

REMARKS OF CHAIRMAN PATRICIA M. WORTHY,
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ALTERNATIVES TO RATE OF RETURN REGULATION

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I'M DELIGHTED TO BE HERE THIS MORNING. I HAVE BEEN ASKED TODAY TO DISCUSS ALTERNATIVES TO RATE OF RETURN REGULATION FROM THE PERSPECTIVE OF A CHALLENGING COMMISSIONER. WHILE THAT CHARACTERIZATION, PRESUMABLY, REFERS TO MY LONG-HELD OPPOSITION TO ILL-CONSIDERED INTERFERENCE WITH A LONG PROVEN METHOD OF UTILITY REGULATION, I CHARACTERIZE MYSELF AS ONE OF THE FEW REMAINING VOICES OF MODERATION IN THE CURRENT DIALOGUE OF REGULATORY REFORM. MY VIEW IS THAT RATHER THAN CHALLENGING THE CONTINUATION OF RATE OF RETURN REGULATION IN FAVOR OF MORE FASHIONABLE (THOUGH UNTESTED) ECONOMIC THEORY, REGULATORY COMMISSIONS SHOULD PROCEED DELIBERATELY TO INVESTIGATE WAYS THAT THE TRADITIONAL MODEL OF RATE OF RETURN REGULATION CAN BE IMPROVED. I BELIEVE THAT RATHER THAN SCRAP WHAT WORKS, WE SHOULD FIND INSTEAD WAYS OF IMPROVING THE EXISTING REGULATORY REGIME.

IT HAS BECOME FASHIONABLE DURING THE REAGAN ADMINISTRATION TO ATTACK ESTABLISHED INSTITUTIONS, TO DRIVE TOWARD LESS AND LESS GOVERNMENT OVERSIGHT, AND TO PROMOTE COMPETITION IN INDUSTRIES LONG CONSIDERED NATURAL MONOPOLIES. I THINK IN LARGE PART THIS SHOW OF DEREGULATORY ZEAL IS THE PRODUCT OF THE "FAST-FIX" MENTALITY, AND A FAILURE ON THE PART OF THE LEGISLATIVE AND EXECUTIVE BRANCHES OF OUR FEDERAL GOVERNMENT TO PROPERLY ANALYZE, DEVELOP, COORDINATE AND IMPLEMENT A NATIONAL COMMUNICATIONS POLICY.

OPPONENTS OF HASTY, ILL-CONSIDERED REGULATORY REFORM, LIKE MYSELF, HAVE BEEN PLACED ON THE DEFENSIVE BY AN OVERWHELMING TIDE OF INDUSTRY EFFORTS AT PERSUADING POLICY MAKERS OF THE INADEQUACY OF RATE OF RETURN REGULATION IN THE POST-DIVESTITURE ERA. A CAREFUL ANALYSIS OF THE PRESENT DIALOGUE DEMONSTRATES THAT, MORE FREQUENTLY THAN NOT, PROPONENTS OF RATE OF RETURN REGULATION HAVE BEEN FORCED TO FOCUS NOT ON THE MODEL'S STRENGTHS, BUT ON WHY ITS WEAKNESSES DO NOT MILITATE IN FAVOR OF IMMEDIATE CHANGE. RATHER THAN DESCRIBING WHAT IS GOOD ABOUT RATE OF RETURN REGULATION, WE

ARE FORCED TO DEFEND WHY ITS NOT SO BAD. THIS, I BELIEVE, DISTORTS THE COLLOQUY, AND MISPLACES THE BURDEN OF PROOF.

ALLOW ME, THEN, TO REITERATE SOME OF THE ACHIEVEMENTS OF RATE OF RETURN REGULATION WHICH ARE NOT, IN MY OPINION, RECEIVING SUFFICIENT ATTENTION. UNDER RATE OF RETURN REGULATION, THIS COUNTRY CONTINUES TO ENJOY THE BEST TELECOMMUNICATIONS SERVICES TO THE GREATEST NUMBER OF CITIZENS IN THE WORLD. WHILE SOME COUNTRIES HAVE DEPLOYED ISDN AND OTHER TECHNICAL IMPROVEMENTS MORE QUICKLY THAN WE HAVE, IT IS STILL A GAME OF CATCH-UP FOR MOST OTHER COUNTRIES. TO ITS CREDIT, THE UNITED STATES TELECOMMUNICATIONS INDUSTRY IS ABLE, DUE TO THE EXISTING REGULATORY CLIMATE, TO INVEST IN RESEARCH AND DEVELOPMENT TO A GREATER DEGREE THAN OTHER AMERICAN INDUSTRIES. AT THE SAME TIME, THE UNITED STATES TELECOMMUNICATIONS INDUSTRY HAS REALIZED PRODUCTIVITY GAINS THAT ARE FAR GREATER THAN THE OVERALL ECONOMY.

THE ABILITY TO CALL FROM ANYWHERE TO ANYWHERE IS MORE READILY AVAILABLE OVER A LARGER GEOGRAPHIC AREA HERE THAN ANYWHERE ELSE IN THE WORLD. AT THE SAME TIME, LEVELS OF TELEPHONE

PENETRATION IN THE UNITED STATES IS ENVIABLE, APPROACHING 93% OVERALL, AND HIGHER IN MANY POPULATION CENTERS. THE INCREASE IN PENETRATION IS, IN PART, BECAUSE RATE OF RETURN REGULATION HAS ENABLED A GENERAL DECLINE IN THE COST OF NETWORK ACCESS IN RELATION TO OTHER SERVICES. THE NATIONAL OBJECTIVE ESTABLISHED IN THE FEDERAL COMMUNICATIONS ACT OF ACHIEVING UNIVERSAL SERVICE HAS, THEREFORE, BEEN LARGELY REALIZED.

IN PART, THESE QUALITATIVE AND QUANTITATIVE SUCCESSES ARE THE RESULT OF THE EFFECTIVENESS OF THE ADMINISTRATIVE PROCEDURES APPLIED AND ISSUES SCRUTINIZED IN RATE OF RETURN REGULATION. MOST IMPORTANTLY, THE EXISTING REGULATORY REGIME ENSURES, BY CLOSE SCRUTINY OF UTILITY RATES, COSTS, AND PRACTICES, THAT RATEPAYERS ARE ASSURED A SHARE OF EFFICIENCIES AND PRODUCTIVITY GAINS REALIZED BY REGULATED ENTITIES. RATHER THAN RELYING ON THE WHIMS OF THE MARKET PLACE, OR THE GOODWILL OF THE RESPECTIVE PLAYERS, POLICYMAKERS ARE REQUIRED TO FLOW THROUGH TO CUSTOMERS THESE COST SAVINGS, BY PERIODIC AND THOROUGH SCRUTINY OF COMPANIES' OVERALL OPERATIONS THROUGH GENERAL RATE PROCEEDINGS.

THE SUCCESS OF RATE OF RETURN REGULATION CAN BEST BE EVALUATED WHEN COMPARED TO THE ABUSES THAT EXISTED PRIOR TO ITS IMPLEMENTATION. PRIOR TO THE INTRODUCTION OF REGULATION IN THE DISTRICT OF COLUMBIA, THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY (C&P) PURCHASED THE EXCLUSIVE LOCAL FRANCHISE AND BEGAN DOING BUSINESS AT THE TURN OF THE CENTURY. THE COMPANY INITIALLY CHARGED \$12 FOR A TELEPHONE HOOK-UP. WHEN CUSTOMER SUBSCRIBERSHIP INCREASED, THEY RAISED THE RATES TO \$25. CUSTOMERS COMPLAINED, AND THEY RAISED THE RATES AGAIN TO \$40, AND THEN TO \$60, AND ULTIMATELY, TO \$125 A LINE FOR PREMIUM SERVICE. THE COMPANY MISINFORMED CUSTOMERS AS TO PENDING CHARGES AND THE COMPANY'S INTENTION TO RAISE RATES IN THE FUTURE. C&P ALSO IMPOSED EGREGIOUS USE RESTRICTIONS, WHICH INCLUDED MONITORING TELEPHONE CALLS TO ENSURE THAT BUSINESS LINES WERE NOT USED FOR PERSONAL CALLING, AND, IF AN OPERATOR OVERHEARD A NON-BUSINESS CONVERSATION, THE CALLS WERE TERMINATED.

HOWEVER, THE PENDULUM IS NOW SWINGING AWAY FROM REGULATION TO THE "FREE MARKET" APPROACH THAT ALL OF US HAVE READ ABOUT IN

ECONOMICS 101. THAT IS TO SAY, THAT ESSENTIALLY MONOPOLY FIRMS ARE FREE TO PURSUE THEIR OBJECTIVES WITHOUT THE DISCOMFORT AND ALLEGED INEFFICIENCY OF GOVERNMENT INTRUSION. I BELIEVE THAT, IN LARGE PART, THIS TREND IS SHORT-SIGHTED, LACKS ADEQUATE JUSTIFICATION, AND IS POLITICALLY MOTIVATED. WHILE RATE OF RETURN REGULATION HAS NEVER BEEN CONSTRUED AS A PANACEA, AND DOES BURDEN UTILITIES AND RATEPAYERS ALIKE WITH SIGNIFICANT REGULATORY COSTS, I HAVE YET TO SEE AN ALTERNATIVE REGULATORY PROPOSAL THAT HAS BEEN PROVEN AS EFFECTIVE AS TRADITIONAL COST OF SERVICE REGULATION AT CURBING INCENTIVES TO EXERCISE ABUSIVE MONOPOLY POWER. I AM, HOWEVER, COMMITTED TO MAINTAINING AN OPEN MIND.

IT IS SAID THAT THE STATES ARE LABORATORIES FOR TESTING GOVERNMENTAL POLICIES. THOSE POLICIES SUCCESSFUL AT THE STATE LEVEL OFTEN FIND THEIR WAY INTO FEDERAL REGULATION AND LAW. THE TREND TOWARD COMMUNICATIONS REFORM IS A PERFECT EXAMPLE. WHILE THE INITIAL IMPETUS FOR INTRODUCING COMPETITION INTO THE TELEPHONE INDUSTRY RESULTED FROM AN INDUSTRY RESTRUCTURING EFFECTED BY THE REAGAN ADMINISTRATION (BY WAY OF THE AT&T CONSENT

DECREE AND THE FCC) REVISIONS TO THE METHODS OF REGULATING THE TELEPHONE COMPANIES THEMSELVES HAVE LARGELY BEEN SPEARHEADED BY THE STATES. THESE ACTIONS HAVE RESULTED FROM LEGISLATIVE INITIATIVES, REGULATORY PROCEEDINGS, OR BOTH. IN THAT COMMISSIONER BARRETT HAS PROVIDED AN EXCELLENT DISCUSSION OF THE VARIOUS STATES' APPROACHES TO REGULATORY REFORM, I THOUGHT IT WOULD BE USEFUL TO DISCUSS BRIEFLY ONE OF THE REGULATORY APPROACHES BEING TAKEN AT THE STATE LEVEL, AS WELL AS THE FEDERAL COMMUNICATIONS COMMISSION'S PRICE CAP PROPOSAL.

RECENTLY THE WEST VIRGINIA PUBLIC SERVICE COMMISSION AUDITED A DEREGULATION PLAN FOR C&P. BEGINNING JANUARY 1, 1989, INTRALATA TOLL COMPETITION WILL BE PERMITTED, COUPLED WITH A THREE YEAR TRIAL OF PRICING FLEXIBILITY IN LOCAL TELEPHONE MARKETS. THE EXPERIMENT DIVIDES TELEPHONE SERVICES INTO THREE CATEGORIES. CATEGORY ONE INCLUDES OPTIONAL SERVICES CLAIMED TO HAVE MARKET ALTERNATIVES, AND IS SUBJECT TO FLEXIBLE REGULATION. THESE SERVICES INCLUDE, AMONG OTHERS, COIN PHONES, MOST CUSTOM CALLING SERVICES, CENTREX INTERCOM, PRIVATE LINE, TOLL OPERATOR SERVICES,

MOBILE TELEPHONE, AND ALARM TELEMTRY. PRICE CHANGES ARE ALLOWED ON THESE SERVICES ON 14 DAYS NOTICE. THE WEST VIRGINIA COMMISSION HAS, AND IS CONTINUING TO, INVESTIGATE MEANS OF PROTECTING AGAINST CROSS-SUBSIDIZATION AND ANTICOMPETITIVE BEHAVIOR WITH RESPECT TO THESE LARGELY UNREGULATED SERVICES.

CATEGORY II OF THE WEST VIRGINIA PLAN INCLUDES LOCAL EXCHANGE AND BASIC TELEPHONE SERVICE PACKAGES, AND IS SUBJECT TO TRADITIONAL REGULATORY OVERSIGHT, WITH RATES FROZEN FOR THREE YEARS. THESE SERVICES INCLUDE RESIDENTIAL AND SMALL BUSINESS LOCAL EXCHANGE SERVICE (BOTH ACCESS AND MESSAGE), SERVICE CONNECTION, AND DIRECTORY ASSISTANCE.

CATEGORY III INCLUDES CARRIER ACCESS SERVICES, INCLUDING SWITCHED AND SPECIAL ACCESS. THE RATES CHARGED FOR THESE SERVICES MAY BE REDUCED, ON THIRTY DAYS NOTICE, BUT NOT INCREASED.

MOREOVER, WEST VIRGINIA HAS OBTAINED SOME ADDITIONAL PROMISES FROM THE TELEPHONE COMPANY IN EXCHANGE FOR LIMITED DEREGULATION. C&P HAS AGREED TO EXTEND ITS SERVICE TERRITORY TO AREAS NOT PRESENTLY RECEIVING TELEPHONE SERVICE, AND TO TAKE

OTHER MEASURES TO PROMOTE UNIVERSAL SERVICE. C&P HAS ALSO COMMITTED TO INVEST \$300 MILLION INTO THE NETWORK TO MODERNIZE IT, AS WELL AS TO COMMIT ITSELF TO CONTINUE EFFORTS TO CREATE JOBS IN WEST VIRGINIA.

IN PASSING, LET ME NOTE THAT C&P HAS PROPOSED A SIMILAR HYBRID OF THE SOCIAL CONTRACT ARRANGEMENT FOR THE DISTRICT OF COLUMBIA. BECAUSE C&P'S PROPOSAL WILL LIKELY COME BEFORE THE COMMISSION, I MUST REFRAIN FROM ADDRESSING IT AT THIS TIME.

THE WEST VIRGINIA EXPERIENCE IS ONE OF THE EXAMPLES OF THE "SOCIAL CONTRACT" ALTERNATIVE TO RATE OF RETURN REGULATION. IN ESSENCE, THE SOCIAL CONTRACT PROVIDES CARRIERS WITH THE OPPORTUNITY TO MARKET SERVICES DESIGNATED COMPETITIVE OR DISCRETIONARY WITH A MINIMUM OF REGULATORY OVERSIGHT, IN EXCHANGE FOR WHICH THEY MUST FREEZE THE RATES OF CORE TELECOMMUNICATIONS SERVICES. SOMETIMES, SUCH AS IN THE CASE IN WEST VIRGINIA, THE TRADE-OFF INCLUDES THE CARRIER SWEETENING THE POT BY PROVIDING ADDITIONAL SOCIAL BENEFITS, SUCH AS FINANCIAL COMMITMENTS TO THE JURISDICTION'S ECONOMIC GROWTH AND WELL BEING OR INVESTMENTS IN

NETWORK MODERNIZATION. WHILE SUPERFICIALLY ATTRACTIVE, THE SOCIAL CONTRACT HAS SERIOUS FLAWS. IT IS, IN MY OPINION, AN OPEN INVITATION TO MONOPOLY CONDUCT WHICH WOULD HAVE A DELETERIOUS EFFECT ON ALL RATEPAYERS UNTIL AND UNLESS STATE COMMISSIONS ARE ABLE TO ESTABLISH MECHANICAL COST ALLOCATION PROCEDURES. THE SOCIAL CONTRACT EFFECTIVELY SEGREGATES THE CAPTIVE CUSTOMERS, AND ALLOWS LOCAL EXCHANGE CARRIERS TO DIMINISH SERVICE IN REGULATED SECTORS IN ORDER TO CONCENTRATE RESOURCES IN UNREGULATED ACTIVITIES. BECAUSE CARRIERS ARE EXPERIENCING DECREASING COSTS IN MANY OF THE ASPECTS OF THEIR OPERATIONS LIKELY TO BE SUBJECT TO REGULATORY FORBEARANCE, IT WOULD BE IN THEIR BEST INTERESTS TO CONCENTRATE AS MUCH OF THEIR AVAILABLE AND FUTURE CAPITAL AS POSSIBLE INTO THE UNREGULATED SECTOR. AS SUCH, IT IS UNCERTAIN WHETHER ADOPTION OF THE SOCIAL CONTRACT IS IN THE BEST INTERESTS OF ALL RATEPAYERS.

FURTHER, IN MOST PROPOSED UNREGULATED MARKETS, INSUFFICIENT COMPETITION EXISTS TO ACT AS AN ADEQUATE SUBSTITUTE FOR REGULATORY OVERSIGHT. SUBSCRIBERS RECEIVING SERVICE ON AN

UNREGULATED BASIS WOULD SUFFER BECAUSE OF THE TREMENDOUS LEVERAGE MONOPOLIST CARRIERS WOULD WIELD. REGARDLESS OF TECHNICAL INNOVATION, LOCAL EXCHANGE CARRIERS RETAIN AT THIS TIME AN EXCLUSIVE FRANCHISE OVER THE LOCAL PUBLIC SWITCHED NETWORK. THERE IS AT PRESENT NO ALTERNATIVE TO LOCAL CARRIERS FOR LARGE SEGMENTS OF THE POPULATION. EVEN IF LARGE BUSINESS CUSTOMERS ARE ABLE TO BYPASS THE LOCAL NETWORK TO OBTAIN INTER- AND INTRA- EXCHANGE TOLL SERVICE, TO COMMUNICATE WITH SUBSCRIBERS TO INTERCONNECTED SHARED TENANT SERVICES, AND TO ACCESS PERSONS SERVED BY LARGE PRIVATE BRANCH EXCHANGES, THERE REMAINS A SOLE SUPPLIER OF SWITCHED PUBLIC SERVICE. TELECOMMUNICATIONS COMPANIES -- PUBLIC UTILITIES -- ENJOYING THIS ENVIABLE POSITION WOULD NO DOUBT TAKE FULL ADVANTAGE OF THEIR ECONOMIC POSITION. THEY DID IN 1910 AND THERE IS NO REASON TO BELIEVE THAT THEY WON'T DO IT NOW. RATES FOR UNFROZEN SERVICES COULD BECOME UNCONSCIONABLY HIGH, AND SERVICE GENERALLY COULD DECLINE.

SOCIAL CONTRACT REGULATION IS ALSO INADEQUATE BECAUSE IT CONFLICTS WITH OUR STATUTORY MANDATE TO ENSURE AND ESTABLISH

REASONABLE AND NONDISCRIMINATORY RATES. IF THE GOVERNMENT ENSURES REASONABLE RATES FOR SOME CARRIER SERVICES, IT MUST, IN MY OPINION, DO SO FOR ALL. IT IS AXIOMATIC THAT THE GOAL OF REGULATION IS TO PROTECT ALL MEMBERS OF SOCIETY FROM THE INEFFICIENCIES OF MONOPOLISTIC PIRACY. EQUITY AND FAIRNESS, THE CORNERSTONES OF OUR UTILITY REGULATION, WOULD APPEAR TO COMPEL THIS CONCLUSION.

LET ME NOW FOCUS ON THE INFAMOUS ALTERNATIVE TO RATE OF RETURN REGULATION, THE FEDERAL COMMUNICATIONS COMMISSION'S PROPOSAL TO EMPLOY PRICE CAPS TO SET RATES FOR AT&T'S INTERSTATE SERVICE AND THE BELL OPERATING COMPANIES' PROVISION OF INTERSTATE EXCHANGE ACCESS SERVICE. AS YOU KNOW ON MAY 23, 1988, THE FCC RELEASED ITS FURTHER NOTICE OF PROPOSED RULEMAKING IN CC DOCKET NO. 87-313 (FURTHER NOTICE). THE FURTHER NOTICE WAS FAR MORE DETAILED AND REPRESENTED, IN MY OPINION, A SIGNIFICANT EFFORT BY THE FCC TO ADDRESS THE CONCERNS RAISED IN LIGHT OF ITS ORIGINAL NOTICE. AS COMMENTERS, INCLUDING THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA, POINTED OUT, HOWEVER, THE FCC'S

PRICE CAP PROPOSAL STILL CONTAINED CERTAIN FLAWS AND WEAKNESSES WHICH NEEDED TO BE ADDRESSED PRIOR TO A DECISION AS TO WHETHER A PRICE CAPS REGIME SERVED THE PUBLIC INTEREST.

IT IS NO SECRET THAT STATE REGULATORS HAVE MADE KNOWN THEIR POSITIONS CONCERNING PRICE CAPS. LED BY OUR ASSOCIATION, THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC), OUR CONCERNS REGARDING PRICE CAPS HAVE BEEN MADE CLEAR TO THE FCC AND TO CONGRESS. LET ME SHARE WITH YOU THE D.C. COMMISSION'S OWN POSITION AND THEN CERTAIN ISSUES RAISED BY OTHER STATES.

OF PARAMOUNT CONCERN TO OUR COMMISSION IS THE QUESTION OF WHETHER PRICE CAPS WILL PRESERVE THE HIGH-LEVEL OF QUALITY WHICH WE, AS NETWORK USERS, ENJOY TODAY. LET ME FIRST SAY, THAT SERVICE QUALITY IS NOT A JURISDICTIONAL ISSUE. THEREFORE, PRIOR TO ANY IMPLEMENTATION OF PRICE CAP, IT IS MY FIRM BELIEF THAT STATE AND FEDERAL REGULATORS SHOULD WORK TOGETHER TO DEVELOP AND PUT IN PLACE A SYSTEM FOR EFFECTIVELY ADDRESSING AND MONITORING SERVICE QUALITY ISSUES. I WOULD SUGGEST TO YOU THAT A GOOD STARTING POINT WOULD BE THE MODEL SERVICE QUALITY RULES ADOPTED

BY NARUC IN 1987.

BUT WHY, YOU MAY ASK, WOULD PRICE CAPS UNDERMINE LEVELS OF SERVICE QUALITY? THE CONCERN IS SIMPLY THAT THE PRICE CAP PROPOSAL, IF IMPLEMENTED, MAY CREATE INCENTIVES TO FORSAKE NETWORK INVESTMENT AND THEREFORE QUALITY, IN ORDER TO INCREASE PROFITS, OR THAT UNDER A PRICE CAP REGIME, THE COMPANIES WILL BEGIN TO OFFER AS A SERVICE, AND PRICE ACCORDINGLY, DIFFERENT LEVELS OF SERVICE QUALITY. ONE DOES NOT HAVE TO BE VERY INTUITIVE TO FIGURE OUT THAT THE RESIDENTIAL CUSTOMERS WOULD FALL IN THE CATEGORY OF POOREST SERVICE. I ALSO HAVE CONCERNS OVER THE USE OF THE GNP-PI AS THE GENERAL INFLATION INDEX. THE D.C. COMMISSION ARGUED THAT THE DEVELOPMENT OF A TELECOMMUNICATIONS-SPECIFIC INDEX SHOULD BE ATTEMPTED. WHILE THE DEVELOPMENT OF SUCH AN INDEX COULD BE TIME CONSUMING AND PROBABLY CONTENTIOUS, DIFFICULTY ALONE SHOULD NOT THWART ITS DEVELOPMENT. SECOND, I HAVE CONCERNS REGARDING NOT ONLY THE 5% BANDING PROPOSAL AND THE EMPIRICAL EVIDENCE SUPPORTING THAT PROPOSAL, BUT ALSO THE VAGUE STANDARDS WHICH THE FCC PROPOSES TO USE TO GOVERN OUT-OF-BAND

PRICING PROPOSALS. FINALLY, I NOTE THAT THE FCC'S DEFINITION OF "NEW SERVICES" IS LOOSELY DEFINED. MY CONCERN IS THAT BECAUSE NEW SERVICES ARE ORIGINALLY KEPT OUT OF THE PRICE CAP FOR ONE YEAR, CARRIERS SUBJECT TO PRICE CAPS MAY BE ABLE TO PRICE OUTSIDE THEIR RESPECTIVE CAPS BY MEANS OF MINIMAL RESTRUCTURING OF CURRENT SERVICE OFFERINGS.

LET ME NOW TOUCH ON A FEW POINTS RAISED BY MY COLLEAGUES REGARDING PRICE CAPS. THESE ISSUES HIGHLIGHT ADDITIONAL CONCERNS WHICH I LIKewise SHARE. THE FIRST ISSUE WAS STATED QUITE CLEARLY IN TESTIMONY BEFORE THE UNITED STATES SENATE PRESENTED ON BEHALF OF NARUC BY DEPUTY CHAIRMAN GAIL GARFIELD SCHWARTZ OF THE NEW YORK PUBLIC SERVICE COMMISSION. IN THAT TESTIMONY SHE RAISES A VERY VALID CONCERN REGARDING THE FCC'S PRODUCTIVITY FACTOR. SHE NOTES THE IRONY THAT THE FCC STRONGLY CRITICIZES THE EFFICIENCY OF RATE OF RETURN REGULATION, YET IT IS THIS MODE OF REGULATION WHICH FORMS THE FOUNDATION FOR THE HISTORICAL PRODUCTIVITY ANALYSIS UPON WHICH THE FCC RELIES TO BASE ITS PRODUCTIVITY FACTOR. SHE CONCLUDES, AND I AGREE, THAT "[I]F THE

INEFFICIENCIES IN THE FORMER REGIME WERE AS GREAT AS CLAIMED, SURELY THE THEORETICALLY MORE EFFICIENT REGIME OF PRICE CAPS SHOULD RESULT IN A HIGHER-THAN-HISTORIC PRODUCTIVITY INCREASE."

SHE ALSO NOTES THAT BECAUSE OF THE POTENTIAL 20% INCREASE IN PRICES OVER THE 4-YEAR TRIAL PERIOD (5% PER YEAR FOR 4 YEARS) AND THE DEGREE OF DISCRETION WHICH THE FCC'S PROPOSAL WOULD PERMIT THE CARRIER TO HAVE OVER THESE INCREASES, THERE IS THE CONCERN THAT CUSTOMERS OF THE LESS ELASTIC SERVICES WILL NOT BE PROTECTED "FROM PRICES FAR ABOVE COST BY THE CONSTRAINTS OF THE COMPETITIVE MARKET." UNDER THIS SCENARIO, I LIKewise AGREE WITH MY COLLEAGUE THAT THERE IS AN INCENTIVE TO DECREASE PRICES FOR THE COMPETITIVE ELASTIC SERVICES WHILE OFFSETTING THESE DECREASES WITH HIGHER PRICES FOR THE LESS ELASTIC SERVICES.

FINALLY, I NOTE THE CONCERNS EXPRESSED BY THE MICHIGAN PUBLIC SERVICE COMMISSION IN ITS JULY 26, 1988 COMMENTS ON THE PRICE CAP PROPOSAL. ONE OF THE CONCERNS EXPRESSED WAS THAT THE PROPOSAL WOULD PRESENT INCENTIVES FOR COMPANIES UNDER INTERSTATE PRICE CAPS TO ALLOCATE MORE COSTS TO THE INTRASTATE ACTIVITIES

WHICH ARE NOT UNDER A PRICE CAP REGIME. THE MICHIGAN COMMISSION'S CONCLUSION THAT SAFEGUARDS NEED TO BE DEVELOPED TO PREVENT THE POTENTIAL FOR COST SHIFTING SHOULD THE FCC ADOPT PRICE CAPS FOR INTRASTATE SERVICES SHOULD LIKEWISE BE FOLLOWED.

WHILE I HAVE NOT TOUCHED ON ALL ISSUES RAISED BY COMMENTERS ON THE FCC'S FURTHER NOTICE, I DO HOPE THAT MY COMMENTS HAVE SUGGESTED WHAT ARE, IN MY OPINION, SOME OF THE MORE CRITICAL CONCERNS PRESENTED BY THE FCC'S PRICE CAP PROPOSAL. ON BALANCE, AND IN LIGHT OF THE LIMITED RISKS ASSOCIATED WITH THE PROPOSAL TO CARRIERS WHICH ELECT THAT ALTERNATIVE, AND THE LACK OF CLEAR-CUT GUARANTIES THAT CONSUMERS WILL BE BETTER OFF UNDER PRICE CAPS, I CONCLUDE AND SUBMIT TO YOU THAT THE FCC'S CURRENT PROPOSED ALTERNATIVE TO RATE OF RETURN IS NOT IN THE PUBLIC INTEREST.

IN LIGHT OF MY REMARKS OF THE PAST FEW MINUTES, IT MAY SURPRISE YOU TO KNOW THAT I AM NOT OPPOSED TO REGULATORY REFORM. I AM AWARE OF THE CHANGES OCCURING IN THE INDUSTRY. I BELIEVE, HOWEVER, THAT CHANGE FOR ITS OWN SAKE IS NOT PROGRESS: IT IS

MERELY THE REPLACEMENT OF ONE FORM OF REGULATION FOR ANOTHER.
BEFORE I WILL SUBSCRIBE TO A PARTICULAR ALTERNATIVE APPROACH, IT
MUST BE PROVEN THAT THE CHOSEN METHOD OF RE-REGULATION WILL
IMPROVE THE OVERALL STATE OF TELECOMMUNICATIONS, THAT IT WILL
INCREASE EFFICIENCIES, YIELD TECHNOLOGICAL INNOVATIONS, CREATE
SUSTAINED PRICE REDUCTIONS, AND THAT BENEFITS WILL APPRECIABLY
EXCEED RISKS. LET US NOT PROCEED WILLY-NILLY INTO RADICAL
REVISIONS TO LONG-STANDING, WELL-KNOWN REGULATORY METHODS ABSENT
ASSURANCES THAT THE DEVIL WE KNOW IS NOT BETTER THAN THE ONE WE
DON'T. I ALSO BELIEVE THAT CHANGE SHOULD PROCEED SLOWLY,
CAUTIOUSLY, ON A SERVICE-BY-SERVICE BASIS, AND ONLY AFTER A
CONVINCING SHOWING THAT IT IS IN THE BEST INTEREST OF CUSTOMERS
AND COMPANY ALIKE.

THANK YOU.