Specifically, GTE proposes that the same dimensions used to define a relevant market for streamlining should also be used for nondominance. A LEC would be able to propose nondominant treatment for one or more of these markets. Careful market definition is crucial as the Commission extends its consideration of nondominance below the firm level.[96]

The criteria for the determination of nondominance should similarly be based upon those used for streamlining. These criteria are consistent with those developed in the *Competitive Carrier* proceeding and rely on indicators which are simple to measure, and for which clear thresholds can be defined. This will reduce uncertainty for the LEC, and ease administration for the Commission.

GTE proposes that the same addressability construct that is developed for streamlining should also be used for nondominance. However, the threshold should be set at a higher level. If the market for which the LEC is seeking nondominant treatment has already been streamlined, then the LEC already will have demonstrated that customers in that market accept available alternatives as substitutes for the LEC's services. It should not be necessary to repeat this portion of the showing.

If the LEC is seeking nondominant status for services provided to small customers, it should also be required to show that barriers to entry for local

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[96] For example, control of bottleneck facilities has been one of the criteria used under the *Competitive Carrier* criteria to determine whether a firm is nondominant. However, control of facilities in one relevant market will not necessarily confer market power in another relevant market.

exchange markets have been removed in the relevant geographic area. This should be done by showing that the LEC has met the requirements established by the state commission to govern local competition. Local exchange markets are regulated today by the states; many state commissions are currently developing policies with respect to local competition. The Commission should not duplicate these efforts, but should require the LEC to comply with requirements established by the state as a condition for nondominance.

This requirement should not apply if the LEC seeks nondominant status only for services provided to large customers. As discussed *supra*, for large customers, the choice of an access provider is separable from the choice of a local dial tone provider. Access providers are able to enter a geographic market and provide interstate access services which are substitutable for LEC access services, without offering local exchange service.[97] Therefore, the issue of barriers to entry into local exchange service should not be relevant in markets where the customers are large.

B. In markets where they have been found to be nondominant, LECs should be treated the same as other nondominant carriers.

The *SFNPRM* (at ¶153) proposes to allow LECs under nondominant treatment to file tariffs on one day's notice, without cost support. GTE supports

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[97] *See* USTA's Comments in the instant proceeding, Attachment 2 for an extensive list of cities where access competitors are providing service. Most of these firms have entered the market as access providers, not as local exchange carriers.

this proposal. However, GTE emphasizes that the treatment of nondominant carriers should be symmetric. A LEC found to be nondominant in a given market should be regulated in the same manner as any other nondominant carrier with which it must compete in that market. In addition to allowing tariffs on one day's notice, the Commission has minimized its regulation of nondominant carriers in other ways. For example, nondominant carriers are not required to file domestic 214 applications.[98] This should also apply to LECs when providing services found to be nondominant.

Further, the Commission may modify its regulation of nondominant carriers over time.[99] As the regulation of nondominant carriers evolves, the Commission should ensure that all nondominant carriers – including LECs – are treated symmetrically.

CONCLUSION

For the foregoing reasons, GTE strongly supports the Commission's efforts in this proceeding and urges the Commission to act expeditiously in resolving the issues addressed in the *Second Notice*. It is essential for the Commission to eliminate restrictions in the current rules impairing the LECs' ability to introduce new service offerings and to develop the criteria that will determine when the

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[98] There may be some issues to be addressed in applying some of these measures to a carrier only in a particular market, rather than to the firm as a whole.

[99] For example, the Commission has announced its intention to begin a proceeding to specify the regulatory treatment it will afford nondominant interexchange carriers.

market is ready for streamlined regulation and nondominant reclassification of the price cap LECs.

Respectfully submitted,

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behalf of its affiliated domestic
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December 11, 1995

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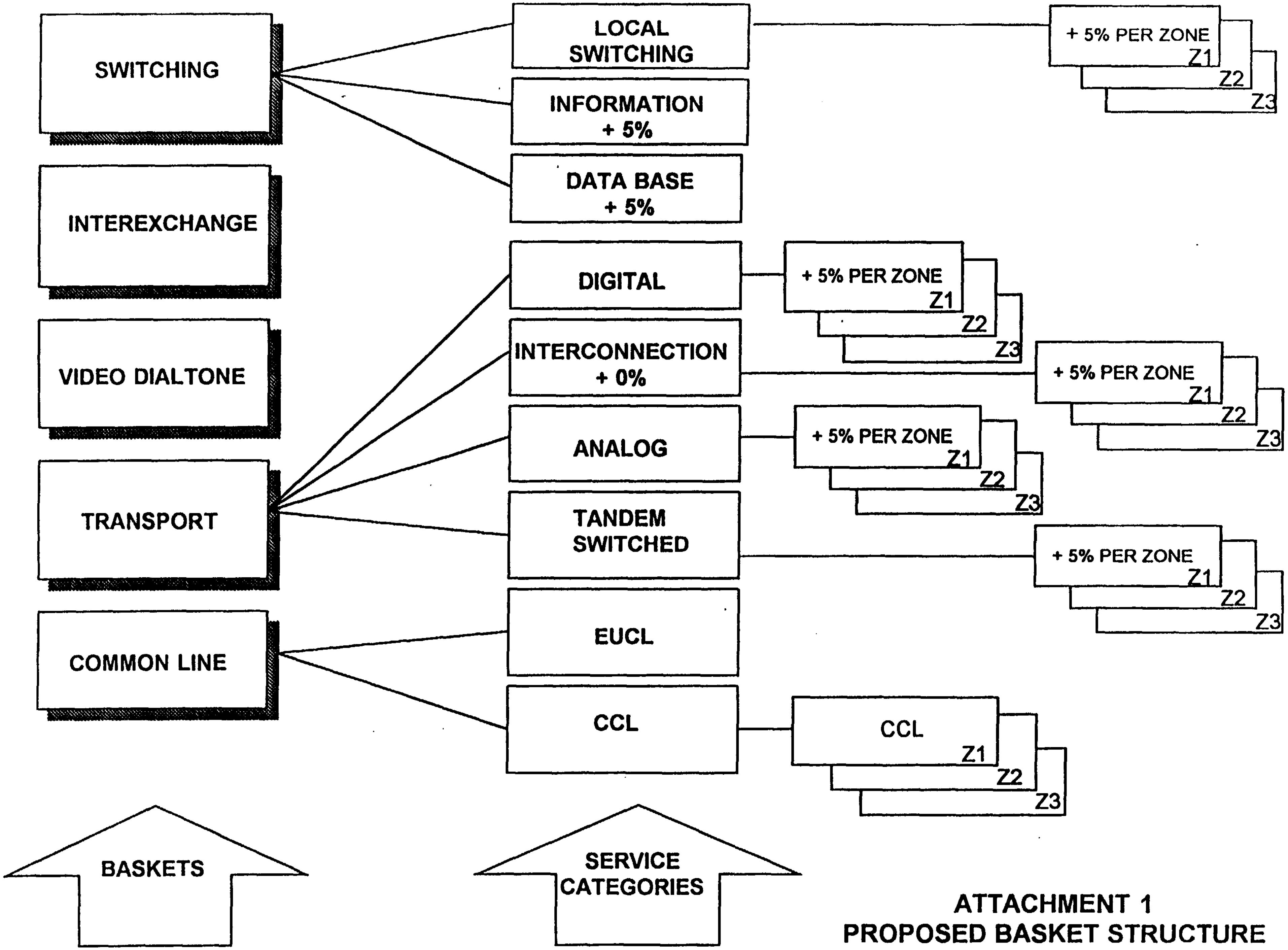
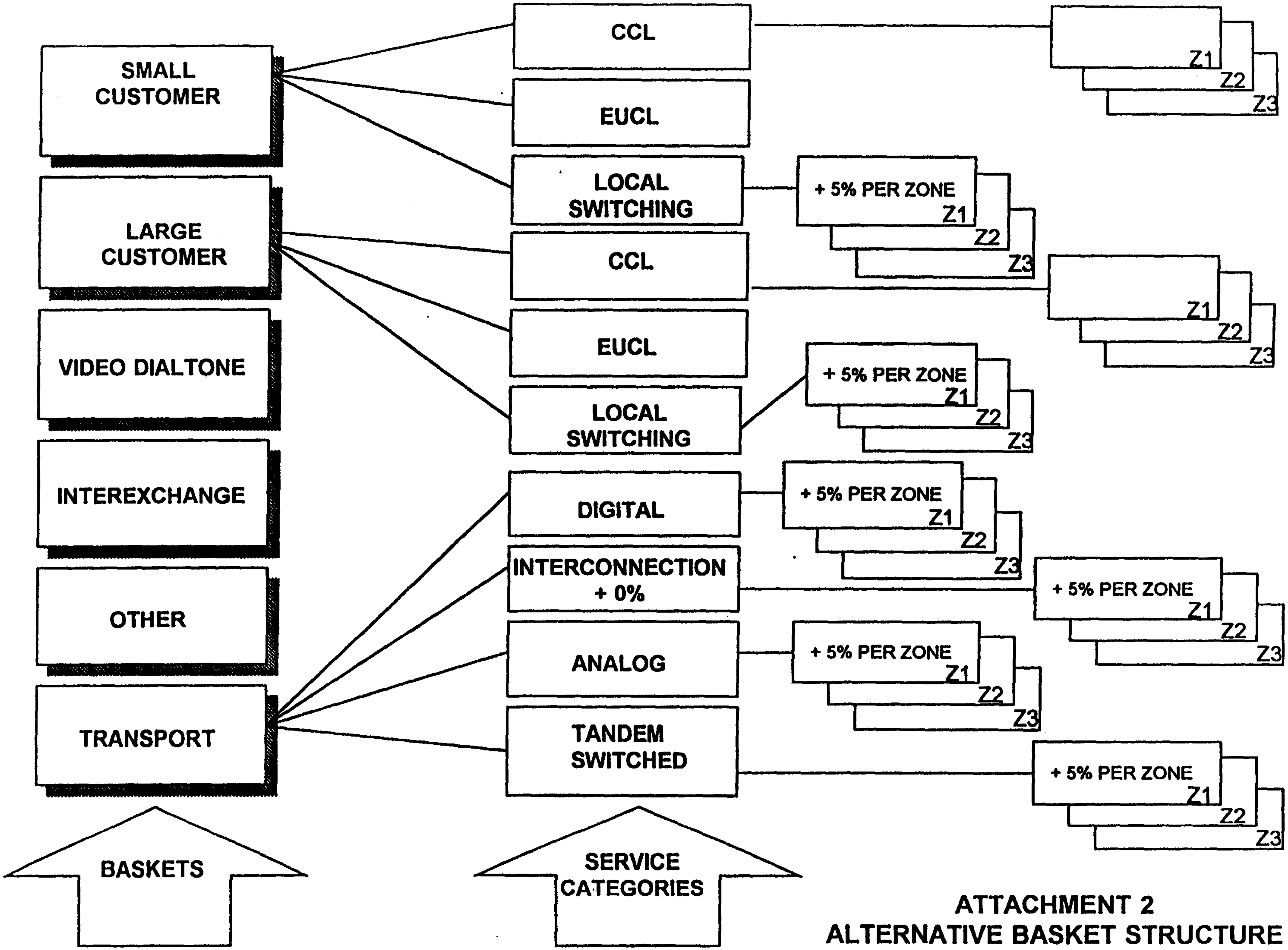
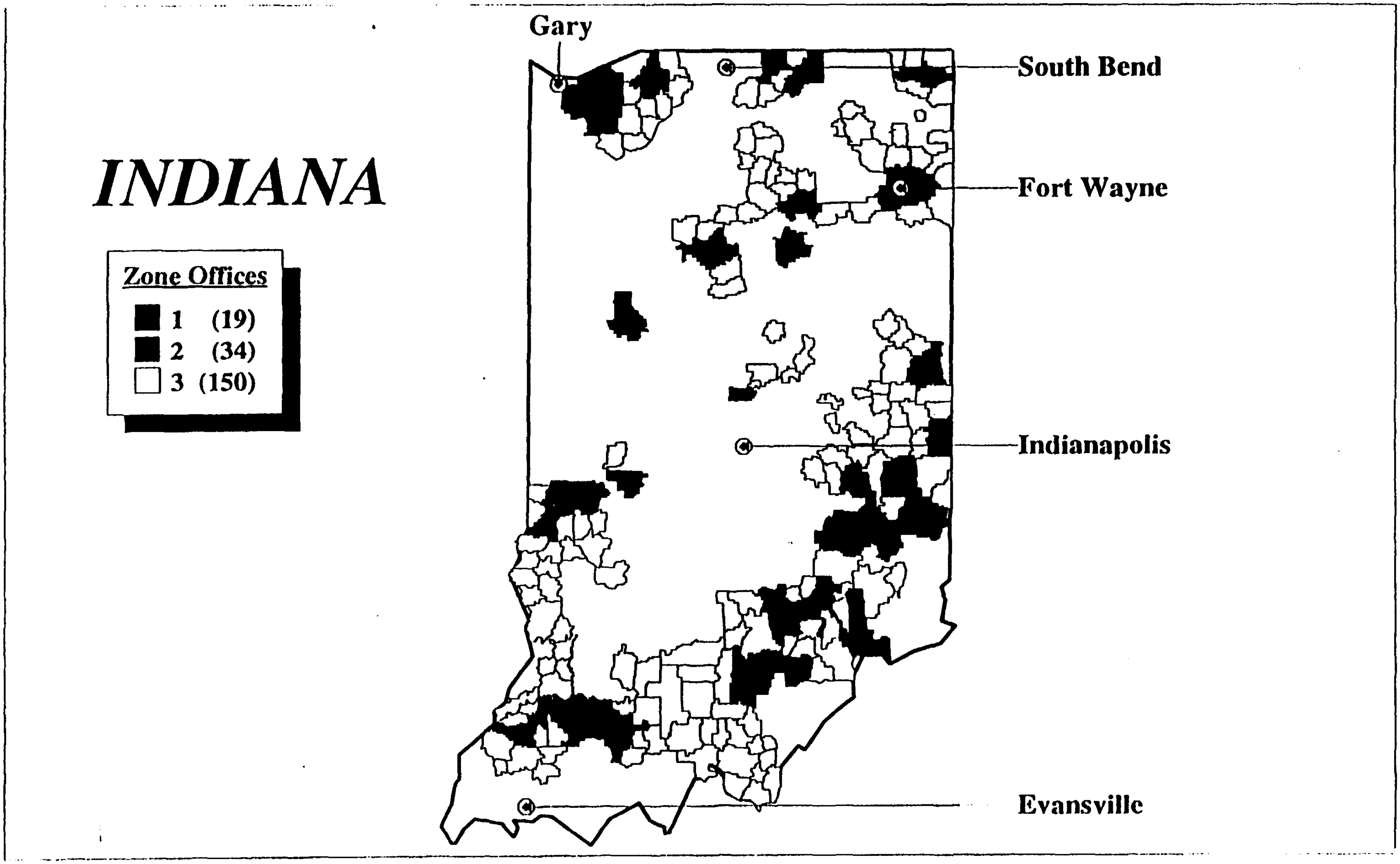


ATTACHMENT 1
PROPOSED BASKET STRUCTURE



ATTACHMENT 2
ALTERNATIVE BASKET STRUCTURE



ATTACHMENT 3

Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "Comments of GTE" have been mailed by first class United States mail, postage prepaid, on the 11th day of December, 1995 to all parties on the attached list.

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APPENDIX F

1/11/96

Receipt 9A

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

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	

GTE's COMMENTS

GTE Service Corporation and its affiliated domestic telephone operating companies

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SUMMARY

GTE recommends that the Commission return to "first principles" and structure the price cap formula so that it contains a direct measure of changes in unit cost for Local Exchange Carriers ("LECs" or "exchange carriers") and LEC Total Factor Productivity ("TFP"). The formula recommended by GTE is the growth of the LEC input price minus the rate of LEC TFP growth adjusted for exogenous costs -- which is the theoretically accurate measure of the Price Cap Index adjustment. This formula eliminates all economy-wide data from the price cap formula and concentrates purely on the price cap LECs. This method eliminates any controversy over the existence of an input inflation differential. In addition, and as an essential part of its recommendation, GTE recommends that the PCI adjustment factor for a given year be an optimal forecast of the PCI change that would occur in that year, based on actual observed changes in the PCI in previous years.

The Commission's previous reasons for not using a direct measure are no longer valid; *i.e.*, (i) that an input inflation index for LECs did not exist; or (ii) that, if one existed, the LECs could manipulate it. The tentative conclusion by the Commission that it is appropriate to incorporate an input price differential into a TFP-based X-Factor demonstrates that the Commission is willing to employ an input inflation index for the LECs and is no longer so concerned with manipulation as to reject its use. Otherwise, the Commission would not be willing to employ a LEC input inflation index to calculate an input price differential.

Alternatively, GTE could support a formula that determines the change in the price cap index by subtracting the change in US TFP from the change in LEC TFP -- adjusted for exogenous costs. GTE could support this formula because of its ease of computation, as long as the Commission recognizes that it should not include an adjustment for deviations between economy-wide and LEC input price change series. This alternative formula is an approximation of the economically sound formula proposed by GTE and has the advantage of being more stable as it does not depend upon difficult-to-obtain input price data.

GTE cannot support a formula that contains an input price differential. GTE and USTA have both demonstrated, using various economic methods, that the addition of an input inflation differential to the GDPPI-based price cap formula is not economically sound. Further, to incorporate an input inflation differential into a PCI adjustment factor would cause pricing instability that would not be consistent with the functioning of a well-working competitive market. GTE submits that the controversy over this issue would be eliminated by replacing "GDPPI-X" in the price cap formula with the growth of LEC input prices minus the rate of LEC TFP growth.

TFP is the most appropriate measure of LEC productivity. GTE supported the original Christensen TFP study and supports the simplified method proposed by Christensen in the instant proceeding. Christensen's simplified model uses only publicly available and verifiable data as its sources, and thus can easily be updated annually. The simplified model negates the Commission's concern regarding the availability of data sources for the Christensen TFP method. GTE urges the Commission to adopt Christensen's simplified model.

GTE does not support the calculation of a separate interstate TFP because it is not economically meaningful. A properly constructed productivity offset: (i) reflects the entire range of diverse factors that cause changes in the unit cost of production for the LECs; and (ii) measures changes in the overall efficiency of production. Partial measures of productivity -- which is what an interstate measurement would be -- are inconsistent with the economics of price caps because they are confined to particular inputs or outputs. Further, there is no economically meaningful method of separating production between inter- and intrastate unless the technology of the industry is separable between inter- and intrastate -- a condition that does not apply to telecommunications. The appropriate PCI should contain the effects of all inputs and outputs used by the firm. It should not be distorted by artificial jurisdictional separations that have no basis in production or significance in market terms. Separability requires that the production of the separable activities be most efficiently done independently. If efficient operation requires common facilities or shared resources -- which is a recognized characteristic of the telecommunications industry -- this is a conclusive sign that the activities are not separable. For these reasons, GTE opposes the use of an interstate-only TFP methodology.

Further, GTE does not support the inclusion of data for industry segments other than price cap LECs in the calculation of TFP. As a matter of precedent, as well as logic, price cap regulation establishes productivity factors based only on those firms being regulated. Further, the inclusion of other industry segments would serve to distort the actual productivity of price cap LECs. This distortion could go either way; it could make the productivity factor higher or lower -- depending on the subset of other firms included in the analysis. The Commission should not waste its energies seeking to determine which other firms should be included. It should decide at the outset to measure only the productivity of those firms being regulated.

GTE opposes the addition of a Consumer Productivity Dividend ("CPD") to LEC productivity. There should be no CPD because: (i) the decision to add a CPD, and the value selected, were arbitrary; (ii) a mechanism to pass the first benefits of price caps is no longer needed; and (iii) adoption of a methodology that forecasts the next year or, in the alternative, a methodology that includes only years under price cap regulation obviates any perceived need to adjust for historical gains.

GTE submits that the inclusion of sharing diminishes the coherence and effectiveness of price caps to a point where it becomes indistinguishable from rate of return-regulation modified by factors forcing prices downward. Further, in a well-functioning competitive market, the rate of output price changes would not contain a sharing term. Inclusion of a sharing term distorts the price cap mechanism and prevents it from emulating a competitive market. The record of this proceeding will provide ample evidence to substantiate the selection of a productivity factor that accurately predicts the LECs' productivity. The Commission no longer lacks experience with price caps, and no longer requires sharing as a "backstop" mechanism.

GTE submits that TFP is a direct measure of productivity where all inputs (labor, capital, materials) and all outputs (lines, minutes, *etc.*) are taken into account. This means a separate formula for the common line basket is not required. Certain costs incurred by LECs will not be captured even with a direct measure of the change in LEC input prices and the change in LEC TFP. These costs should be afforded exogenous treatment. Until price cap LECs are allowed to operate in a fully competitive market where administrative, legislative or judicial actions do not uniquely affect them, they should be allowed to seek exogenous treatment for costs incurred as a result of these actions – provided these costs are not accounted for in the PCI adjustment factor.

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

In the Matter of	)	
	)	
Price Cap Performance Review for Local Exchange Carriers	))	CC Docket No. 94-1

GTE's COMMENTS

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby offer comments on the Commission's Fourth Further Notice of Proposed Rulemaking ("*Fourth Notice*"), FCC 95-406 (released September 27, 1995), in the proceeding captioned above with reference to the specifics of the price cap formula.

BACKGROUND

In the *Fourth Notice*, the Commission deals primarily with the long-term structure of the components of the price cap formula: the productivity measurement or X-Factor; the link between the X-Factor and sharing; the common line formula regarding the treatment of "g";[1] and exogenous cost treatment or the Z-Factor.[2] The price cap

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1 "g" is the growth in minutes-of-use per line.

2 The initial LEC price cap formula was established in *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786 (1990), and Erratum, 5 FCC Rcd 7664 (1990) ("*LEC Price Cap Order*"), *modified on recon.*, 6 FCC Rcd 2637 (1991) ("*LEC Price Cap Reconsideration Order*"), *aff'd sub nom. National Rural Telecom Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993).

formula resets the Price Cap Index ("PCI")[3] for each price cap basket annually based on the Gross Domestic Product Price Index ("GDPPI")[4] less a productivity offset or X-Factor,[5] and allows adjustments for exogenous costs or the Z-Factor.[6] The Common Line basket receives slightly different treatment. In order to cap carrier common line rates, the Commission devised a formula known as the "Balanced 50/50 formula"[7] which sets the PCI for the Common Line basket to "reflect expected LEC performance

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[3] LECs' interstate access services are segregated into baskets based on the type of service; *i.e.*, Interexchange, Common Line, Trunking, Traffic Sensitive, and Video Dialtone, with each basket having its own PCI. The original basket structure has been modified twice since the *LEC Price Cap Order. See Transport Rate Structure and Pricing*, Second Report and Order, CC Docket No. 91-213, 9 FCC Rcd 615 (1994); and *Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation*, Second Report and Order and Third Further Notice of Proposed Rulemaking, CC Docket No. 94-1 ("*D.94-1*"), FCC 95-394 (released September 21, 1995).

[4] Initially, the Commission selected the Gross National Product Price Index ("GNPPI") as the appropriate measure of economy-wide inflation. *LEC Price Cap Order*, 5 FCC Rcd at 6792-93. The Commission changed this inflation index to the GDPPI in the *First Report and Order. Price Cap Performance Review for Local Exchange Carriers*, First Report and Order, 10 FCC Rcd 8961, 9115-9116 (1995) ("*First Report and Order*").

[5] The X-Factor "reflects the fact that changes in unit costs in the telecommunications industry historically have been below the level of inflation." *Fourth Notice* at para. 13.

[6] Exogenous costs are costs incurred by LECs caused by administrative, legislative, or judicial requirements beyond their control. *LEC Price Cap Order*, 5 FCC Rcd at 6807.

[7] *Id.* at 6795.

in lowering loop costs and to share the benefits of the productivity gains associated with increased common line usage between LECs and their customers."[8]

In the *LEC Price Cap Order*, the Commission mandated an X-Factor of at least 3.3 percent. This X-Factor was based on the average of two studies, Spavins/Lande and Frentrup/Uretsky, which reflected a historical productivity growth of 2.8 percent.[9] A 0.5 percent CPD was "added to assure that the first benefits of price caps flow to customers in the form of reduced rates."[10]

In response to the *First Notice*,[11] the Commission received various suggestions regarding the appropriate method of calculating the X-Factor. USTA and the price cap LECs proposed using the TFP method submitted by Laurits R. Christensen, Philip E. Schoech, and Mark E. Meitzen ("Christensen") and supported by National Economic Research Associates, Inc. ("NERA")[12] AT&T submitted a Direct Model, which the Commission refers to as the Historical Revenue Model,[13] that bases the X-Factor on the rate of return earned by the RBOCs.

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8 *First Report and Order,* 10 FCC Rcd at 9078.

9 *See LEC Price Cap Order,* 5 FCC Rcd at 6798.

10 *Id.* at 6799.

11 *See D.94-1*, Notice of Proposed Rulemaking, 9 FCC Rcd 1687 (1994) ("*First Notice*").

12 *See Fourth Notice* at para. 22.

13 *Id.* at para. 77.