

DOCKET FILE COPY ORIGINAL RECEIVED

APR - 7 1995

BEFORE THE

Federal Communications Commission FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

WASHINGTON, D.C. 20554

In the Matter of)
)
Computer III Further Remand)
Proceedings: Bell Operating)
Company Provision of Enhanced)
Services)

CC Docket No. 95-20

COMMENTS OF COMPUSERVE INCORPORATED

Randolph J. May
Brian T. Ashby
SUTHERLAND, ASBILL & BRENNAN
1275 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2404
(202) 383-0100

April 7, 1995

Its Attorneys

No. of Copies rec'd 044
List ABCDE

TABLE OF CONTENTS

SUMMARY iii

I. INTRODUCTION 2

II. PROCEDURAL BACKGROUND 5

III. DISCUSSION 11

 A. The Commission's Conclusion That California III Returns The BOCs To A Service-By-Service CEI Plan Regime Is Wrong And Could Skew The Outcome Of The Cost/Benefit Analysis Required By The Ninth Circuit 12

 B. The BOCs' Dominance In The Local Exchange Gives Them An Incentive And The Ability To Cross-Subsidize Their Enhanced Service Offerings With Revenues From Their Monopoly Local Exchange Services And Also To Discriminate Against Their Enhanced Service Competitors 16

 C. A Careful, Open-Minded Evaluation Of The Relative Costs And Benefits Of Structural Separation And Nonstructural Safeguards Will Demonstrate That The Benefits Of Structural Safeguards Outweigh Their Purported Costs And That The Commission Should Require Structural Separation For BOC Provision Of Enhanced Services 19

 1. The Benefits Identified By The Commission In Support Of Its Decision To Abandon Structural Separation Are Illusory 23

 2. The Costs Incurred By The BOCs' Enhanced Service Competitors And Their Local Exchange Customers As A Result Of The Commission's Decision To Abandon Structural Separation Are Enormous And Clearly Outweigh The Alleged Benefits Of Integrated BOC Enhanced Service Offerings 26

 a. Examples Of Cross-Subsidization 27

b. Examples Of Discrimination 36

IV. CONCLUSION 49

SUMMARY

With over 2.8 million subscribers to its consumer information services and over 1800 companies that subscribe to its business information services, CompuServe is one of the nation's -- and, indeed, the world's -- leading providers of enhanced services. Because of its interest in the establishment and maintenance of a fair, competitive enhanced services market in which it can obtain the local exchange facilities upon which it presently depends to distribute its enhanced services to its customers, CompuServe has been an active participant in the Computer III proceeding. As it has in the past, CompuServe urges the Commission to require that the BOCs offer enhanced services through fully separate subsidiaries.

In these comments, CompuServe demonstrates that the BOCs -- despite their claims to the contrary -- presently maintain a local exchange monopoly, and that this dominant market power in the local exchange still gives them an incentive and the ability to act anticompetitively toward their enhanced service competitors. Generally, the BOCs' monopoly enables them to cross-subsidize their enhanced services with revenues from their monopoly local exchange services and to discriminate against their competitors in the provision of access to the local exchange.

The record established in this proceeding will show that the potential for BOC cross-subsidization and discrimination is more than just theoretical. Examples of both cross-subsidization and discrimination abound. For instance, the Commission reviewed a number of BOC audits just last month that uncovered irregularities and apparent violations of agency accounting and reporting requirements. The Commission found that the irregularities and apparent violations benefited the BOCs to the detriment of their captive local exchange ratepayers. The Commission said that the BOCs' accounting and record-keeping practices seriously undermined its confidence that the BOC accounts accurately reflect compliance with the Commission's cost assignment and allocation requirements. As shown in these comments, other BOC audits have revealed similar problems. In a recent Southwestern Bell audit, for example, the Commission stated that "neither historical time studies nor any contemporaneous records exist to support the parent's cost allocations to subsidiaries" and that "[o]ur auditing of regulated carriers . . . is severely compromised if we cannot evaluate the cost inputs that form the basis of cost allocations to carrier operations." In any event, a major problem from a competitive perspective with reliance on these audits to uncover cross-subsidization is that the audits almost always are not completed until five or more years after the erroneous cost assignments occur. For competitors, of course, the injury to

their businesses from cross-subsidization long since has been inflicted.

There is also much evidence of access discrimination. For example, the Georgia Public Service Commission found in 1991 that Southern Bell had discriminated against its competitors in connection with the provision of MemoryCall voice-mail service. Indeed, there is a plethora of evidence that BOC entry into the voice-mail market, the principal enhanced services market which the BOCs to date have entered, has been characterized by widespread discrimination. In these comments, CompuServe presents evidence of some of the problems it and others have experienced with regard to the provision, maintenance, and repair of access facilities. It is important, however, for the Commission to keep in mind that the BOCs thus far have not entered the interLATA information services market, so it is not surprising that the bulk of complaints concerning anticompetitive practices have been lodged in the intraLATA enhanced services market, such as the market for voice-mail services.

CompuServe commends the Commission for its expressed willingness to conduct an open-minded examination to determine whether BOC enhanced services should be governed by structural separation or nonstructural safeguards. CompuServe believes that the record compiled in this proceeding will show that, at least until effective competition develops in the local exchange, the benefits of structural separation far outweigh the costs. Structural separation is superior to nonstructural safeguards because it reduces the common transactions between the BOCs' regulated and unregulated operations, highlights those transactions, and makes it easier for BOC employees working on regulated matters to deal with employees of the BOCs' separate subsidiaries on an arm's length basis. Structural separation also has the advantage of being less regulatorily-intrusive and resource-intensive than nonstructural safeguards, and it is becoming more clear each day that the Commission lacks the resources, and realistically cannot expect to obtain additional resources in this era of declining budgets, to implement and oversee nonstructural safeguards in an effective manner.

CompuServe is concerned, however, that the outcome of the Commission's analysis could be skewed by the agency's view that the Ninth Circuit's remand, rather than returning the BOCs to a structural separation regime, merely returns the BOCs to a service-by-service CEI plan regime. This determination constitutes a legal error because it fails to acknowledge that the Ninth Circuit found CEI to be inadequate, by itself, to protect against BOC discrimination and that, for this and other reasons, the Commission's entire nonstructural safeguards regime was vacated and remanded by the court.

Counting the expenses associated with establishing separate subsidiaries as part of the "costs" of structural separation -- the same costs, by the way, which are encountered by non-BOC enhanced service providers and every new business getting started that must hire employees, rent space, buy equipment and the like -- could skew the outcome of the Commission's analysis. The BOCs took a calculated risk when they began providing integrated enhanced services while the Commission's nonstructural safeguards regime still was under review by the Ninth Circuit, and the BOCs should not now be allowed to rely on the "costs" of establishing structurally separate subsidiaries as a justification for continued integration. In light of the two Ninth Circuit orders vacating the Commission's nonstructural safeguards regime, these "costs" should have been incurred -- or at least reasonably expected -- by the BOCs long ago. As such, the starting point for the Commission's analysis must be a recognition that the BOCs currently are governed by structural separation and that structural relief only may be granted if it can be shown that the benefits of abandoning structural separation outweigh the costs of not providing structural relief.

RECEIVED

APR - 7 1995

BEFORE THE

Federal Communications Commission

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

WASHINGTON, D.C. 20554

In the Matter of)
)
Computer III Further Remand) CC Docket No. 95-20
Proceedings: Bell Operating)
Company Provision of Enhanced)
Services)

COMMENTS OF COMPUSERVE INCORPORATED

CompuServe Incorporated ("CompuServe"), by its undersigned attorneys, hereby submits these comments in response to the Notice of Proposed Rulemaking ("NPRM") released by the Federal Communications Commission ("Commission") on February 21, 1995 in the above-captioned proceeding.^{1/} In these comments, CompuServe urges the Commission to require the Bell Operating Companies ("BOCs") to provide enhanced services through structurally separate subsidiaries.^{2/}

^{1/} FCC 95-48 (released February 21, 1995).

^{2/} A report prepared by Hatfield Associates, Inc. is being submitted jointly to the Commission by CompuServe, the Information Technology Association of America ("ITAA"), and MCI under separate cover today. ONA: A Promise Not Realized -- Reprise, Hatfield Associates, Inc. (filed April 7, 1995). The conclusions contained in that report are incorporated by reference into these comments.

I. INTRODUCTION

1. CompuServe is one of the world's leading providers of online information database services. Through its consumer information service, CompuServe provides access to over 2,000 interactive computer-based services. Among other things, these services allow people to: (1) bank, shop, and make travel reservations from their homes; (2) access up-to-the-minute news, weather, financial, and sports information; (3) utilize a host of instructional, educational, scientific, and other reference databases; (4) participate interactively in special interest forums and electronic bulletin boards on a wide-range of subjects; (5) send/receive electronic mail; and (6) access and utilize Internet services. Currently, CompuServe has more than 2.8 million residential, educational, nonprofit, and small business subscribers to its consumer information service. These subscribers reside in over 150 countries. Moreover, approximately 1,800 companies worldwide rely on CompuServe's business information services such as financial transactions processing, electronic data interchange, proprietary business networks, and business electronic-mail.

2. Because of CompuServe's interest in the establishment and maintenance of a fair, competitive enhanced services market and one in which it can obtain the local exchange facilities upon which it is dependent to offer its enhanced services on a nondiscriminatory and reasonable cost basis, CompuServe has been

an active participant throughout the Commission's Computer III proceeding.^{3/} In the past, CompuServe has demonstrated that the BOCs, by virtue of their local exchange monopolies, have an incentive and the ability to cross-subsidize their competitive services, including enhanced services, with revenues from their monopoly local exchange services and also to discriminate in the provision of access to the local exchange. Based on the many examples of cross-subsidization and discrimination involving BOC provision of enhanced and other non-monopoly services, CompuServe has shown that structural separation is the most effective, inexpensive, and least regulatorily-intrusive way to protect the BOCs' enhanced service competitors and local exchange customers from being harmed by cross-subsidization and to protect the BOCs' enhanced service competitors from discrimination. As explained in detail below, recent developments further demonstrate that the Commission's present nonstructural safeguards regime is inadequate to protect the BOCs' customers and competitors, and

^{3/} Amendment of Section 64.702 of the Commission's Rules and Regulations, 104 F.C.C.2d 958 (1986) ("Computer III Phase I Order"), recon., 2 FCC Rcd 3035 (1987) ("Computer III Phase I Reconsideration Order"), further recon., 3 FCC Rcd 1135 (1988), second further recon., 4 FCC Rcd 5927 (1989), Computer III Phase I Order and Computer III Phase I Reconsideration Order vacated sub nom. California v. FCC, 905 F.2d 1217 (9th Cir. 1990) ("California I"); 2 FCC Rcd 3072 (1987) ("Computer III Phase II Order"), recon., 3 FCC Rcd 1150 (1988), further recon., 4 FCC Rcd 5927 (1989), Computer III Phase II Order vacated sub nom. California v. FCC, 905 F.2d 1217 (9th Cir. 1990); Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571 (1991) ("Computer III Remand Order"), vacated in part and remanded sub nom., California v. FCC, 39 F.3d 919 (9th Cir. 1994) ("California III").

that, therefore, the BOCs once again should be required to provide enhanced services through fully separate subsidiaries.

3. It is important to emphasize at the outset, however, that it would be unsound for the Commission to base its determination in this proceeding upon some notion that a certain number of "complaints" about anticompetitive conduct must be filed by BOC competitors in order to trigger a finding that structural separation should be required. As explained in these comments, there have been a number of such complaints filed concerning alleged anticompetitive activity of which CompuServe is aware. Obviously, there are many more complaints filed of which CompuServe is not aware and does not have the time or resources to uncover. Moreover, most competitors of the BOCs do not want to become engaged in a time-consuming and costly public adjudicatory proceeding, particularly one that often would necessitate involvement by that competitor's customers and/or potential customers. Finally, and perhaps most importantly, the BOCs have only recently begun to provide enhanced services within Local Access and Transport Areas ("LATAs") and do not compete in the interLATA enhanced services market. Because the market for most enhanced services are national in scope -- other than the market for voice-mail services where there have been a substantial number of complaints filed by the BOCs' competitors -- one would not necessarily expect at this time to find a large number of complaints concerning anticompetitive practices lodged in the interLATA market.

II. PROCEDURAL BACKGROUND

4. The history behind the NPRM is, of course, long and somewhat tortured. Its roots can be traced back to the Commission's Computer II proceeding.^{4/} In that proceeding, the Commission adopted regulations to govern the provision of enhanced services by the pre-divestiture Bell System.^{5/} Under the Computer II regulatory regime, AT&T was required to provide enhanced services through structurally separate subsidiaries. Among other things, the Computer II regime required that AT&T's separate subsidiaries operate independently and at arm's length by: (1) obtaining all transmission facilities necessary for the provision of enhanced services pursuant to tariff; (2) maintaining their own books of account, employing separate officers, utilizing separate operating, marketing, installation, and maintenance personnel, and utilizing separate computer

^{4/} Amendment of Section 64.702 of the Commission's Rules and Regulations, 77 F.C.C.2d 384 (1980) ("Computer II Order"), recon., 84 F.C.C.2d 50 (1981), further recon., 88 F.C.C.2d 512 (1981), aff'd sub nom. Computer and Communications Indus. Ass'n. v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983), aff'd on second further recon., 56 RR2d 301 (1984).

^{5/} The Commission defines "enhanced services" as:

[S]ervices, offered over common carrier facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information.

See 47 C.F.R. § 64.702(a).

facilities in the provision of enhanced services; (3) developing their own software or contracting with non-affiliated vendors; and (4) reducing to writing any transactions between the separate subsidiaries and AT&T which involved the transfer, either direct or by accounting or other record entries, of money, personnel, resources, other assets, or anything of value.^{6/}

5. After the entry of the Modified Final Judgement ("MFJ"), the Commission decided to extend the structural separation requirement to the BOCs.^{7/} However, the Commission's belief in the need for structural separation to protect against the BOCs' dominance in the local exchange was short-lived. In 1986, the Commission abruptly changed course in the Computer III proceeding and allowed the BOCs to provide enhanced services pursuant to nonstructural safeguards.^{8/} The Commission claimed that, when compared to nonstructural safeguards, the costs of structural separation outweighed the benefits.^{9/}

6. The nonstructural safeguards established by the Commission included cost allocation regulations designed to

^{6/} See 47 C.F.R. § 64.702(c).

^{7/} Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Services by the Bell Operating Companies, 95 F.C.C.2d 1117 (1984) ("BOC Separation Order"), aff'd sub nom. Illinois Bell Tel. and Tel. Co. v. FCC, 740 F.2d 465 (7th Cir. 1984), aff'd on recon., 49 Fed. Reg. 26,056 (1984) ("BOC Separation Reconsideration Order"), aff'd sub nom. N. Am. Tel. Ass'n v. FCC, 772 F.2d 1282 (7th Cir. 1985).

^{8/} Computer III Phase I Order, 104 F.C.C.2d at 964.

^{9/} 104 F.C.C.2d at 1007-08.

minimize the ability of the BOCs to cross-subsidize their enhanced service operations, and other regulations intended to prevent the BOCs from discriminating against competing providers of enhanced services. The cost allocation regulations consisted primarily of procedures for the allocation of joint and common costs associated with the provision of integrated enhanced services,^{10/} and the antidiscrimination regulations generally consisted of two components: (1) Comparably Efficient Interconnection ("CEI") arrangements whereby each BOC was required, pending promised more permanent changes, to provide competitors with connections to the local exchange equal to the connections available to the BOCs' own enhanced service operations;^{11/} and (2) Open Network Architecture ("ONA") whereby each BOC was required to unbundle its basic transmission facilities into individual elements to promote the efficient and innovative use of the local exchange by enhanced service providers.^{12/}

7. The Commission's decision to remove the structural separation requirement was challenged in the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit"). The Ninth Circuit found that the record established during the Computer III

^{10/} See Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, 2 FCC Rcd 1298 (1987), recon., 2 FCC Rcd 6283 (1987), further recon., 3 FCC Rcd 6701 (1988), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

^{11/} Computer III Phase I Order, 104 F.C.C.2d at 1018-59.

^{12/} 104 F.C.C.2d at 1059-68.

proceeding did not support the Commission's assertion that abandoning structural separation would not increase the risk of BOC cross-subsidization and, therefore, the court vacated and remanded the agency's decision.^{13/} On remand, the Commission made modest changes to its nonstructural regime intended to "strengthen" the safeguards against cross-subsidization and reaffirmed its decision to replace structural separation with nonstructural safeguards.^{14/}

8. The Commission's nonstructural safeguard's regime has been reviewed by the Ninth Circuit on two further occasions since the Computer III Remand Order. In the first instance, even though it affirmed a series of the Commission's ONA decisions,^{15/} the court concluded that the Commission had weakened the ONA concept by retreating from its original requirement that the BOCs fundamentally unbundle their local transmission facilities.^{16/} The Ninth Circuit found that the ONA plans approved by the Commission up to that time had not

^{13/} California I, 905 F.2d at 1235.

^{14/} Computer III Remand Order, 6 FCC Rcd at 7575-76.

^{15/} California v. FCC, 4 F.3d 1505 (9th Cir. 1993) ("California II"). The ONA decisions reviewed by the Ninth Circuit in California II were those issued by the FCC after California I. See Filing and Review of Open Network Architecture Plans, 4 FCC Rcd 1 (1988), recon., 5 FCC Rcd 3084 (1990), further order, 5 FCC Rcd 3103 (1990); Computer III Remand Proceedings, 5 FCC Rcd 7719 (1990).

^{16/} California II, 4 F.3d at 1512.

achieved the fundamental unbundling originally envisioned by the agency.^{17/}

9. Next, the Ninth Circuit reviewed the Computer III Remand Order and, as it had in California I, determined that the Commission had not provided a rational basis for the substitution of nonstructural safeguards for structural separation.^{18/} Based on its findings in California II, the court explained that the Commission's original vision of ONA "still has not been achieved."^{19/} The Ninth Circuit reasoned that, because the Commission had found that the CEI regulations -- along with other antidiscrimination regulations -- were not adequate to prevent access discrimination without fully implemented ONA, the Commission had not "explained adequately how its diluted version of ONA will prevent this behavior,"^{20/} and remanded the Computer III Remand Order for reconsideration of the cost/benefit analysis underlying the Commission's decision to replace structural separation with nonstructural safeguards.^{21/}

10. The NPRM responds to the California III decision. In the NPRM, the Commission argues that the Ninth Circuit's remand "generally reinstates the Computer III service-by-service CEI

^{17/} 4 F.3d at 1512.

^{18/} California III, 39 F.3d at 930.

^{19/} 39 F.3d at 929.

^{20/} Id. at 929.

^{21/} Id. at 930.

plan regime."^{22/} Although the court found that CEI -- even in conjunction with the Commission's other antidiscrimination regulations -- is "not adequate to prevent access discrimination,"^{23/} the Commission claims in the NPRM that "California III focused . . . on the decision to move from the CEI plan regime to full structural relief under ONA . . ."^{24/} For this reason, the Commission requests comment on whether its nonstructural safeguards provide the BOCs' enhanced service competitors with sufficient protection -- given the alleged benefits of integrated BOC provision of enhanced services -- to warrant replacing the CEI plan regime with the full structural relief afforded by ONA.^{25/} Moreover, even though beyond the scope of the specific issues that the Commission claims it is

^{22/} NPRM at 9. Similarly, in response to a request for waiver of the structural separation requirement filed by the BOCs soon after the California III decision, the Commission found that the Ninth Circuit's decision returned the BOCs to a service-by-service CEI plan regime. In the Matter of Bell Operating Companies' Joint Petition for Waiver of Computer II Rules, 76 RR2d 1536 (1995) ("BOC Waiver Order"). ITAA filed a petition for reconsideration of the BOC Waiver Order on February 10, 1995. Petition for Reconsideration of the Information Technology Association of America Concerning the Bell Operating Companies' Joint Petition for Waiver of Computer II Rules (filed February 10, 1995). On February 23, 1995, ITAA's petition was put on public notice, and the Commission has accepted comments and reply comments on the petition. Pleading Cycle Established for Comments and Replies on ITAA's Petition for Reconsideration of Interim Waiver for BOC Provision of Enhanced Services, DA 95-346 (released February 23, 1995). To date, the Commission has not taken any action on the petition.

^{23/} California III, 39 F.3d at 930.

^{24/} NPRM at 10.

^{25/} Id. at 11.

required to address under California III, the agency notes that "several parties have raised broader questions about whether our decision to rely on nonstructural safeguards serves the public interest."^{26/} The Commission, therefore, requests comment "on the broader issue of whether some form of structural separation should be reimposed for the provision of enhanced services by the BOCs."^{27/} Specifically, the Commission solicits comment "on the relative costs and benefits of structural and nonstructural safeguards for the provision of enhanced services by the BOCs."^{28/}

III. DISCUSSION

11. CompuServe commends the Commission for its expressed willingness to conduct an open-minded analysis to determine whether BOC enhanced service offerings should be governed by structural separation or nonstructural safeguards. CompuServe believes that the record to be compiled in this proceeding will lead to the conclusion that, at least until effective competition develops in the local exchange, structural separation serves the public interest. This fresh look, however, could be tainted by the Commission's incorrect conclusion that California III, rather than returning the BOCs to a Computer II regime, merely returns

them to a Computer III service-by-service CEI plan regime. This approach indicates that the Commission may have prejudged the outcome of its inquiry into the relative costs and benefits of structural versus nonstructural safeguards. The issue presented by the court's remand is not whether the BOCs should be required to provide enhanced services pursuant to an ONA or CEI plan regime, but whether the BOCs should be accorded any structural relief whatsoever.

A. The Commission's Conclusion That California III Returns The BOCs To A Service-By-Service CEI Plan Regime Is Wrong And Could Skew The Outcome Of The Cost/Benefit Analysis Required By The Ninth Circuit

12. Despite the Commission's conclusion in the NPRM that the California III decision returns the BOCs to a service-by-service CEI plan regime, a review of the Ninth Circuit's decision demonstrates that the Commission's interpretation of California III is wrong and that the decision instead returns the BOCs to a structural separation regime. The invalidity of the Commission's interpretation is demonstrated by the fact that it reached a different conclusion in California I. As with California III, portions of the Commission's decision to replace structural separation with nonstructural safeguards were found by the Ninth Circuit to be arbitrary and capricious in California I, but rather than hold that that decision returned the BOCs to a service-by-service CEI plan regime, the Commission held that California I returned "the Commission to a Computer II

regime."^{29/} While it is true that the Ninth Circuit focused more on the dangers of BOC cross-subsidization in California I and focused more on the dangers of BOC access discrimination in California III, the Ninth Circuit's decision to vacate and remand portions of the Commission's nonstructural safeguards in both California I and California III logically should have been found to have had the same effect on the BOCs in both cases.

13. Moreover, the Commission's conclusions regarding the effect of California III are wrong because they seem to rest on the erroneous assumption that the CEI regime was not vacated by the Ninth Circuit because CEI does not provide the BOCs with "full" structural relief. For example, the NPRM contains numerous references to the Ninth Circuit's vacation of those portions of the Computer III Remand Order that provide "full structural relief . . . [emphasis added]"^{30/} or that "totally lift structural separation . . . [emphasis added]." ^{31/} The implication of the Commission's interpretation is that the Ninth Circuit drew a distinction between the "full" or "total" structural relief afforded by ONA and the less "full" or "total" structural relief afforded by CEI. No such distinction, however, was drawn by the court.

^{29/} Bell Operating Companies' Joint Petition for Waiver of Computer II Rules, 5 FCC Rcd 4714, 4714 (1990).

^{30/} NPRM at 9 and 24.

^{31/} NPRM at 3, n. 5.

14. Under the nonstructural safeguards regime, structural separation is "lifted" as to a given enhanced service under both CEI and ONA. In the Computer III Remand Order, the Commission discussed its experience with the unseparated provision of BOC enhanced services under CEI and characterized that situation as the "removal of structural separation requirements."^{32/} In other words, BOC provision of enhanced services pursuant to CEI, not just ONA, constitutes the "lifting" of structural separation. The Commission's attempt at drawing a distinction between CEI and ONA, at least in terms of the litigation posture of the instant proceeding, cannot withstand analysis.

15. The Commission is mistaken in its assertion that California III vacated ONA but upheld CEI. While it is true that the Ninth Circuit acknowledged differences between CEI and ONA, it did not exempt the former from its vacation of portions of the Computer III Remand Order. In fact, the Ninth Circuit specifically found that CEI, without fully implemented ONA, is "not adequate to prevent access discrimination."^{33/} Accordingly, the court's remand did not return the BOCs to a service-by-service CEI plan regime, but rather, vacated and remanded the Commission's nonstructural safeguards regime, including both ONA and CEI, in toto. In so doing, California III, like California I, returned the BOCs to a structural

^{32/} Computer III Remand Order, 6 FCC Rcd at 7575.

^{33/} California III, 39 F.3d at 929-30.

separation regime. The Commission's finding to the contrary constitutes a legal error.^{34/}

16. CompuServe's reasons for objecting to the Commission's erroneous interpretation of California III are more than academic because the agency's interpretation indicates that it may have prejudged the outcome of its inquiry into the relative costs and benefits of structural and nonstructural safeguards.^{35/} The starting point for that inquiry must be that the BOCs currently are governed by structural separation and that they may only be afforded structural relief if the benefits of doing so outweigh the costs. In other words, the issue presented by the court's remand is not whether the BOCs should be required to provide enhanced services pursuant to ONA or CEI, but whether the BOCs should be accorded any relief from structural separation whatsoever.

^{34/} The Commission's erroneous interpretation of California III was discussed in detail by MCI in its comments on ITAA's petition for reconsideration of the BOC Waiver Order. Comments of MCI Telecommunications Corporation in Support of the ITAA Petition for Reconsideration (filed March 15, 1995). Rather than repeat all of the arguments made by MCI, CompuServe incorporates those arguments by reference into these comments.

^{35/} The Commission's flawed reading of the Ninth Circuit's decision thus far also has enabled the Commission to allow the BOCs to continue providing integrated enhanced services without obtaining a waiver of the structural separation requirements established in the Computer II proceeding. See BOC Waiver Order, 76 RR2d at 1537.

B. The BOCs' Dominance In The Local Exchange Gives Them An Incentive And The Ability To Cross-Subsidize Their Enhanced Service Offerings With Revenues From Their Monopoly Local Exchange Services And Also To Discriminate Against Their Enhanced Service Competitors

17. Any analysis of the relative merits of structural separation and nonstructural safeguards must start with a recognition of the BOCs' near total domination of their respective local exchange markets. This fact has been recognized repeatedly by the Commission, Congress, the courts, state regulatory agencies, and telecommunications industry experts. For instance, one of the findings made in the comprehensive telecommunications reform legislation introduced in the Senate on March 23, 1995 by Senator Pressler (R-SD) is that "[l]ocal telephone service is predominantly a monopoly service."^{36/} Likewise, Assistant Attorney General Bingaman observed recently that the BOCs "still carry more than 99 percent of local traffic in their respective areas."^{37/} Indeed, the Ninth Circuit referred to the BOCs' local exchange monopolies in California

^{36/} S. 652, 104th Cong., 1st Sess., § 5 (1995).

^{37/} Speech of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, Department of Justice, Before the Network Economy Conference USA at 9 (September 26, 1994). Similarly, during recent testimony before the House Energy and Commerce Committee, Ms. Bingaman stated that:

[D]espite some gradual erosion of the monopoly held by local exchange carriers, in the majority of markets today, local exchange carriers maintain control over the essential facilities needed for the provision of telephone service.

H.R.Rep. 103-560, 103rd Cong., 2d Sess. at 37-39 (1994).

III.^{38/} It, therefore, is indisputable that the BOCs still have local exchange monopolies in their respective service areas.^{39/}

18. CompuServe's own situation exemplifies the extent of the BOCs' local exchange market dominance at present. In its response to the BOCs' request for waiver of the MFJ's interexchange restriction to provide interLATA enhanced services, CompuServe stated that it was completely dependent on the BOCs to deliver enhanced services to its subscribers.^{40/} In an affidavit attached to the CompuServe Opposition, Vicki Rutkowski, Manager of CompuServe's Network Operations, indicated that "to the best of my knowledge and belief, in areas served by the

^{38/} California III, 39 F.3d at 923 ("[The] network [used by enhanced service providers to distribute their services] is controlled by the [BOCs] that maintain monopolies over local telephone service . . .").

^{39/} It is worth noting that the monopoly position of the BOCs continues to be buttressed by state statutes or regulations that limit local exchange competition. The following states have legal restrictions on the ability of competing companies to enter the local exchange market: Alabama; Alaska; Arizona; Arkansas; California; Colorado; Delaware; Florida; Georgia; Hawaii; Idaho; Indiana; Kansas; Kentucky; Louisiana; Maine; Mississippi; Missouri; Nebraska; Nevada; New Hampshire; New Jersey; New Mexico; North Carolina; North Dakota; Ohio; Oklahoma; Oregon; Pennsylvania; Rhode Island; South Carolina; South Dakota; Tennessee; Texas; Utah; Vermont; Virginia; West Virginia; and Wyoming. Some of these states allow competitive provision of special access service, but prevent competitive provision of switched access service. Most states continue to prohibit both. See Report on the State of Competition in Intrastate Telecommunications, National Association of Regulatory Utility Commissioners at 203-05 (September 1, 1994).

^{40/} Opposition of CompuServe Incorporated to the Motion of the Bell Companies for a Waiver of the Interexchange Restriction to Permit Them to Provide Information Services Across LATA Boundaries at 5 (filed October 29, 1994) ("CompuServe Opposition").

[BOCs], CompuServe relies exclusively on the [BOCs] for the local telephone facilities used to provide its services."^{41/} To this day, CompuServe remains almost totally dependent on the BOCs' local exchange facilities for the distribution of its services in the areas served by the BOCs.

19. The fact that the BOCs still have local exchange monopolies in their respective service areas provides them with a powerful incentive, as well as the ability, to cross-subsidize their enhanced service operations and discriminate against their enhanced service competitors.^{42/} Cross-subsidies can take many forms. These include: (1) revenue shifts between the BOCs' local exchange activities and their enhanced service operations; (2) personnel transfers between local exchange and enhanced service operations; and (3) use of customer proprietary network information and regulated local exchange marketing resources to assist enhanced service operations.^{43/} Discrimination also can

^{41/} Affidavit of Vicki E. Rutkowski Concerning the Opposition of CompuServe Incorporated to the Motion of the Bell Companies for a Waiver of the Interexchange Restriction to Permit Them to Provide Information Services Across LATA Boundaries at 2 (October 27, 1993) ("Rutkowski Affidavit").

^{42/} In California I, the Ninth Circuit concluded that the BOCs "can effectively subsidize their unregulated enhanced services business by misallocating costs to ordinary telephone service." California I, 905 F.2d at 1235. Similarly, in California III, the Ninth Circuit found that the BOCs "have the incentive to discriminate and the ability to exploit their monopoly control over the local networks to frustrate regulators' attempts to prevent anticompetitive behavior." California III, 39 F.3d at 929.

^{43/} See The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, Economics and Technology, Inc./Hatfield (continued...)

take many forms. Among these are: (1) various forms of restrictions which impair the ability of enhanced service competitors to interconnect with the local exchange; (2) unequal treatment in terms of the installation, maintenance, and repair of local exchange facilities; (3) restrictions on the resale of services to enhanced service competitors; and (4) strategic pricing targeted at enhanced service competitors.^{44/} As will be demonstrated below, concerns about anticompetitive cross-subsidization and discrimination are more than theoretical.

C. A Careful, Open-Minded Evaluation Of The Relative Costs And Benefits Of Structural Separation And Nonstructural Safeguards Will Demonstrate That The Benefits Of Structural Safeguards Outweigh Their Purported Costs And That The Commission Should Require Structural Separation For BOC Provision Of Enhanced Services

20. The record to be established in this proceeding will demonstrate conclusively that the costs of replacing structural separation with nonstructural safeguards outweigh the benefits and that separate subsidiaries should be required for the BOCs' enhanced service operations.^{45/} The nonstructural safeguards established by the Commission during the Computer III proceeding

^{43/} (...continued)
and Associates, Inc. at xx (February 1994) ("Enduring Local Bottleneck").

^{44/} Enduring Local Bottleneck at xxi.

^{45/} Note that this formulation of the analysis to be conducted by the Commission more accurately reflects the correct legal posture of the instant remand proceeding in terms of what should be the current in-place regime. See ¶ 15 supra.