system as implemented and its review of the LECs' performance under that system. Fourth Further Notice, ¶ 1. The Commission completed the first phase of its performance review in March 1995, and shortly thereafter released its decision thereon.³ In the First Report and Order in this docket, the Commission revised on an interim basis several aspects of the LEC price cap plan dealing with productivity, sharing, and exogenous costs.

In this Fourth Further Notice, the Commission directed that "long-term changes" to the LEC price cap plan would be determined in this rulemaking proceeding. Fourth Further Notice, ¶ 1. Accordingly, the Commission has solicited comments from the

² Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990) (LEC Price Cap Order), recon., 6 FCC Rcd. 2637 (1991) (LEC Price Cap Reconsideration Order), aff'd sub nom. National Rural Telephone Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

³ Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, 10 FCC Rcd. 8961 (Apr. 7, 1995) (First Report and Order), petition for review pending, Bell Atlantic, et al. v. FCC, D.C. Cir. Nos. 95-1217, et al..

parties on a number of issues pertaining to the basic topics to be considered for revising the price cap rules.

These Comments of AT&T, together with the Appendices, respond to the issues and sub-issues delineated in the Fourth Further Notice.⁴ As an integral part of these Comments, there are attached the statements of Dr. John R. Norsworthy, a distinguished economist, noted writer and researcher on productivity, and former Chief of the Productivity Research Division of the U.S. Bureau of Labor Statistics, where he introduced total factor productivity measurements into governmental productivity statistics.⁵ In his statements, Dr. Norsworthy responds to the issues raised in the Fourth Further Notice, discusses the pronounced deficiencies in the productivity model previously submitted by the United States Telephone Association (USTA), describes the basic structure of the Performance-Based Model (developed in conjunction with AT&T) to determine the total factor productivity of the LECs, and presents

⁴ In addition, the Commission has requested that the parties herein respond to certain related issues raised in the Commission's Second Further Notice of Proposed Rulemaking in CC Docket Nos. 94-1, et al., released September 20, 1995, FCC 95-393 (Second Further Notice). In particular, AT&T responds to matters raised in Issues 19 and 20 (paragraphs 159-172) of the Second Further Notice. To assist the Commission and interested parties, AT&T has appended a table (Appendix D) indicating the pages of these Comments and the Appendices that address the particular issues set forth in the Fourth Further Notice and the Second Further Notice.

⁵ Appendix C hereto contains biographical data on Dr. Norsworthy, together with his curriculum vitae.

various data concerning his responses and the description of the Performance-Based Model (Appendices A and B).

Part I of these Comments addresses the major area to be considered in this rulemaking proceeding -- namely, the measurement and application of the productivity offset or "X-Factor" in the LECs' price cap plan. As we show herein, there are numerous and material deficiencies in the previously submitted model of USTA proposing to calculate the X-Factor according to the total factor productivity (TFP) method. The USTA proposal, relying essentially on the study by Christensen, Schoech, and Meitzen (Christensen Study), is methodologically unsound, is based on unreliable and unauditible data, utilizes data not publicly available, and employs unsupportable and erroneous assumptions. The USTA model, therefore, produces results that substantially understate the LECs' X-Factor for interstate access, and the application of this model would be repugnant to the very purposes of the LEC price cap plan adopted by this Commission.

Part I further describes the productivity model sponsored by AT&T, which is vastly superior to the USTA model. This Performance-Based Model, developed by Dr. Norsworthy in collaboration with AT&T, applies the principles of the total factor productivity method, and is fully consistent with the general criteria enunciated by the Commission concerning the

appropriate procedures for calculating the LECs' X-Factor. Unlike the USTA model, the Performance-Based Model relies on publicly available data, is based on well-documented and supportable assumptions, and determines results based on interstate only (not total company) data. The results under the Performance-Based Model for the period 1985-94 show that the correct X-Factor for the LECs' interstate access services should be 7.3 percent.

Part I further discusses other issues related to the implementation of the X-Factor adjustment in the LEC price cap plan. As shown herein, the Commission should continue the Consumer Productivity Dividend (CPD) at its present value for inclusion in the X-Factor. Although a single X-Factor would most closely replicate conditions the LECs would face in a competitive market, it is recommended that the Commission continue to allow at least two X-Factor options for election by the LECs to be used in connection with the sharing provisions of the plan. At the present stage of the development of the TFP approach for measuring the X-Factor, it is also recommended that there be no automatic updating mechanism (such as a moving average) until the Commission gains more experience in implementing the correct X-Factor measurement procedures.

Part II herein addresses the issues concerning the sharing requirements. AT&T recommends that the Commission

continue to apply the sharing mechanism, along with two X-Factor options, to create incentives for each LEC to select an X-Factor appropriate for its economic circumstances. It is also suggested that, as decided in the First Report and Order, the LECs selecting the highest appropriate X-Factor option should not be subject to the sharing requirement. On the other hand, it would not be compatible with the purposes of incentive regulation for the Commission to retain the low-end adjustment mechanism. Instead, the Commission should examine, on a case-by-case basis, the special circumstances of a LEC experiencing low earnings in connection with its petition seeking waiver of the price cap rules, a request for declaratory ruling, or request for similar relief.

Part III of these Comments responds to the issues relating to the common line formula. It is shown that the Commission should eliminate the existing "Balanced 50-50" formula, which does not accurately track changes in common line costs and consequently results in an unjustified windfall to the price cap LECs. The "Balanced 50-50" formula should be replaced with a per-line formula that provides an appropriate incentive to reduce carrier common line rates.

Part IV of these Comments deals with the treatment of exogenous costs under the LEC price cap plan. In this regard, AT&T recommends that the Commission follow, on a long-term basis,

the analysis and conclusions it approved in its First Report and Order (§§ 292-320). In particular, AT&T endorses the Commission's adoption of a standard that limits exogenous costs to economic cost changes and thus denies exogenous cost treatment for accounting rule changes that do not affect a carrier's cash flow. Id. at §§ 293-302. Moreover, the Commission properly determined that proposals as to whether a particular cost change should be given exogenous cost treatment should not be resolved on an ad hoc basis but rather in the same (or consolidated) rulemaking proceeding to assure consistency in results. Id. at ¶ 316.

Finally, Part V briefly addresses the Commission's questions concerning the timing of the LEC price cap performance review. Regardless of whether the X-Factor is adjusted automatically and periodically (such as through a moving average), there is a need to examine other aspects of the LEC price cap plan on an annual basis. Moreover, a more intensive LEC performance review by the Commission, together with its consideration of further revisions in the applicable price cap rules, should be scheduled to take place every three years.

I. THE METHODS FOR MEASURING THE LECs' PRODUCTIVITY OFFSET, OR "X-FACTOR," SHOULD BE REVISED.

Central to the issues to be determined in this proceeding are the appropriate procedures to be used for measuring the LECs' productivity offset or "X Factor." The

Commission has requested comments concerning the calculation of the X-Factor by the total factor productivity (TFP) method or by any other appropriate method. Further, the Commission has solicited comments on related X-Factor issues, such as the means of updating the X-Factor, the number of X-Factors in the plan, and the relationship of X-Factor levels to sharing requirements. Fourth Further Notice, ¶ 14.

In Part I herein, together with the attached statements of Dr. Norsworthy (Apps. A and B) we respond to these areas of inquiry. First, we consider the USTA proposal using the TFP method that it previously submitted in this docket. Second, we describe and provide details on a much more valid and reliable application of the TFP method, known as the Performance-Based Model. Third, we deal with the other issues related to the measurement and application of the X-Factor in the LEC price cap plan.

A. The USTA Model for Calculating the X-Factor Is Replete With Substantive Errors and Should Not Be Adopted.

In this LEC performance review proceeding, and in subsequent ex parte presentations, USTA introduced its studies to calculate the X-Factor according to the TFP method.⁶ Initially,

⁶ USTA commissioned two studies: one performed by Christensen, Schoech, and Meitzen (Christensen Study) and the other by National Economic Research Associates, Inc. (NERA). Because the Christensen Study described TFP in
(continued...)

the Commission indicated its preference for using the TFP approach to compute the X-Factor in the future.⁷ However, as shown below, the USTA version of the TFP method is unsound, contains numerous deficiencies, and produces results that substantially understate the LECs' X-Factor.

1. **The USTA model does not meet the essential criterion that the calculation of the X-Factor should be based on accessible and verifiable data.**

At the outset of the Fourth Further Notice the Commission enumerated "essential characteristics" of the long-term LEC price cap plan, among which is the criterion that the calculation of the productivity offset or X-Factor should be reasonably simple and "based on accessible and verifiable data." Fourth Further Notice, ¶ 16.

Contrary to the Commission's admonition that the data used to calculate the X-Factor should "be publicly available in a timely fashion" (Fourth Further Notice, ¶ 17), the USTA model makes extensive use of confidential, proprietary data that are not accessible for public scrutiny. Dr. Norsworthy gives various

(...continued)

greater detail, the Commission stated that it will focus on that study for purposes of this rulemaking. Fourth Further Notice, ¶ 22. Accordingly, unless otherwise indicated, AT&T's comments on, and references to, the "USTA model" are directed to the Christensen Study as previously submitted to the Commission in this docket.

⁷ First Report and Order, 10 FCC Rcd. at 9031 (¶ 155); Fourth Further Notice, ¶ 25.

examples of the reliance of the USTA model on non-public, so-called "proprietary" information and the LECs' collection of data according to unknown procedures (App. A at pp. 3-6).⁸ As AT&T previously pointed out, the data necessary to measure TFP in the USTA model are not compiled in the Automated Reporting Management Information System (ARMIS) or other available public sources.⁹ Moreover, the methods and procedures employed by USTA to derive its calculations are not disclosed, contrary to the Commission's requirements.¹⁰

The prevalence of inaccessible data and undisclosed methods, which are essential ingredients in the USTA model, severely hampers the Commission's ability to rely on "public comments in the process of reviewing economic information." Fourth Further Notice, ¶ 18. Moreover, the unavailability of the data used in the USTA model and its failure to specify and document its compilation procedures undermine the Commission's goal of ensuring the "auditability" of the calculations of the X-Factor. Id. ¶ 21.

⁸ In contrast, however, the Performance-Based Model, sponsored by AT&T, is based entirely on publicly available data.

⁹ AT&T Comments in CC Docket No. 94-1, Jan. 31, 1995, p. 6.

¹⁰ See Second Further Notice of Proposed Rulemaking, CC Docket No. 94-1, released September 20, 1995, ¶ 178; Fourth Further Notice, ¶ 148.

2. **A major defect in the USTA model is its omission of the input price differential.**

A critical -- and entirely unsupportable -- hypothesis inherent in the USTA model is its assumption that the LECs' input price differential, compared to input prices in the national economy, is simply zero. USTA's assumption is flatly contrary to the evidence before the Commission showing a significant input price differential between the LECs and the U.S. economy.

In the LEC Performance Review proceeding, Commission economists Bush and Uretsky analyzed the data supplied in the Christensen Study, and used these data to report input prices for telephone carriers and for the U.S. economy.¹¹ Using these data for the eight-year period (1984-92), Bush and Uretsky found that the average annual input price differential between the LECs and the national economy was 2.23 percent (i.e. during this period U.S. input prices increased on average 3.95 percent annually; the average annual increases for LEC input prices was 1.73 percent).¹² Applying econometric methods to compare price movements in the LEC and U.S. input prices, these researchers concluded that there were significant differences between the movement of telephone input prices before and after divestiture, and that post-divestiture prices would be the most appropriate

¹¹ "Input Prices and Total Factor Productivity," by C. Anthony Bush and Mark Uretsky, Appendix F, First Report and Order, 10 FCC Rcd. at 9213.

¹² Id. at 9222. See also App. A at pp. 9-10.

for use in the LEC price cap plan. Bush and Uretsky further stated that: "we conclude that the input price differential is, in fact, an essential component of the X factor to correct the distortion in USTA's own measurement of TFP differential."¹³

Despite these findings by the Commission's economists, in their studies for USTA both Christensen and NERA used specious statistical logic to reach an erroneous assumption that there is no difference between the movement of input prices for the LECs and those for the national economy (see App. A at pp. 6-17). On this basis, USTA assumed that the movements in the U.S. input price index could be used to represent movements in the LEC input price index. The USTA assumption is not only unsupportable, it is demonstrably incorrect. The Bush-Uretsky analysis plainly demonstrates that the most likely statistical value for the input price differential for the 1984-92 period is at least 2.2 percent.

Dr. Norsworthy calculated the input price differential for 1985-1994, and determined it to be 2.54 percent. Unlike the Bush-Uretsky analysis, which was derived from data in the Christensen Study, Dr. Norsworthy independently determined the LEC-specific input prices for labor, material and capital and applied them to the time period of 1985-1994. Thus, Dr. Norsworthy concluded unequivocally that (a) an input price

¹³ 10 FCC Rcd. at 9229.

differential should be included in calculating the X-Factor used for the LEC price cap plan, and (b) USTA was entirely wrong in assuming that the input price differential was zero. (App. A at pp. 6-22.)

3. Another major defect in the USTA model is its reliance on total company, rather than on interstate only, data.

Another pervasive infirmity in the USTA model is that its analysis purports to measure total company productivity growth for all the LECs' regulated services, rather than productivity growth in the provision of interstate access services. Thus, the USTA study includes productivity measured not only for interstate access but also for intrastate and local services. In the USTA model, interstate and intrastate (including local) productivity are not separately identified.

USTA's failure to separate between total company data and interstate only data creates a severe bias in the productivity results and substantially understates the LECs' X-Factor for interstate access (App. A at pp. 23-30, 72-77). There is no reason to assume, as does the USTA model, that productivity for interstate access is the same as for all the regulated services provided by the LECs. Indeed, the data show that the X-Factor for interstate access is significantly higher.

As Dr. Norsworthy found (App. A at pp. 23-29), there is strong evidence that the rate of productivity growth in interstate access far exceeds the rate of productivity growth for all services offered by the LECs. This was also the conclusion of the Commission in the LEC Price Cap Order, when it recognized the necessity of separating interstate productivity measures from intrastate (and local) productivity. The Commission pointed out that its analysis showed that "the more rapid growth in interstate usage results in higher apparent interstate productivity growth" compared to intrastate. 5 FCC Rcd. at 6798 (¶ 92) (emphasis supplied).

Given the recognized differences between the growth in interstate productivity and growth in intrastate productivity, it is absolutely essential to measure separately the TFP for the LECs' interstate services. Dr. Norsworthy demonstrates that the productivity growth in the LECs' interstate services can be separately measured, and thus a TFP model can be applied to calculate productivity growth for these interstate services (App. A at pp. 23-29, 72-77).

Moreover, the USTA proposal to measure the LECs' TFP for their interstate access services solely on the basis of total company data, without considering separately determined interstate data, contravenes the Communications Act and applicable judicial decisions. The measurement of the

productivity factor for interstate services based on changes in total company revenues and costs (including those for local and intrastate services) would violate provisions of the Communications Act requiring a separation between the interstate and intrastate jurisdictions. As the Commission noted in the Fourth Further Notice (¶ 63), "the Commission's jurisdiction is limited by Section 2(b) of the Act." Section 2(b) makes it clear that "nothing in this Act shall be construed to apply to or give the Commission jurisdiction with respect to (1) charges, classifications, services, facilities, or regulations, for or in connection with intrastate communication service . . ." 47 U.S.C. § 152(b).

Indeed, the landmark decision of the Supreme Court in Smith v. Illinois Bell Tel. Co. established the doctrine that the "separation of interstate and intrastate property, revenues, and expenses of the Company . . . is essential to the appropriate recognition of the competent governmental authority in each field of regulation."¹⁴ Therefore, "under the Smith analysis as adopted by Congress," there must be some determination by which the federal authorities regulate interstate rates "based on the carrier's property apportioned to interstate usage. . . ."¹⁵ The

¹⁴ Smith v. Illinois Bell Tel. Co., 282 U.S. 133, 148 (1930) (emphasis supplied).

¹⁵ Crockett Telephone Co. v. FCC, 963 F.2d 1564, 1572-73 (D.C. Cir. 1992). See also Illinois Bell Tel. Co. v. FCC, 883 F.2d 104, 114 n.9 (D.C. Cir. 1989) (characterizing the Smith (continued...))

Supreme Court has made clear that the Commission must apportion interstate and intrastate costs if there is a "reasonable" basis for such an apportionment: "While difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required," reasonable measures to apportion costs and revenues between the interstate and intrastate jurisdictions are "essential."¹⁶

Given the fact that there are reasonable procedures to measure separately the LECs' interstate productivity growth and the productivity growth for the LECs' intrastate and local services, there is no justification to rely on the LECs' total company data to represent their interstate TFP. The Communications Act and the judicial decisions make it mandatory

¹⁵ (...continued)

decision as the "landmark case in which the Supreme Court held that maintenance of the proper division of regulatory power between state and federal communications authorities requires estimation of the value of property used to provide intrastate and interstate services, respectively. Such an allocation of exchange plant between intrastate and interstate jurisdictions, according to the Court, ensures the confinement of conflicting regulatory tribunals to their proper spheres"(citations omitted).

¹⁶ Smith, 282 U.S. at 150-51; see also Crockett, 963 F.2d at 1566. In Smith, the state regulatory agency had assumed that all exchange property should be allocated as costs of the intrastate jurisdiction. The Court remanded the case. Although it acknowledged the difficulty of apportionment, the Court stated that "it is quite another matter to ignore altogether the actual uses to which the property is put. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden . . ." Id.

to determine TFP for the interstate services on a separately apportioned basis.

Furthermore, USTA's failure to separate between total company data and interstate only data produces a serious bias in the interstate productivity results and thus substantially understates the LECs' X-Factor for their interstate access services. As shown by Dr. Norsworthy and previously recognized by the Commission, there is compelling evidence that the rate of productivity growth in interstate access far exceeds the rate of productivity growth for the intrastate and local services. Therefore, the use of total company data (which are weighted heavily with intrastate and local data) creates a pronounced downward bias in the X-Factor for the LECs' interstate services, and permits them to charge artificially high interstate access rates. As a result, the charges for the LECs' interstate access services would bear an "undue burden" -- which the Supreme Court found to be unlawful in Smith.¹⁷

In sum, because the LECs' productivity for interstate access services differs markedly from their productivity for intrastate and local services, the Commission must use separated data "to ensure that interstate rates remain just and reasonable." See Fourth Further Notice, ¶ 63. The USTA model relying on total company, rather than interstate only, data to

¹⁷ See Smith, 282 U.S. at 148-51.