Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Multi-Association Group (MAG) Plan for	)	CC Docket No. 00-256
Regulation of Interstate Services of	)	
Non-Price Cap Incumbent Local Exchange	)	
Carriers and Interexchange Carriers	)	

COMMENTS OF SPRINT CORPORATION

Sprint Corporation hereby respectfully submits its comments on the Further Notice of Proposed Rulemaking (FCC 01-304) released on November 8, 2001 in the above-captioned proceeding. In this FNPRM, the Commission seeks further comment on the MAG incentive plan and how it might be modified to provide incentives for cost efficiency gains by rate of return carriers; additional pricing flexibility measures for rate of return carriers; and application of the Commission's all-or-nothing rule (47 C.F.R. Section 61.41). As discussed below, Sprint supports the Commission's efforts to move the interstate access rates of rate of return carriers towards lower, cost-based and economically efficient levels, and believes that the price cap model initially implemented for the large ILECs in 1990 provides an appropriate model for the Commission to use here.

A. Incentive Regulation

In the FNPRM (para. 217), the Commission states that "based on the present record, we are unable to conclude that the MAG's incentive regulation plan should be adopted." Sprint agrees with the Commission's analysis of the MAG proposal, since that proposal would allow rate of return ILECs to take advantage of the benefits of incentive regulation, without accepting any of the downside risk of such regulation and without requiring these carriers to share any productivity or efficiency gains with their access customers in the form of lower interstate access charges. As the Commission correctly emphasizes (para. 221), "the benefits to be realized from the adoption of an alternative regulation plan should be shared equitably between the carrier and its customers."

Incentive regulation is intended to encourage LECs "to move prices for interstate access services to economically efficient levels, to reduce costs, to invest efficiently in new plant and facilities, and to develop and deploy innovative service offerings."[1] Price cap regulation for the largest LECs has been in place for over a decade now, and has resulted in a cumulative access rate decrease (excluding exogenous cost adjustments) of over 20%[2] -- rate decreases which have been flowed through to end users in the form of lower toll rates. Under price cap regulation (1991-2000), the BOCs' interstate interLATA access minutes of use increased over 70%,[3] BOC average net investment remained stable, increasing 14%,[4] the BOCs' earned rate of return remained at very healthy levels,[5] and the Commission found no evidence of deterioration in service quality.[6] Sprint believes that many of these same benefits would result if current rate of return carriers were to switch to price cap regulation.

The Commission notes that there is significant "diversity among rate-of-return carriers in their operating conditions" (*see, e.g.,* para. 227). However, it is simply not

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[1] *Price Cap Performance Review for Local Exchange Carriers ("Price Cap Performance Review Order")*, 10 FCC Rcd 8961, 8965 (para .1) (1995).
[2] Cumulative difference in inflation minus productivity factors for the period 1991-2001.
[3] FCC's Statistics of Common Carriers; 1991 data from Table 2.10 (BOCs, GTE and Contel); 2000 data from Table 2.19 (BOCs).
[4] For the BOCs, including GTE and PRTC. Source: www.fcc.gov/ccb/armis
[5] See Attachment 1 for summary of BOCs' earned rate of return.
[6] *See, e.g., Price Cap Performance Review Order*, para. 40.

possible to develop a different price cap plan for every small ILEC; beside the obvious administrative problems, data are not available on key factors such as the productivity levels a small ILEC has in the past or may in the future be able to achieve (*see, e.g.,* FNPRM, para. 219). Therefore, Sprint recommends that the Commission rely upon its past experience, and adopt a price cap plan for rate of return LECs which reflects the plan initially adopted for larger ILECs as well as elements from the CALLS access reform plan. Sprint recommends that this new incentive plan include the following features:

- A choice of productivity ("X") factors (3.3% or 4.3%). LECs choosing the lower X-factor would be required to share 50% of earnings between 12.25% and 16.25%, and 100% of earnings over 16.25%. LECs choosing the 4.3% X-factor would share 50% of earnings between 13.25% and 17.25%, and 100% of earnings over 17.25%. Although data on small LEC productivity are generally not available, experience has shown that both the 3.3% and 4.3% productivity factors were substantially lower than what the largest LECs achieved, and it is significant that all of the larger price cap LECs subsequently chose the 6.5%/no sharing option when that alternative became available.

- Lower end formula adjustment mechanism (LFAM) – the carrier would be allowed to increase its rates to generate a rate of return of 10.25%. The carrier assumes the risk of earning 10.25% rather than the current 11.25% authorized return available under rate of return regulation. However, to encourage carriers to exit from current pooling arrangements, the LFAM should become effective only if the pool's earned return is 9.25% or less. (Thus, the pool assumes the risk of earning 9.25% rather than 11.25% under rate of return regulation.)

- Initial rates under the new incentive regulation plan should be reduced by a "consumer productivity dividend" of 0.5%.

- Productivity reductions should be targeted to the same traffic sensitive services defined in the CALLS plan, with the local switching rate element reduced by at least its proportional share of the annual productivity amount, for at least the first five years of the new incentive regulation plan. This approach is reasonable because most of the efficiencies of the circuit switched network (*e.g.,* deployment of digital switching and fiber-based transport) have accrued to switching and transport services.

In order to maximize the benefits of incentive regulation, and to reduce the impact of self-selection (LECs which believe they can beat the productivity factor elect price cap regulation and exit the pool, while high cost/low efficiency LECs choose to remain under cost of service regulation, thereby increasing overall NECA pool rates), Sprint recommends that incentive regulation be mandatory for all rate of return LECs. If a LEC believes that its access rates under incentive regulation have been forced below the economic cost of providing the service, that LEC should have the opportunity to file cost studies demonstrating the forward-looking economic costs incurred. If these cost studies prove that the rates have reached economic costs, the Commission could waive application of the productivity factor to that carrier's rates for some period of time.

Sprint believes that continued pooling under price cap regulation tends to mute any individual carrier's incentive to maximize efficiency, since a pooling carrier must share the rewards of its individual efficiency-enhancing efforts. However, should the Commission decide to continue to allow pooling, the pool should be treated as a single entity for price cap purposes: it may select only one productivity factor option, and sharing and the LFAM adjustment will be based on overall pool results. If a carrier chooses to exit the pool after the start of incentive regulation,[7] it should calculate its price cap indices and rates as if it had been subject to incentive regulation from the first year in which incentive regulation was available to/mandatory for rate of return LECs, adjusted (if applicable) to reflect pool results in subsequent years.

Some current rate of return LECs might argue that the parameters set forth above are too aggressive given their operating conditions. However, if the Commission sets the bar too low (as was -- in retrospect -- the case for the initial version of price cap regulation for the largest LECs), the result will not be an equitable sharing of the benefits of incentive regulation between carriers and their access customers, and will not present much of a challenge to rate of return LECs to maximize their operating efficiencies. Moreover, there is relatively little downside risk, and substantial potential upside gain, associated with the plan described above. At worst, an individual LEC would earn 10.25% under price cap regulation, as opposed to the 11.25% it is allowed under cost of service regulation. On the upside, however, an individual LEC choosing the 3.3% productivity factor could earn up to 14.25% after sharing, and those choosing the 4.3% option could earn up to 15.25% after sharing.

B. Pricing Flexibility

In the FNPRM (paras. 248-259), the Commission seeks comment on the types and timing of pricing flexibility which should be extended to current rate of return LECs in addition to what is currently available.

As an initial matter, Sprint would note that competition in regions served by rate of return LECs is generally quite limited today. Furthermore, it appears that existing pricing flexibility measures (geographically deaveraged transport and special access rates, and volume and term discounts on transport services) are sufficient, given the few instances in which rate of return LECs have even offered such options.

Sprint does support the principle that LECs should receive additional pricing flexibility as competition increases. Assuming that the rates established pursuant to any pricing flexibility mechanism are cost-based (as they are supposed to be), the likelihood

[7] Reentry into the pool should be prohibited to avoid gaming the system (exiting in years that achieved efficiency exceeds the X-factor, reentering in years when achieved

that "pricing flexibility might be used to erect a barrier to competitive entry" (FNPRM, para. 250) is minimal; to the contrary, cost-based flexibly priced rates should encourage entry where a competitor can provide the service more economically, while discouraging uneconomic entry. If the Commission concludes that additional pricing flexibility is warranted, it should consider increasing the number of zones in zone density plans. This action would allow further deaveraging of rates to reflect different costs in different geographic areas.

The record does not contain sufficient information to assess whether existing triggers for competition-based pricing flexibility measures available to price cap LECs are equally relevant to smaller rate of return LECs. However, many price cap LECs (such as Sprint's rural local telephone companies) closely resemble rate of return LECs in terms of operational scope and geographical characteristics, and these price cap LECs have been able to adapt to changing market conditions with existing pricing flexibility mechanisms. In the absence of more complete information, Sprint recommends that the Commission rely upon its experience with pricing flexibility measures granted to price cap LECs, and apply existing triggers to all LECs. Small LECs that believe that these triggers are too stringent can request a waiver of the rules. Based upon the showing made over time in these putative waiver requests (or in a broader proceeding), the Commission will be in a better position to determine whether to lower the competition-based triggers.

C. All or Nothing Rule

In the FNPRM (para. 266), the Commission asks whether the "all or nothing" rule (Section 61.41) should be incorporated in the new incentive plan. This rule was designed to prevent cost shifting from a LEC's price cap affiliate to its non-price cap affiliate, and

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efficiency is less than the X-factor).

to prevent attempts to game the system by switching back and forth between rate of return and price cap regulation (para. 261).

If the new incentive plan is mandatory for all current rate of return LECs, as recommended by Sprint, the all or nothing rule becomes moot. A price cap LEC would not be able to shift costs to a non-price cap affiliate, because there would be no non-price cap affiliates.

If the Commission makes incentive regulation optional, then it should retain the all or nothing rule to prevent the types of behavior noted above. Under optional incentive regulation, each LEC has the opportunity to evaluate the risks presented by the plan, and can analyze whether such risks are outweighed by the potential rewards. Eliminating the all or nothing rule under these circumstances allows the LEC to shift the risks of a faulty evaluation or poor execution to its access customers. For example, if a LEC opts for incentive regulation, and realizes that it will earn only 10.25% for the monitoring period, it may attempt to shift some costs which should be allocated to its price cap operations to its non-price cap operations. Similarly, absent the all or nothing rule, a LEC which realizes that it will not be as efficient as it initially estimated (and thus will not benefit from incentive regulation as much as it expected) would have an incentive to revert back to cost of service regulation rather than to make the kind of hard choices needed to become more efficient. Such behavior reduces the potential benefits of incentive regulation, and the Commission should accordingly retain the all or nothing rule.

Respectfully submitted,

SPRINT CORPORATION

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Attachment 1

BOCs' Interstate Rate of Return Under Price Cap Regulation*

1991	12.08%
1992	12.98%
1993	13.49%
1994	13.62%
1995	13.60%
1996	14.78%
1997	15.36%
1998	15.98%
1999	18.17%
2000	19.22%

* Includes GTE and PRTC

Source: www.fcc.gov/ccb/armis

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Comments of Sprint Corporation was delivered by electronic mail, on this 14th day of January, 2002, to the parties listed below.

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