productivity performance beyond the previous industry average. Indeed, the X-Factor measured by the Performance-Based Model is quite conservatively stated, with the likelihood that further refinements in the model and additional data from the LECs would produce a higher X-Factor.[82]

Second, as the Commission recognized in the Fourth Further Notice, there might be new sources of productivity improvements in the coming years. Thus, the Commission sought comment on whether the CPD should be retained for that reason as well.[83] USTA argues that such improvements cannot be anticipated.[84] The record demonstrates, however, that the LECs do have the potential for, and should experience, increasing productivity growth arising from extensive new technologies installed in recent years and from other efficiency opportunities.[85]

Finally, USTA makes the curious argument that the CPD plays no role in providing the productivity incentives to the LECs, but that it is used instead only to force prices downward

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82 See AT&T Comments, App. B at 29-30.

83 See Fourth Further Notice, ¶¶ 94-95.

84 See USTA Comments at 13; id., Appendix C at 33.

85 See AT&T Comments at 35-36, and id., App. B. at 29-30.

arbitrarily.[86] To the contrary, the record demonstrates that the LECs have the realistic ability to attain the additional productivity gains associated with a CPD. In fact, there is significant "quantitative evidence that the LECs can accommodate a 'stretch' factor such as the CPD."[87] Accordingly, the CPD remains economically meaningful, and it should be retained in the determination of the X-Factor.

## III. THE COMMISSION SHOULD RETAIN THE SHARING REQUIREMENT AS AN ESSENTIAL PART OF THE LEC PRICE CAP PLAN, BUT THERE IS NO NEED TO KEEP THE LOW-END ADJUSTMENT.

AT&T recommends, as set forth in the preceding section, that price cap LECs would have a choice of two X-Factor options: 7.8 percent and 8.8 percent. The LECs selecting the lower option would be subject to the same sharing requirements that the Commission recently adopted for those LECs electing the minimum X-Factor.[88] The sharing obligation would be eliminated, however, for those LECs selecting the highest X-Factor (8.8 percent).[89]

In their comments here, the LECs uniformly take the position that the Commission should completely eliminate all

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[86] See USTA Comments at 13-14.

[87] See AT&T Comments, App. B at 29.

[88] See First Report and Order, 10 FCC Rcd. at 9050 (¶ 200).

[89] See id.

sharing requirements under all circumstances.[90] Adoption of the LECs' position would be deleterious to the effective operation of price cap regulation. As AT&T demonstrated in its Comments, sharing is essential to the proper functioning of this price cap system.[91] Sharing provides the proper incentives for the LECs, and it should be retained for those LECs selecting the minimum X-Factor. Although the LECs unanimously oppose all forms of sharing, no LEC has offered any compelling reason to abandon this critical requirement.

### A. The Commission Should Retain Sharing For The Minimum X-Factor Election To Provide The Proper Incentives Under The LEC Price Cap Plan.

As explained in AT&T's Comments, sharing serves several necessary purposes to permit LEC price cap regulation to function effectively. In a system of multiple X-Factors, sharing is needed to ensure that each LEC chooses the X-Factor that is most appropriate for its particular circumstances. Therefore, AT&T has proposed maintaining sharing for the lower (industry-wide) X-Factor, while eliminating sharing for those LECs electing the higher X-Factor. Moreover, if the Commission in fact adopts an entirely new and untested TFP methodology for determining the LECs' X-Factor, it should retain sharing as an essential

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[90] See, e.g., USTA Comments at 38-41; Ameritech Comments at 9-10; US West Comments at 22.

[91] See AT&T Comments at 37-39.

"backstop" mechanism while it gains sufficient experience with implementation of this new system.[92]

The LECs opposing sharing offer three principal arguments against its retention. As shown below, none of these arguments has merit.

1. The LECs first argue that sharing "dampens" the incentives in the price cap system for them to become more efficient.[93] Contrary to this argument, however, sharing can be designed to encourage LEC efficiency. A properly designed price cap system, such as that proposed by AT&T, would retain sharing without undermining the incentives for the LECs to improve productivity.

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92 Id.

93 See, e.g., USTA Comments at 38; Bell Atlantic Comments at 3-4; SWB Comments at 30-31; BellSouth Comments at 38-40; Pacific Comments at 9; see also Ameritech Comments at 9-10.

The LECs attempt to create the impression that the sharing obligation prevents them entirely from benefiting from their efficiency improvements. On the contrary, they still benefit from productivity gains under the sharing system adopted in the First Report and Order, as well as under AT&T's sharing proposal. There is a "no-sharing zone" for realized returns that are 100 basis points above the FCC-prescribed rate of return level. When their returns are 100 to 200 basis points above the prescribed return, they only share partially with consumers. And, under AT&T's proposal, no sharing at all would be required for those LECs selecting the higher X-Factor option.

The best overall incentive structure for the LEC price cap plan is to have two X-Factor options, with sharing required only for those LECs selecting the lower X-Factor. Sharing would thus provide an important incentive for a LEC both to choose the appropriate X-Factor and, if choosing the lower option, to move up to the higher X-Factor as soon as its individual circumstances warrant. AT&T has recommended the elimination of sharing for those LECs choosing the higher X-Factor option. Thus, those LECs that could achieve the higher level of productivity growth would be able to keep all of their earnings. At the same time, consumers would benefit right away through a LEC's selection of a higher X-Factor, which in turn imposes a lower price cap constraint and results in lower rates.

AT&T's recommendation is the only one that is compatible with providing the LECs realistic incentives for efficiency improvements, while still balancing consumer interests in immediately receiving benefits from productivity gains. AT&T's proposal adequately takes into account all of the Commission's stated objectives. It provides an X-Factor choice with more than one option to account for differing circumstances of the individual LECs (Fourth Further Notice, ¶ 109); it provides an incentive for each LEC to choose the X-Factor appropriate for its economic condition based on its own assessment of its likely productivity gains (id., ¶ 113); and it provides all LECs the incentive to be as efficient as possible (id., ¶ 114). Under this proposal, even the less efficient LECs that are subject to sharing still have every incentive to improve their efficiency, so that they can move on to the higher X-Factor and retain all their earnings.[94] Until they become more efficient, however, there is no reason either in policy or in logic for the less efficient LECs to be rewarded with the prospect of unlimited earnings at a lower level of productivity. Without any sharing obligation, there is an obvious incentive for each LEC to choose the lowest X-Factor available, and consumers would be deprived of larger and more immediate rate reductions.[95] If no sharing were required, consumers would be the ultimate losers, and the incentive for the LECs to improve their productivity would be seriously deterred.

2. The LECs also claim that the sharing mechanism is no longer necessary as a "backstop" mechanism because LEC price cap regulation has been in effect for several years and the Commission has had "actual experience" with administering price

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[94] See also Sprint Comments at 9-11; MCI Comments at 21.

[95] See, e.g., Fourth Further Notice, ¶ 113 ("without some benefit associated with picking a higher X-Factor, a LEC would select the lower X-Factor regardless of its actual productivity rate").

caps.[96] In fact, a backstop mechanism is every bit as necessary today as it was at the time the LEC price cap plan was first adopted in 1990. Indeed, the Commission right now is in precisely the same position that it was in 1990. The Commission is about to embark on a completely new, untried TFP methodology for determining the LECs' X-Factor. It has no experience with this methodology. Just as in the past, experience may show that the Commission's approach for measuring the X-Factor is inaccurate for all or some of the LECs,[97] or that it has neglected to account for some other as-yet-unknown factors.[98] Therefore, at least for the lower, industry-wide average X-Factor, it is imperative that the Commission retain this backstop mechanism. Until such time that the Commission gains adequate experience with any revised X-Factor methodology, it should not eliminate this essential backstop mechanism.

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96 See, e.g., USTA Comments at 40; Ameritech Comments at 10; Bell Atlantic Comments at 5-6; BellSouth Comments at 39-41.

97 The Commission has recognized that its previously formulated X-Factor procedure resulted in a productivity factor that was inadequate. As it stated in its 1995 First Report and Order, 10 FCC Rcd. at 9053 (¶ 208), the "rapid rise in LEC earnings under price caps ... suggests that the productivity factor used during the initial price caps period was too low" (emphasis supplied).

98 As the Commission noted in the Fourth Further Notice, the backstop mechanism was necessary for two reasons: in case the X-Factors themselves were "substantially in error," or "in the event that a particular LEC's productivity varied substantially from the average." Fourth Further Notice, ¶ 112 (citations omitted). See also LEC Price Cap Order, 5 FCC Rcd. at 6801 (¶¶ 120-21).

3. Finally, the LECs contend that complete elimination of all sharing would better facilitate the removal of their services from FCC price cap regulation and thereby ease the transition to a competitive environment.[99] This argument is highly premature and speculative. As explained in AT&T's Comments in response to the Second Further Notice in this docket, however, the LECs do not presently face any meaningful competition for their price cap services, nor will they in the near future.[100] Therefore, there is no need for the Commission to restructure the LEC price cap plan in this proceeding to permit the withdrawal of any LEC services from price cap regulation.

In light of the LECs' overwhelming dominance in their respective markets, providing for the removal of services from price cap regulation is a decidedly secondary consideration. Regardless of sharing, withdrawing any service from price caps would necessarily be a complex undertaking, and should not be done automatically based on achievement of pre-selected milestones. The removal of services from this regulatory regime should be done only in the context of a rulemaking, where the

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99 See, e.g., USTA Comments at 39; Ameritech Comments at 9-10; SWB Comments at 31; Pacific Comments at 10.

100 See AT&T Comments responding to Second Further Notice (filed December 11, 1995) at pp. 2-8.

Commission can properly sort out its effects on the LECs' ratepayers and potential competitors.

The far more pertinent consideration for the present is establishing a backstop mechanism in the event that the adoption of any new, untested TFP methodology underestimates LEC productivity and provides an unintended windfall to the LECs at the expense of ratepayers. As noted before, the retention of sharing for the lower X-Factor option both provides the needed incentives for the LECs to improve their productivity and serves the interests of consumers.

### B. The Moving-Average Proposal For Measuring The LECs' X-Factor Should Not Be Adopted Nor Should It Be Used As A Substitute For Sharing.

In their Comments, the LECs argue that a moving average procedure for calculating the X-Factor would provide the same protection for consumers as a sharing requirement.[101] This is not the case. A moving average would offer consumers far less protection than retaining sharing for the lower of the two X-Factor choices. The moving average proposal by USTA, for example, is a five-year moving average, combined with a two-year

[101] See, e.g., USTA Comments at 40, 43.

time lag.[102] Thus, any productivity gains achieved by the LECs would not be fully passed on to consumers for seven years.[103]

In a truly competitive market, competition itself forces firms to reflect productivity gains in their pricing and thus benefit consumers almost immediately. Because the LECs do not now operate in such a competitive environment, the LEC price cap system should be structured to provide the same discipline that competition produces. However, a moving average system that takes seven years for productivity gains to flow through fully to consumers would allow the LECs to retain those gains for an unreasonably extended time frame.[104] Indeed, had such a system

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102 See USTA Comments at 36-37.

103 See ETI Report at 68.

104 Indeed, USTA's expert, Dr. Christensen, made this very point in the former Interstate Commerce Commission's (ICC's) proceeding considering such a system for the railroads:

> "The [ICC]'s proposed five-year moving average . . . [would] delay[] the effect on the proposed productivity adjustment of any productivity improvement, thereby allowing the railroads to profit from such improvements for a period of years. Because a two-year measurement lag and the five years encompassed by the averaging, the railroads will be allowed seven years before productivity improvements are fully reflected in the adjusted RCAF [rail cost adjustment factor]. This delay is highly favorable to the railroads."

Railroad Cost Recovery Procedures -- Productivity (continued...)

been in place during the period 1991-1995, consumers would still be waiting to enjoy much of the unanticipated productivity gains that were actually achieved by the LECs in those years. The sharing mechanism should therefore be retained (at least for the lower, industry-wide X-Factor) because it would pass on any extra, unanticipated productivity gains during a time frame that would be much more consistent with the operation of a fully competitive market.[105]

Finally, implicit in USTA's proposal is that the moving average of the TFP figures for each year would be determined on the basis of data from the Simplified Christensen Model. As fully discussed above, that model is replete with errors, is methodologically unsound, and produces invalid and grossly understated results. Accordingly, any consideration of a moving average system based on the Christensen Model should be rejected.[106]

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104 (...continued)
Adjustment, ICC Ex Parte No. 290 (Sub-No. 4), Joint Reply Comments of Concerned Shippers, Reply Verified Statement of Douglas W. Caves and Laurits R. Christensen, p. 25 (January 17, 1989) (emphasis supplied).

105 See LEC Price Cap Order, 5 FCC Rcd. at 6801 (¶ 124) ("This level of sharing will ensure that customers receive their fair share of productivity gains that occur, just as they would in an industry with keener competition."). See also ETI Report at 67-68.

106 Although there are compelling reasons for the Commission to (continued...)

C. **The Commission Should Discontinue The Low-End Adjustment.**

The LECs' comments also generally confirm that there is no need for the Commission to retain the low-end adjustment. Indeed, none of the LECs has mounted a serious defense of the low-end adjustment, and most oppose it outright.[107] The

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[106] (...continued)
continue its practice of periodic LEC price cap performance reviews (see AT&T Comments at 46-48), some LECs argue that adoption of their moving-average proposal would make further performance reviews unnecessary. See NYNEX Comments at 23; SWB Comments at 24, 40; Ameritech Comments at 13. That is not the case. As noted earlier, the Commission has had no experience in applying a TFP methodology or in making a moving-average computation of TFP. The Commission should therefore assess the reliability and validity of any new TFP procedure in the context of periodic LEC performance reviews. Indeed, this is especially true of a moving-average system, because if the TFP methodology chosen by the Commission leads to inaccurate results, the error could be compounded in successive years by the use of a moving-average X-Factor.

Moreover, regardless of whether the Commission adopts the LECs' moving-average proposal (which it should not), the Commission must still conduct regular reviews to evaluate other matters: the LECs' performance (including the quality of their service) under incentive regulation, and the impact of changing conditions in the telecommunications industry. For example, the recently enacted Telecommunications Act of 1996 mandates several modifications in the way subsidies are currently built into access charges (see, e.g., 47 U.S.C. § 254), and the Commission may also need to re-evaluate the effect of these and other changes in connection with its LEC price cap performance review.

[107] See, e.g., USTA Comments at 43; BellSouth Comments at 41 (any disadvantaged LEC must make a stringent showing to price above cap); Bell Atlantic Comments at 2, 6-7 (low-end adjustment rewards inefficient companies); US West Comments
(continued...)

Commission's original fear -- that unique economic circumstances could result in chronic underearnings for a particular LEC, which could in turn threaten continued service capability -- has not materialized. As AT&T pointed out, the low-end adjustment has only been abused.[108]

The sole argument that any LEC has made on behalf of the low-end adjustment is a plea for symmetry, i.e., if the Commission retains sharing, it should also retain the low-end adjustment.[109] However, if adverse economic conditions ever truly threaten a LEC's ability to attract capital and provide service, it can seek a waiver of the Commission's price cap rules, or request other special relief.[110] Therefore, there is no longer any justification for retaining the low-end adjustment procedure as an explicit part of the LEC price cap rules.

## IV. THE COMMISSION SHOULD ADOPT A PER-LINE FORMULA FOR THE COMMON LINE BASKET.

The Commission concluded in its LEC price cap performance review that a "per-line" formula for capping common

[107] (...continued) at 25.

[108] See AT&T Comments at 40-41.

[109] See, e.g., SWB Comments at 34-35; NYNEX Comments at 4 n.9.

[110] See AT&T Comments at 41.

line charges would be "superior" to the present "Balanced 50/50" formula.[111] In this rulemaking, however, the Commission seeks comment on the question whether the adoption of a TFP methodology might eliminate the need for using a separate common line formula at all.[112] In response, USTA and most of the LECs argue that the Commission should eliminate the separate common line formula.[113] The LECs' position is unsupported, and they have provided no sound basis for the Commission to eliminate the separate common line formula. Rather as the record demonstrates, the Commission should adopt the "superior" per-line formula for the common line basket.

As the Commission found in the First Report and Order, the LECs' common line costs are not traffic-sensitive.[114] Nonetheless, the current Balanced 50/50 formula allows the LECs to recover their common line costs partly on a traffic-sensitive basis, and it permits over-recovery of these costs. The Commission found further that there was no record support for assuming that the LECs can stimulate increased use of the common

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111 First Report and Order, 10 FCC Rcd. at 9079 (¶ 271).

112 Fourth Further Notice, ¶¶ 132-35.

113 See, e.g., USTA Comments at 44-45; Ameritech Comments at 8; US West Comments at 25-26; SWB Comments at 35-37; BellSouth Comments at 42; NYNEX Comments at 29-31.

114 See First Report and Order, 10 FCC Rcd. at 9079 (¶ 270).

lines.[115] Therefore, retention of the Balanced 50/50 formula sends distorted economic signals to both the LECs and the IXCs, and in effect rewards the LECs for gains that are not properly attributable to them. For these reasons, the Commission concluded in the First Report and Order that "it is not necessary to create price cap incentives for LECs to increase growth in common line usage," that the "per-line formula properly recognizes that loop costs are not traffic sensitive," and that the per-line formula is "superior to the per-minute and 50-50 formulas".[116]

Regardless of whether the Commission adopts the TFP methodology to measure the X-Factor, it should still maintain the common line formula, but should revise it to a per-line approach. Without that revision, the LEC price cap system would continue to send distorted economic signals to the LECs, and the LECs would continue to reap an unwarranted windfall from common line traffic growth for which they are not responsible. As Dr. Norsworthy explained, the common line formula adjustment serves cost recovery objectives that should be dealt with independently from

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115 Id. at 9078 (¶ 266) ("The record does not support a finding that LECs have a significant effect on common line usage.")

116 Id. at 9078-79 (¶¶ 269-71).

the application of the X-Factor in the price cap plan.[117] Therefore, contrary to the LECs' argument here, adoption of the TFP methodology by itself is not relevant to, and does not alter, the Commission's conclusions that the LECs should not be rewarded for common line traffic growth because "they have little influence over such growth" and that over the long term the common line formula should be placed entirely on a per-line basis.[118]

There are other advantages to retaining a separate formula for the common line basket. This separate formula helps ensure more equitable treatment among the LECs and avoids exacerbating geographic disparities among the LECs in their CCL charges.

The common line basket is unique because of the dichotomy between output and revenue recovery. The relevant output consists of common lines, while revenues are recovered on the basis of both per-minute charges (the CCL rates) and per-line charges (e.g., end-user rates). Further, the proportion of common line revenues collected on a per-minute basis and on a per-line basis varies substantially among the LECs. Without a

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117 AT&T Comments, App. B at 41-44.

118 First Report and Order, 10 FCC Rcd. at 9078-79 (¶¶ 269-270).

separate common line formula, those LECs who obtain the larger portion of their revenues from per-minute (CCL) charges (essentially the LECs with the higher costs) would enjoy much greater revenue growth than those LECs deriving most of their common line revenues from per-line charges.[119] The application of the separate common line formula puts a more effective cap on the common line charges and thus helps avoid rewarding the higher cost LECs with greater revenue growth.

In addition, the existence of a separate common line formula properly recognizes that the IXCs should be the carriers who receive the benefits from stimulating greater common line use. As the Commission stated, "if the IXCs are largely responsible for fostering growth in common line usage," then the IXCs should benefit "in the form of lower CCL rates."[120] The Commission, in fact, did find that the IXCs, not the LECs, are

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119 Under a standard price cap formula, revenue growth is a function of growth in billed volumes. Because growth in minutes generally exceeds the growth in lines, the LECs which obtain a large portion of their common line revenue from a per-minute (CCL) charge will experience higher revenue growth than those LECs which obtain a larger portion of their revenue from a per-line (end-user) charge. This would have the effect of rewarding the high cost LECs whose CCL rates are the highest, and would exacerbate geographic disparities in rates among the LECs.

120 First Report and Order, 10 FCC Rcd. at 9077-78 (¶ 265). Notably, the Commission also observed that the "per-line approach would force CCL rates down faster than either the per-minute or balanced 50-50 approach." Id. (emphasis supplied).

primarily responsible for increasing demand on the common lines and that it is appropriate "to give IXCs an incentive to increase that [common line] usage."[121] Thus elimination of the separate common line formula, as urged by the LECs here, would deny to the IXCs the incentives which the Commission found to be necessary.

Finally, there is no valid support for the LECs' argument against a separate common line formula. USTA claims that this formula is unnecessary if the Commission adopts the TFP methodology. It argues that use of the TFP procedures and further adjusting the rates in the common line basket would result in "double counting" productivity gains.[122] Remarkably, USTA fails to provide any convincing demonstration of this so-called "double counting" other than to make this broad and vague assertion. USTA does not provide any reference to specific procedures in the Simplified Christensen Model, which it vigorously supports, to show how the use of that model (or any other TFP model) would create such a "double counting" situation.

In sum, any modification of the price cap system to eliminate the separate common line formula would be a move in precisely the wrong direction. In the First Report and Order,

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121 Id. at 9078-79 (¶ 269).

122 USTA Comments at 44-45; see also Ameritech Comments at 8; BellSouth Comments at 42; US West Comments at 25-26.

the Commission recognized that the current "Balanced 50/50" formula overstates the LECs' influence on stimulating demand, and that a per-line formula is preferable as a long-term method of capping common line rates. The complete elimination of the common line formula, as advocated by the LECs, would contravene the Commission's conclusions -- it would abandon an economically sound constraint on the LECs' common line charges. Moreover, discontinuing the separate formula would deny the IXCs a needed incentive to stimulate greater demand on the common lines and thus foster lower unit costs.

## V. THE COMMISSION SHOULD RETAIN ITS EXISTING RULES GOVERNING EXOGENOUS COST ADJUSTMENTS.

As AT&T explained in its Comments (at 44-46), the Commission should not modify its recently adopted rules governing the treatment of exogenous costs. In the First Report and Order in this docket, the Commission adopted a rule under which exogenous cost changes could only be recognized by the LECs when the change had an effect on "economic costs." First Report and Order, 10 FCC Rcd. at 9090-92 (¶¶ 293-99). Regardless of the methodology adopted in this proceeding, such a rule enhances the efficiency standards of the LEC price cap plan and should be retained.

Significantly, most of the commenting LECs also advocate continuation of the Commission's recently adopted rules regarding exogenous costs.[123] As USTA and others point out, the procedures in the present system afford the Commission the flexibility to consider individual cost changes on a case-by-case basis.[124] Because most accounting changes do "not have an economic cost associated with them," see First Report and Order, 10 FCC Rcd. at 9095 (¶ 306), and hence would not be considered an exogenous cost change, this system should not be unduly burdensome to the Commission.

## VI. ALTERNATIVE PROPOSALS BY CERTAIN LECS ARE WITHOUT MERIT AND SHOULD NOT BE ADOPTED.

Finally, we mention briefly two different proposals put forward by certain LECs as alternatives to the existing system of LEC price cap regulation. They are (1) a proposal for a significant change in the LEC price cap formula, urged by a handful of LECs, and (2) the "Capped Index Plan," advocated by US West. There is no basis for adopting either of these proposals, and they should be denied.

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123 See, e.g., USTA Comments at 46-47; Ameritech Comments at 12; SWB Comments at 39-40; US West Comments at 27; but see BellSouth Comments at 43.

124 See, e.g., USTA Comments at 46.

1. Certain LECs, notably Ameritech, Lincoln, and GTE have put forth a proposal that would drastically alter the LEC price cap formula. They propose to eliminate the X-Factor entirely and calculate the LEC price cap index (PCI) adjustment as the difference between the percentage change of the LEC input prices and the percentage change in LEC TFP.[125] By eliminating the X-Factor, this proposal would make no reference to data on input prices and productivity growth for the U.S. economy.[126] The fact is, however, that the relevant data on the U.S. economy (the nonfarm business sector) are not subject to real controversy; these data are publicly available, determined independently and published as official governmental statistics. Thus, this proposal asks that the Commission forego reliance on these objectively determined data in the price cap formula.

Although this "direct method" proposal is suggested as a more "simplified" approach,[127] it adds no simplicity. It would still require the complex calculations of the LECs' input prices and their TFP growth. The record herein shows that there is considerable controversy over the appropriate procedures to determine LEC input prices and TFP, and these measurements are an

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125 See, e.g., Ameritech Comments at 4; Lincoln Comments at 7-8; GTE Comments at 8-11.

126 Lincoln Comments at 7.

127 See Lincoln Comments at 7.

essential part of this alternative proposal. Furthermore, this so-called "direct method" eliminates the input price differential, which is an "essential component" of the LEC price cap formula.[128] In short, the proposal by Ameritech and Lincoln is conceptually unsound, erroneously deletes pertinent and objectively determined data in implementing the LEC price cap formula, and does not add any simplicity at all to determining the LECs' PCIs.

2. In an attempt to avoid a Commission decision in this rulemaking proceeding, US West has proposed a "Capped Index Plan." This plan would require the Commission to abandon the present LEC price cap system entirely and cap the LEC price cap indices at their current levels.[129] US West would eliminate sharing altogether and would prevent any future adjustments to the PCIs for inflation, productivity, and exogenous costs.[130]

The critical premise for the US West plan is that, because presently existing or "impending" competition in providing the LECs' interstate access services is "sufficient", market forces alone would impose an effective constraint on LEC

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128 See Bush-Uretsky, supra, 10 FCC Rcd at 9229.

129 US West Comments at 3-5.

130 Id. at 4-5.

access prices.[131] This is untenable. There are no hard market data or other evidence demonstrating that current competition in the access markets is so vigorous and so pervasive that no regulatory constraint is needed. The LECs presently dominate their respective markets for access services, and they face no meaningful competition.[132] US West's assertion that competition is "imminent" is unsupported and speculative.

The Commission should reject US West's frivolous proposal. Its plan appears to be simply a device to get rid of all sharing requirement at once. (US West, incidentally, is one of only two RBOCs still subject to sharing.[133]) Its plan would, in fact, reduce the LECs' existing X-Factors,[134] which the record herein demonstrates are already far too low and should be increased. As the Commission has recognized and the record in this proceeding documents, the levels of previously adopted X-Factors have been inadequate and thus have been overly generous to the LECs in the years since the inception of the price cap plan. Moreover, without any further increase in the LECs' X-

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131 Id. at 4.

132 See AT&T Comments responding to the Second Further Notice.

133 See Fourth Further Notice, ¶ 8.

134 Freezing the PCIs, as US West proposes, would effectively mean that the X-Factor could be no greater than the GDP-PI rate, which most recently has been in the range of about 2-3 percent.

Factor to reflect their greater productivity gains, the LECs' interstate access prices are likely to rise in the future.

It is essential, therefore, that the Commission act expeditiously in this proceeding and adopt a decision providing for a higher X-Factor consistent with the methodology recommended by AT&T. The US West proposal to keep the status quo on the price cap indices, along with eliminating sharing, should be rejected forthwith.

## CONCLUSION

For the reasons stated herein and in AT&T's initial Comments, the Commission should adopt the recommendations of AT&T set forth in this rulemaking regarding the long-term structure of the LECs' price cap plan.

Specifically, AT&T recommends that (1) the procedures proposed by USTA and the RBOCs, known as the Simplified Christensen Model, should not be adopted as a valid method to measure the X-Factor for the LECs' interstate access services; (2) the measurement of the LECs' X-Factor should follow the procedures of the Performance-Based Model, which properly determines the applicable total factor productivity and the input price differential for the LECs; (3) the measurement of the X-

Factor for the LECs' interstate access services should be based on separately determined interstate data, not "total company" data; (4) a Consumer Productivity Dividend of 0.5 percent should continue to be reflected in the LECs' X-Factor measurement; (5) the LECs should have two X-Factor options, which are determined to be 7.8 percent and 8.8 percent under current conditions; (6) the lower X-Factor option would continue to be subject to the sharing mechanism according to the Commission's presently existing sharing requirements and rate-of-return ranges, and the higher X-Factor option would not be subject to sharing; (7) the low-end adjustment mechanism should be eliminated as part of the price cap rules; (8) a separate common line formula should be continued, but the existing Balanced 50/50 formula should be replaced with a per-line formula; (9) the recognition of exogenous costs in the LEC price cap plan should be governed by the standards adopted in the Commission's First Report and Order