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

_____)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review for Local)	CC Docket No. 94-1
Exchange Carriers)	
)	
Interexchange Carrier Purchases of Switched)	CCB/CPD File No. 98-63
Access Services Offered by Competitive Local)	
Exchange Carriers)	
)	
Petition of U S West Communications, Inc. for)	CC Docket No. 98-157
Forbearance from Regulation as a Dominant)	
Carrier in the Phoenix, Arizona MSA)	
_____)	

GTE'S REPLY TO OPPOSITIONS TO PETITIONS FOR RECONSIDERATION

Pursuant to Section 1.429 of the Commission's Rules, GTE Service Corporation and its below-listed affiliates¹ (collectively "GTE") hereby submit this Reply to the Oppositions filed in response to GTE's Petition for Reconsideration ("Petition") that requests the Commission to reconsider certain aspects of its *Fifth Report & Order* in the above-captioned proceedings.²

¹ GTE Alaska, Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., GTE West Coast Incorporated, and Contel of the South, Inc.

² *Access Charge Reform; Price Cap Performance Review for Local Exchange*
(Continued...)

GTE respectfully asks the Commission to reject opponents' contentions that the Commission retain its requirement that price-cap carrier holding company waive its ability to make a low-end adjustment in all of its service region if it gains flexibility in any MSA.³ The low-end adjustment mechanism is constitutionally required to ensure that the Commission's price cap regulations do not violate the Fifth Amendment. At the very most, the Commission should apply this waiver rule only to tariff filing entities that enjoy flexibility in their region, rather than to the holding company. GTE also asks the Commission to reject any modification to the triggers used to establish the right to pricing flexibility in the *Fifth Report & Order*. The FCC should affirm its ruling in this area that one-half of the revenues for interoffice circuits should be attributed to each office at either end of the circuit.

I. THE MANDATORY, HOLDING COMPANY-WIDE WAIVER OF THE LOW-END ADJUSTMENT MECHANISM IS UNCONSTITUTIONAL AND ARBITRARY.

A. The Low-End Adjustment Mechanism Is a Necessary Constitutional Backstop To Ensure that a Company Continues To Have a Fair Opportunity To Earn a Reasonable Return on Regulated Investment

The opponents of GTE's position argue that it is constitutional for the FCC to eliminate the low-end adjustment mechanism at this time, prior to full rate flexibility for a

(...Continued)

Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, 14 FCC Rcd 14221 (1999) ("Fifth Report and Order").

³ See Opposition of AT&T Corp. ("AT&T"); Opposition of MCI WorldCom, Inc. ("MCI"); Opposition of Telecommunications Resellers Assoc. ("TRA").

rate regulated company.⁴ It is beyond dispute that the Fifth Amendment requires the FCC to adopt a rate regulation scheme that will “enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed.”⁵ Despite this black-letter law, the opponents of the low-end adjustment mechanism attempt to trivialize this constitutional requirement and reduce the Commission’s constitutional obligations.⁶ Even the cases they cite for this proposition clearly hold that rate regulation must account for “the return investors expect given the risk of the enterprise.”⁷

AT&T, MCI and TRA make no attempt to demonstrate how the FCC’s obligation changes once it grants a price-cap carrier flexibility in one MSA in its operating area. They cannot because the FCC’s constitutional obligation remains constant for the duration of its rate regulation. Further, these opponents conveniently ignore the FCC’s previous finding that the low-end adjustment mechanism was a critical element in meeting its constitutional obligations. The FCC’s original rationale is just as important today.⁸ In the end, the opponents of the low-end adjustment mechanism cannot

⁴ See AT&T at 2; MCI at 2; TRA at 3-4.

⁵ *Federal Power Comm’n v. Hope Natural Gas*, 320 U.S. 591, 605 (1944); see also *Southwestern Bell Telephone Company; Tariff F.C.C. No. 73*, 13 FCC Rcd 6964, ¶ 17 (1998) (noting that price cap rates must not affect a company’s “financial integrity and prevent it from raising capital, or fail to compensate [it] with returns on investment commensurate with other enterprises having corresponding risks” to satisfy the Fifth Amendment).

⁶ See AT&T at 2; MCI at 3; TRA at 2.

⁷ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989); see also *Federal Power Comm’n v. Texaco, Inc.*, 417 U.S. 380, 393 (1974).

⁸ Petition at 7-8.

undermine the fact that this mechanism is still necessary as a constitutional backstop to ensure that price cap companies are allowed a fair opportunity to earn a reasonable return on regulated investment.

Instead, each of the opponents pointed to the availability of the “above-cap” tariff filing mechanism as an equivalent alternative to the low-end adjustment to justify, on constitutional grounds, its elimination.⁹ This argument suffers from a fatal flaw – the Commission never intended the “above cap” tariff filing to be equivalent to the low-end adjustment mechanism. The Commission itself made this fact perfectly clear when it adopted each of these mechanisms as part of the original price cap plan, and reaffirmed their use each time it reviewed the mechanism.¹⁰ For instance, rather than adopt the same procedures to allow use of the low-end adjustment mechanisms, carriers requesting above-cap rates must make additional showings to satisfy the “stringent review standards” and to overcome the strong presumption against such filings.¹¹ Moreover, despite TRA’s characterization to the contrary,¹² the Commission always intended the above-cap tariff filing to be one that would never actually be used

⁹ See AT&T at 4; MCI at 4; TRA at 3.

¹⁰ See *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, 12 FCC Rcd 16642, 16704-05 (1997). TRA’s attempt to argue that the test for above-cap filings is relatively easy to make is an example of Orwellian “newspeak.”

¹¹ *Policy and Rules Concerning Rates for Dominant Carriers* (Second Report and Order), 5 FCC Rcd 6786, 6823 (1990) (“*LEC Price Cap Order*”).

¹² TRA at 3.

except, perhaps, in extreme situations.¹³ The FCC, of course, did nothing to change the standard for above-cap filings in the *Fifth Report and Order*.

AT&T's alternative proposal that ILECs may file waivers if they are facing "dire financial circumstances"¹⁴ is no answer to the problem. As GTE pointed out in its Petition, the Fifth Amendment requires that the rate regulated entity have a "reasonable, certain and adequate provision for obtaining compensation."¹⁵ The waiver system contemplated by AT&T would fail to satisfy this requirement because it would be a burdensome and inadequate response to meet the Commission's constitutional burden, particularly because it would lead to unreasonable delay in providing relief. There certainly is nothing certain about relying upon a case-by-case determination with an unknown and potentially varying standard.¹⁶ Finally, the FCC itself recognized that forcing a carrier to endure dire financial straits before invoking a regulatory relief mechanism is a wholly inadequate measure.¹⁷

¹³ *LEC Price Cap Order*, at 6823.

¹⁴ AT&T at 4.

¹⁵ *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 125 (1974) (quoting *Cherokee Nation v. Southern Kansas R. Co.*, 135 U.S. 641, 659 (1890)).

¹⁶ The Supreme Court has cautioned against the use of vague standards to determine whether rates are confiscatory. See *Texaco, Inc.*, 417 U.S. at 393 (noting that the lack of standards for reviewing a claim increases the constitutional risks).

¹⁷ For example, the Commission recognized in the cable service context that requiring severe financial consequences was not consistent with a policy that balanced consumer and company interests in seeing reasonable cable rates. Therefore, the Commission adopted benchmark or price cap regulation as the primary regulatory tool, but allowed cost of service filings without any special justification. *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation*, 8 FCC Rcd 5631, 5794-95 (1993).

B. Elimination of the Low-End Adjustment Mechanism on a Company-Wide Level Is Not Necessary To Protect Against a Cross-Subsidy

The opponents of the low-end adjustment mechanism speculate that rate regulated carriers may have incentives to use the low-end adjustment to earn undeserved revenues for services not subject to flexibility.¹⁸ They claim that the elimination of the low-end adjustment is necessary after a carrier obtains pricing flexibility in any area in order to prevent price cap carriers from shifting costs from competitive services to noncompetitive ones. This argument is flawed for two reasons.

First, cost misallocation on a company-wide basis is not likely to occur given the level of regulation of a price cap carrier's rates at the federal and state level. For the costs that are allocated across filing entities, as GTE pointed out in its Petition, the Commission's elaborate set of price-cap rules is designed to keep prices low and to restrict a carrier's ability to shift costs between markets in the manner postulated by the opponents.¹⁹ Moreover, given the level of detailed financial data that price-cap carriers are required to file pursuant to Part 43 of the Commission's Rules, any substantial shift in costs in such a manner postulated by AT&T and MCI would be easily detected by the FCC (and GTE's competitors).²⁰ Additionally, states routinely review cost data in their examination of carrier rates and other audits. As part of their examination of state rates, state regulatory authorities routinely examine total company costs that are allocated to their study area and will thereafter be allocated to the state jurisdiction.

¹⁸ See AT&T at 5; MCI at 6-7.

¹⁹ See GTE Petition at 8-9.

²⁰ In particular, the ARMIS reporting requirements provide the level of detail that could easily be used to detect unusual shifts in allocated costs. 47 C.F.R. § 43.21.

Because an increased allocation of costs would have an effect on the revenues to be derived from a state's ratepayers, the state regulatory agencies have a very strong incentive to monitor the allocation of costs and to prevent a price-cap carrier from engaging in the machinations hypothesized by AT&T and MCI.

Second, these parties fail to appreciate the fact that competition is developing nationwide. Even though a specific area might not have achieved a level of competition that would trigger price flexibility, this does not mean that competitors are not operating in that area or close by and could quickly enter if prices were increased in that area. Thus, cost shifting cannot be successful. An unreasonable shifting of costs would be swiftly countered by market entry that would effectively prevent any unreasonable price increase. Therefore, cost shifting in this manner is highly unlikely.

Because the incentives postulated by the Commission are not an issue, requiring a carrier to waive the low-end adjustment on a holding company-wide basis because it receives pricing flexibility in one MSA does not have "a rational connection between the facts found and the choice made."²¹ Such a policy cannot be legally sustained. Additional caution is particularly warranted by the Commission in this area because of the constitutional import of the rule it seeks to eliminate.

The Commission could act to minimize, if not eliminate, the above constitutional and statutory concerns by more narrowly tailoring its rule. In this case, the FCC could require that only the tariff filing entity that had received pricing flexibility must waive its

²¹ *Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

ability to take advantage of the low-end adjustment mechanism. This change would be a step in the right direction and more directly addresses the issue at hand.

II. THE FCC'S PRIOR CONCLUSION THAT A FIFTEEN PERCENT THRESHOLD IS THE CORRECT LEVEL TO GRANT PHASE I PRICING FLEXIBILITY IS CORRECT AND REASONABLE

Both Network Access Services and MCI attempt to claim that the Commission's Phase I fifteen percent threshold is set too low. MCI tries to make its point by attacking the Commission's revenue attribution rule found at Section 69.725.²²

This attack completely ignores reality. As the Commission correctly determined, "there is a revenue allocation issue" concerning what percentage of revenues of an interoffice circuit can be addressed to a specific office.²³ However, because "[a]ccess customers order special access and dedicated transport services to provide a transmission path between *two customer-designated locations*," the allocation of fifty percent of the revenues to each end point makes economic and logical sense.²⁴

MCI does not directly contest this finding, but attempts to argue that no interoffice revenues should be converted for purposes of making a trigger determination. This is completely unfair and defies common sense. This approach fails to capture a significant revenue characteristic of an end office and the scope of economic activity and competition in that market. It makes perfect sense to attribute at least some of the revenues to the office at each end point because, after all, the

²² 47 C.F.R. § 69.725.

²³ *Fifth Report & Order*, at ¶ 99.

²⁴ *Id.* (emphasis added).

revenues that are generated by the interoffice circuit are due to the customer's determination that there is economic value in the end-points. It is the fact that these offices exist and is connected to the specific circuit that gives that circuit its value in the first instance.

Finally, MCI makes no attempt to craft an alternative solution. Because the Commission has designed a workable, sound solution to a very difficult problem, it must reject MCI's request to adjust the Phase I trigger upwards.

III. CONCLUSION

For the foregoing reasons, GTE respectfully requests the Commission to grant its Petition for Reconsideration and to deny the Petition of Reconsideration of Network Services.

Respectfully submitted,

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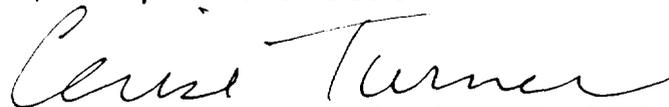
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