

-- as evidenced by the many examples of BOC cross-subsidization and discrimination described below -- simply are inadequate, without more, to protect the BOCs' enhanced service competitors and their captive local exchange customers. At present, structural separation provides the only effective way to guard against cross-subsidization and discrimination.

21. There are a number of reasons why structural separation is superior to nonstructural safeguards. First and foremost, by separating the BOCs' regulated local exchange activities from their unregulated enhanced service operations, structural separation eliminates many joint and common costs. As a result, it minimizes the need for difficult and, often, arbitrary cost allocations and, thereby, reduces the opportunity for cross-subsidization. Structural separation also deals much more effectively with the BOCs' ability to manipulate the availability, installation, maintenance, repair, and quality of their basic transmission facilities. By requiring the BOCs' separate subsidiaries to utilize basic transmission facilities on the same basis as their enhanced service competitors, structural separation not only helps ensure nondiscriminatory access to the BOCs' basic transmission facilities, but it also promotes cost-based pricing. Moreover, structural separation addresses the "human factor" by making it easier for BOC employees working on matters related to regulated local exchange activities to deal with employees of their separate subsidiaries on an arm's length basis.

22. Another reason why structural separation is superior is that it would help protect BOC competitors and customers with a minimum of Commission involvement. Unlike the extensive and ongoing regulatory oversight required by the Commission's existing nonstructural safeguards, structural separation would not require that the Commission actively and regularly monitor the BOCs' enhanced service subsidiaries. Given current budgetary constraints and the pressure on the size of the Commission's workforce, regulatory mechanisms such as structural separation that would limit the Commission's oversight responsibilities while increasing the protections afforded American consumers and businesses should be given serious consideration.

23. The advantages of structural separation have been recognized in a number of forums. For instance, during the Computer II proceeding, the Commission succinctly summarized the advantages of structural separation as follows:

Where a carrier has the incentive and ability to engage in sustained cross-subsidization, or predatory pricing, [nonstructural safeguards] may be employed to assist in the identification of such practices, but it cannot prevent the misallocation of joint and common costs associated with the provision of basic and enhanced services if provided by the same entity. On the other hand, the separation requirement serves as a structural check on the proper allocation of costs between basic and enhanced services.<sup>46/</sup>

Similarly, in the BOC Separation Reconsideration Order, the Commission observed:

Structural separation reduces the common transactions between providers of basic services and affiliated providers of competitive offerings, and highlights

---

<sup>46/</sup> Computer II Order, 77 F.C.C.2d at 464.

transactions, such as the flow of funds, transfers of information, and the procedures for accomplishing interconnection by affiliated vendors.<sup>47/</sup>

24. The advantages of structural separation also have been recognized elsewhere. For example, the comprehensive telecommunications reform legislation recently introduced in the Senate contains a provision that would require the BOCs to provide most enhanced services through a structurally separate subsidiary.<sup>48/</sup> In addition, Assistant Attorney General Bingaman recently advised the Senate that the most effective and only proven way to limit the ability of the BOCs to misuse their control over the local exchange -- short of outright exclusion from the enhanced services market -- is to require the BOCs to provide enhanced services through separate subsidiaries.<sup>49/</sup> The courts too have commented favorably on structural separation:

It is generally agreed that if the [BOCs] conducted competitive activities through separate subsidiaries, intracompany transactions would become more apparent and thus cross-subsidization and other anticompetitive conduct could more easily be prevented or rectified.<sup>50/</sup>

---

<sup>47/</sup> BOC Separation Reconsideration Order, 49 Fed. Reg. at 26,059.

<sup>48/</sup> S. 652, 104th Cong., 1st Sess., § 102 (1995).

<sup>49/</sup> See Statement of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, Department of Justice, Before the Committee on Commerce, Science and Transportation, United States Senate at 13 and 22 (March 2, 1995).

<sup>50/</sup> United States v. W. Elec. Co., Inc., 592 F.Supp. 846, 870-71 (D.D.C. 1984).

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

25. In the NPRM, the Commission indicates that one of the reasons identified during the Computer III proceeding for its abrupt shift concerning the costs and benefits of structural separation was that "structural separation hurts consumers by creating inefficiencies and slowing or preventing the development of enhanced services . . ." <sup>51/</sup> In addition, the Commission indicates in the NPRM that any assessment of the costs and benefits of requiring BOC provision of enhanced services through structurally separate subsidiaries must "include a recognition that all the BOCs are currently offering some enhanced services on a structurally integrated basis subject to their approved ONA plans." <sup>52/</sup> The Commission claims that requiring the BOCs to utilize separate subsidiaries at this time would impose certain transitional costs on the BOCs and, therefore, could result in service disruptions and customer confusion. <sup>53/</sup> Recent experience, however, demonstrates that whatever benefits have resulted from the Commission's abandonment of structural separation are de minimis when compared to the costs.

26. The benefits of integrated BOC enhanced service offerings identified by the Commission are largely illusory. To

---

<sup>51/</sup> NPRM at 25.

<sup>52/</sup> Id. at 27.

<sup>53/</sup> Id.

begin with, the "inefficiencies" referred to by the Commission during the Computer III proceeding as justification for abandonment of structural separation are nothing more than use by the BOCs of their local exchange monopolies to promote their own enhanced services by means of cross-subsidization and discrimination. The Commission recognized as much in the BOC Separation Order when it noted that the efficiencies gained by the BOCs through use of their monopolies, rather than competitive factors, does not come without substantial expense.<sup>54/</sup> To put things in terms of a cost/benefit analysis, the "cost" of lost BOC efficiencies resulting from structural separation is actually the benefit of avoiding the anticompetitive abuses which are inherent in a unified monopoly/non-monopoly regulatory structure.

27. The illusory nature of the "benefits" associated with nonstructural safeguards were illustrated in a report prepared by Dr. Lee Selwyn in November 1991.<sup>55/</sup> The Selwyn Report analyzed a number of ex parte letters submitted by the BOCs to the Commission purporting to identify the costs of establishing separate subsidiaries for the provision of enhanced services. Of the two general cost categories identified by the BOCs in their ex parte submissions, the Selwyn Report concluded that the first

---

<sup>54/</sup> BOC Separation Order, 95 F.C.C.2d at 1138. The Commission concluded that the relative inefficiencies of separate subsidiaries "should be tolerated in light of the public interest benefits which could be derived from compliance with separation conditions." 95 F.C.C.2d at 1130.

<sup>55/</sup> L. Selwyn, The Costs of Separate Subsidiaries, Economics and Technology, Inc. (November 1991) ("Selwyn Report").

category consisted of costs universally associated with start-up ventures, such as the cost of acquiring facilities and personnel, and that the second category consisted of costs resulting from the loss of joint marketing and consolidated customer service opportunities achievable only by virtue of the BOCs' local exchange monopolies.<sup>56/</sup> In other words, the Selwyn Report demonstrated that the principal "benefits" to the BOCs of structural relief arise not from physical integration of enhanced facilities with basic services, but from exploitation by the BOCs of their monopoly position and the regulatory advantages attendant to that position.<sup>57/</sup>

28. Importantly, the extent to which requiring the BOCs to provide enhanced services through structurally separate subsidiaries would impose transition costs on the BOCs should not be considered by the Commission when evaluating the relative merits of structural and nonstructural safeguards. The BOCs took a calculated risk by integrating their enhanced service operations while the lawfulness of the Commission's nonstructural safeguards regime was under review by the Ninth Circuit, and in the event structural separation again is required, any costs incurred by the BOCs as a result of their informed decision should be absorbed by them.<sup>58/</sup> The costs of compliance with

---

<sup>56/</sup> Selwyn Report at 1.

<sup>57/</sup> Id. at 7-8.

<sup>58/</sup> The Commission and the courts have held that, to the extent an entity relies on a decision of the Commission which is subject  
(continued...)

structural separation, which should have been incurred by the BOCs long ago, cannot now be used as justification for continued application of the Commission's nonstructural safeguards regime. To do so would, in effect, render judicial review meaningless.

**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**

29. While the benefits of the nonstructural safeguards regime are largely illusory, the costs to the BOCs' enhanced service competitors and their captive local exchange customers are enormous. The examples of anticompetitive conduct described below illustrate the inadequacy of nonstructural safeguards to protect against cross-subsidization and discrimination.

---

<sup>58/</sup> (...continued)

to reversal on appeal, it does so at its own risk. For instance, in a decision involving the transfer of a television license prior to judicial review, the Commission concluded that entities which close a transaction approved by it "prior to administrative or judicial review of the decision exercise their independent business judgement and proceed at their own risk with the full understanding that they may ultimately be required to undo the transaction." Application of Improvement Leasing Company and Taft Broadcasting Company for Consent to the Transfer of 100% Control of Channel 20, Incorporated, Licensee of WDCA-TV (Ch. 20), Washington, D.C., 73 F.C.C.2d 676, 684 (1979). The United States Court of Appeals for the Tenth Circuit reached a similar conclusion in a case involving a dispute over grant of a construction certificate for a cable system. Cablevision of Texas III v. Oklahoma W. Tel. Co. and Star Search Rural Television Co., 993 F.2d 208, 210 (10th Cir. 1993) (the court noted that the defendants "concede that they proceed with construction at their own risk; their investment would be lost if the [Commission], or an appellate court reviewing the agency action, were later to reverse the granting of the certificate.").

**a. Examples Of Cross-Subsidization**

30. While the focus of the NRPM is primarily on access discrimination, the Commission appropriately requests comment more basically on all issues relevant to the public interest, including cross-subsidization. Examples of BOC cross-subsidization are prevalent.

31. Early last month, the Commission released a number of decisions that identified numerous instances of apparent cross-subsidization and other violations involving each of the BOCs.<sup>59/</sup> At the direction of the Commission, the National Exchange Carrier Association hired Ernst and Young to conduct audits of BOC-reported adjustments to the Common Line revenue pool for 1988 and the first quarter of 1989. In the seven decisions referred to above, the Commission reviewed each of these audits and found numerous accounting irregularities and apparent violations of its accounting and reporting requirements. These apparent violations, among other things, involve the Commission's jurisdictional separations regulations, misclassifications of revenue, widespread documentation problems,

---

<sup>59/</sup> See The Ameritech Operating Companies, FCC 95-72 (released March 3, 1995) ("Ameritech Audit"); The Bell Atlantic Telephone Operating Companies, FCC 95-73 (released March 3, 1995) ("Bell Atlantic Audit"); The BellSouth Telephone Operating Companies, FCC 95-74 (released March 3, 1995); The NYNEX Telephone Operating Companies, FCC 95-75 (released March 3, 1995) ("NYNEX Audit"); Pacific Bell, FCC 95-76 (released March 3, 1995); Southwestern Bell Telephone Company, FCC 95-77 (released March 3, 1995) ("Southwestern Bell Audit"); US West Communications, Inc., FCC 95-78 (released March 3, 1995) ("US West Audit").

and clerical errors. In the aggregate, the Commission indicated that the BOCs' apparent violations benefited them to the detriment of their customers.<sup>60/</sup> Accordingly, the Commission required each BOC to show cause why it should not: (1) issue Notices of Apparent Liability for the apparent violations found in the audits; and (2) require the BOCs to adjust their price cap indexes to reflect the apparent violations.<sup>61/</sup> The Commission also required many of the BOCs to show cause why they should not bring their internal accounting processes into compliance with the Commission's requirements.<sup>62/</sup>

32. The apparent violations found in the audits cast considerable doubt on the efficacy of the Commission's nonstructural safeguards regime. Indeed, some of the apparent violations involve instances of BOC cross-subsidization. For instance, the US West Audit uncovered an apparent violation of the Commission's cost allocation requirements. Between January 1988 and August 1988, the Commission found that US West apparently assigned unregulated rent revenues to its regulated operations and, as a result, its Common Line expenses for that

---

<sup>60/</sup> See e.g., US West Audit, FCC-95-78 at 4.

<sup>61/</sup> See e.g., Southwestern Bell Audit, FCC 95-77 at 1. Disturbingly, the Commission indicated that the apparent violations identified in the audits occurred so long ago that the statute of limitations for some of the apparent violations may have tolled. See e.g., US West Audit, FCC 95-78 at 7.

<sup>62/</sup> See e.g., US West Audit, FCC 95-78 at 2.

period were overstated for some states and understated for others.<sup>63/</sup> The Commission noted that:

The findings reveal the US West carriers' failure to maintain their accounts, records, and memoranda in the manner prescribed by the Commission. To the extent that this conduct has continued, it must seriously undermine the Commission's confidence that US West's accounts accurately reflect Commission-mandated accounting practices and reveal the true and lawful costs of US West's interstate services.<sup>64/</sup>

33. Other apparent violations involve sloppy accounting procedures or lack of documentation for various cost allocations. For example, in the Bell Atlantic Audit, the Commission found that Bell Atlantic could not provide adequate documentation to support various adjustments to its cost allocations. In total, the Commission identified 14 undocumented adjustments made by Bell Atlantic between January 1988 and March 1989.<sup>65/</sup>

34. In its review of each of the audits, the Commission stated that enforcement of its accounting and reporting requirements are essential and indicated that its ability to enforce those requirements "is impaired if we cannot rely upon the information the carriers are required to submit about the costs of their operations and their allocations of those

---

<sup>63/</sup> US West Audit, FCC 95-78, Attachment A at 12.

<sup>64/</sup> FCC 95-78 at 4. The Commission made similar findings during its review of the other audits. See e.g., Ameritech Audit, FCC 95-72 at 4.

<sup>65/</sup> Bell Atlantic Audit, FCC 95-73, Attachment A at 7-8.

costs . . ."<sup>66/</sup> The Commission also observed that the apparent violations:

[S]hifted costs between or among access elements, thus apparently overstating or understating US West's interstate revenue requirements for particular services. The seriousness of the misstatements is compounded here not only because of the net impact and the extent of understatements and overstatements, but also because of the scope of the errors or apparent violations and the fact that some of them may have continued to the date of this [decision].<sup>67/</sup>

One of the benefits of structural separation is that it reduces the need for and reliance upon the sorts of judgmental cost allocations and record keeping requirements at issue in the audits.

35. Taken together, 100 apparent violations are identified in the audits and, in each case, the Commission noted that the apparent violations may have continued beyond the audit period. In total, the audits indicate that the BOCs misstated or misallocated approximately \$120 million in interstate costs and revenues during the audit period. To put this figure in perspective, the amount apparently misstated or miscalculated by the BOCs is approximately equal to CompuServe's total revenues -- \$154 million -- for the three month period ending January 31, 1995. While it is true that the Commission now has uncovered these apparent violations -- seven years after the fact -- it

---

<sup>66/</sup> US West Audit, FCC 95-78 at 2. Similar statements were made by the Commission during its review of the other audits. See e.g., Bell Atlantic Audit, FCC 95-73 at 2.

<sup>67/</sup> US West Audit, FCC 95-78 at 4. Similar statements were made by the Commission during its review of some of the other audits. See e.g., NYNEX Audit, FCC 95-75 at 4.

appears that the apparent violations have continued beyond the audit period, and as indicated above, some of the apparent violations occurred so long ago that the statute of limitations may have tolled. More importantly, even if the injury to the BOCs' captive local exchange customers can be alleviated to some extent by rate reductions, the Commission cannot undo anticompetitive injury already inflicted on the BOCs' competitors.

36. Similar cost-shifting has been found in other BOC audits. For example, on the same day that the aforementioned audits were released, the Commission released its review of a federal-state joint audit of transactions between Southwestern Bell and its affiliates during the time period 1989 to 1992.<sup>68/</sup> This audit also found numerous apparent violations of the Commission's regulations. These apparent violations involve the accounting methodologies employed by Southwestern Bell and the practices used by it to book charges for services provided to it by its affiliates. Specifically, the Commission's review of the federal-state joint audit, among other things, revealed that Southwestern Bell's records are not adequate to properly audit the charges Southwestern Bell's parent billed it for management services. The Commission indicated that "neither historical time studies nor any contemporaneous records exist to support the

---

<sup>68/</sup> Southwestern Bell Telephone Company, FCC 95-31 (released March 3, 1995) ("Second Southwestern Bell Audit").

parent's cost allocations to subsidiaries,"<sup>69/</sup> and noted that "[o]ur auditing of regulated carriers like [Southwestern Bell] is severely compromised if we cannot evaluate the cost inputs that form the basis of cost allocations to carrier operations."<sup>70/</sup> All together, the audit reviewed by the Commission concluded that Southwestern Bell's captive local exchange customers "may have been burdened by a potential \$92.4 million in overallocations resulting from transactions with [its parent] during the period 1989-1992."<sup>71/</sup>

37. The Commission's review of the federal-state joint audit also found apparent violations involving transactions between Southwestern Bell and its unregulated real estate affiliate. These apparent violations involve possible improper charges by the real estate affiliate to Southwestern Bell.<sup>72/</sup> Accordingly, the Commission required Southwestern Bell to show cause why: (1) a Notice of Apparent Liability should not be issued against it for the apparent violations found in the audit; and (2) its accounting practices should not be brought into conformity with the Commission's regulations.<sup>73/</sup> Again, the long time lag between the period being audited and the completion

---

<sup>69/</sup> Second Southwestern Bell Audit, FCC 95-31 at 4.

<sup>70/</sup> FCC 95-31 at 5.

<sup>71/</sup> Review of Affiliate Transactions at Southwestern Bell Telephone Company, Five States Regulatory Commissions and Federal Communications Commission Joint Audit Team at D-23 (May 1994).

<sup>72/</sup> Second Southwestern Bell Audit, FCC 95-31 at 10.

<sup>73/</sup> FCC 95-31 at 1-2.

of the audit should be noted. To the extent that cost-shifting is designed to undercut the viability of BOC competitors, the injury typically has long since occurred by the time the audit is performed.

38. Another recent example of cross-subsidization involves GTE.<sup>74/</sup> The Commission and GTE entered into a consent decree last year following an audit of business transactions between GTE and two of its enhanced service affiliates that occurred between 1988 and 1990. According to the findings, the prices charged by GTE's unregulated enhanced service affiliates to GTE's regulated operations "were unlawfully excessive."<sup>75/</sup> The reason for this was that GTE's enhanced service affiliates did not use prices charged to third parties to set prices for GTE. Apparently, GTE recorded the full excessive charges for the services provided by its unregulated affiliates as regulated costs, and passed those costs along to its captive local exchange customers.<sup>76/</sup> Among other things, the consent decree required GTE to: (1) lower its common carrier line charge on April 15, 1994 by \$49.5 million on an annualized basis from the charge in effect on July 1, 1993;

---

<sup>74/</sup> The GTE Telephone Operating Companies, 9 FCC Rcd 2594 (1994) ("GTE Consent Decree"). Given the fact that GTE has a local exchange monopoly in its service areas like the BOCs and that GTE is often referred to by the BOCs as an example of why separate subsidiaries are not needed, the Commission's findings in the GTE Consent Decree are relevant to a consideration of potential BOC cross-subsidization.

<sup>75/</sup> Staff Summary of Audit Findings at 3 (released April 8, 1994).

<sup>76/</sup> GTE Consent Decree, 9 FCC Rcd at 2594.

(2) make a permanent downward adjustment of \$14 million to its price cap index for the common line basket on April 15, 1994; and (3) contribute \$350,000 to the United States Treasury.<sup>77/</sup>

Obviously, enhanced service providers competing against GTE during the period covered by the audit were disadvantaged competitively by the cross-subsidization.

39. The foregoing audits reveal the many problems inherent in the Commission's nonstructural safeguards regime. For one thing, as mentioned above, they show that the lag time between when cross-subsidies occur and when they are detected by the Commission typically is so great that the injury to competitors can never be redressed. Moreover, the audits demonstrate the extent to which effective implementation of the Commission's nonstructural safeguards regime is dependent on the willingness of the BOCs to police themselves.<sup>78/</sup> The Commission admitted as much in its recent decisions responding to the audits of all seven BOCs performed by Ernst and Young when it indicated that its ability to enforce its accounting and reporting requirements

---

<sup>77/</sup> 9 FCC Rcd at 2594-95.

<sup>78/</sup> The BOCs realistically cannot be expected to be enthusiastic about policing themselves. This was illustrated by a recent statement of Gary McBee, chairman of the Alliance for Competitive Telecommunications, a coalition of the BOCs, concerning the Commission's requirements for assigning costs between jurisdictions. He said that "[t]here is absolutely no need for [jurisdictional separations]." Daily Report for Executives, Regulations, Economics and Law Section at A-42 (March 29, 1995). While Mr. McBee's statement was made in the context of the debate in the Senate last month over comprehensive telecommunications reform legislation, it displays a rather cavalier attitude regarding the purpose of cost allocation requirements.

is impaired if it cannot rely on the information the BOCs submit concerning the costs of their operations and their allocations of those costs. This admission demonstrates just how shallow the protections afforded by the Commission's nonstructural safeguards regime really are. When the amounts of money to be allocated among lines of businesses are in the tens of millions and depend on judgement factors such as relative use and allocation of time spent on various activities, it is asking too much of human nature to hope that people will take the initiative and police themselves.

40. Even if the Commission's nonstructural safeguards regime theoretically were effective at preventing cross-subsidies, the agency lacks the resources to enforce properly its regulations. In 1987, the General Accounting Office ("GAO") reported that the Commission could not control cross-subsidization because it lacked the resources to audit more than one BOC every 16 years.<sup>79/</sup> A follow-up report, issued in 1993, found that the situation had worsened:

In 1987, we reported that FCC had insufficient staff to ensure that consumers were protected from cross-subsidization. Since that time, FCC's responsibility for overseeing carriers' cost allocations have continued to grow, but the staff resources have declined rather than increased. We believe the number of FCC auditors remains

---

<sup>79/</sup> Controlling Cross-Subsidy Between Regulated and Competitive Services, GAO Report to the Chairman, Subcommittee on Telecommunications and Finance, United States House of Representatives, GAO/RCED-88-34 (October 1987).

inadequate to provide a positive assurance that rate payers are protected from cross-subsidization.<sup>80/</sup>

GAO estimated that the Commission would have to more than triple the size of its audit staff in order to audit each BOC once every five years. Surely, the resources the Commission has allocated for this function have not increased since 1993. Indeed, they probably have declined further.

41. Chairman Hundt said as much in Congressional testimony last year when he indicated that the size of the Commission's staff today is lower than it was in 1980. As a result, he stated bluntly that "[t]here is simply not enough staff for the Commission to do the work envisioned by Congress."<sup>81/</sup> Given the fact that nonstructural safeguards require extensive regulatory oversight, it is unlikely that the Commission currently has the resources needed to effectively enforce its nonstructural safeguards regime.

#### **b. Examples Of Discrimination**

42. There is no shortage of examples of BOC discrimination against their enhanced service competitors. Indeed, CompuServe's own experience exemplifies the ways in which the BOCs can

---

<sup>80/</sup> FCC's Oversight To Control Cross-Subsidization, GAO Report to Congressional Requesters, GAO-RCED-93-94 (February 1993).

<sup>81/</sup> Statement of Reed E. Hundt, Chairman of the Federal Communications Commission, Before the Subcommittee on Telecommunications and Finance, United States House of Representatives at 6 (May 26, 1994).

discriminate against their enhanced service rivals -- if they want to. A summary of CompuServe's experience in this regard was presented to the MFJ court in the above-referenced Rutkowski Affidavit.<sup>82/</sup> The Rutkowski Affidavit lists numerous examples of BOC actions, or inactions, which have delayed or degraded the receipt of adequate local exchange service, including: (1) missed or unilaterally changed facility installation and repair dates; (2) failure to order or maintain necessary facility equipment; (3) attempted installation of facility equipment at wrong CompuServe sites; (4) trouble tickets containing incorrect facility information; (5) trouble tickets being closed out by the BOC without repairing or even examining the problem; and (6) BOC delay in responding to customer concerns and complaints.<sup>83/</sup> The underlying BOC service problems experienced by CompuServe include power failures, switch, trunk, or line problems, programming or routing errors, and other types of service-related performance failures of BOC facilities.<sup>84/</sup>

43. The access service problems identified in the Rutkowski Affidavit obviously effect CompuServe's business relationships with its customers in a negative way, and could benefit the BOCs' competing enhanced service operations. This is not to say, however, that all problems relating to the provisioning of access

---

<sup>82/</sup> A copy of the Rutkowski Affidavit is attached as Exhibit A.

<sup>83/</sup> Rutkowski Affidavit at 3-10.

<sup>84/</sup> Id.

facilities result from anticompetitive intent. Rather, it is to say that neither CompuServe nor the Commission employ mind readers, and structural separation avoids placing personnel in a position where they have a natural incentive to provide unequal treatment.

44. Ample evidence of BOC discrimination exists. At the federal level, the Commission's records indicate that 19 informal complaints have been filed with it -- classified either as Computer III or ONA-related -- since 1991. While CompuServe was unable to obtain copies of most of these complaints -- the Commission staff was able to find copies of only six of the 19 complaints in its archives -- it is logical to assume that, based on the classification of the complaints as Computer III and ONA-related, at least some of the complaints may involve allegations that the BOCs have discriminated against their enhanced service competitors.

45. Examples of BOC discrimination complaints also exist at the state level. For instance, in 1991 the Georgia Public Service Commission ("GPSC") found that Southern Bell discriminated against its competitors in connection with the provision of MemoryCall voice-mail service.<sup>85/</sup> The GPSC indicated that Southern Bell engaged in at least three types of

---

<sup>85/</sup> In the Matter of the Commission's Investigation Into Southern Bell Telephone and Telegraph Company's Provision of Memory Call(sm) Service, Docket No. 4000-U (May 21, 1992) ("MemoryCall Order").

"discriminatory, anticompetitive behavior."<sup>86/</sup> Specifically, the GPSC indicated that Southern Bell's: (1) offering of MemoryCall was undertaken in such a way that its competitors could not use the local network "except to provide a service significantly inferior to MemoryCall;" (2) refusal to allow its competitors to collocate their voice-mail equipment in its central offices "perpetuated a distinction in product quality and price that disadvantages competitors to MemoryCall;"<sup>87/</sup> and (3) manipulation of local exchange facilities technical and operational developments, especially the timing of network unbundling, were designed "to maximize its competitive advantage with respect to its initial offering of MemoryCall."<sup>88/</sup>

---

<sup>86/</sup> MemoryCall Order, Docket No. 4000-U at 27.

<sup>87/</sup> In this vein, it is worth noting that the Commission's physical collocation regulations -- which would have required monopoly local telephone companies, including those owned by the BOCs, to allow their competitors and customers under certain circumstances physically to occupy space in telephone company central offices for interconnection purposes -- were found unconstitutional by the United States Court of Appeals for the District of Columbia. Bell Atlantic Tel. Co. v. FCC, 24 F.3d 1441 (D.C. Cir. 1994). The Commission since has revised its regulations to eliminate mandatory physical collocation and require only that local telephone companies provide virtual collocation intended to allow telephone company competitors to interconnect their transmission facilities with those of the telephone companies at mutually agreeable nearby locations. Without going into all of the details here, virtual collocation places the BOCs' enhanced service competitors at a disadvantage vis-a-vis the BOCs' own collocated enhanced service operations. The reason for this is that the BOCs' enhanced service competitors must arrange for transport between virtual collocation sites and BOC central offices with all of the additional expense entailed, not only for the actual transport, but also for the ongoing maintenance and security of the collocation site.

<sup>88/</sup> MemoryCall Order, Docket No. 4000-U at 27-28.

Moreover, the GPSC held that Southern Bell abused its monopoly position in the local exchange when offering its MemoryCall service by: (1) marketing MemoryCall to customers calling for information about other services;<sup>89/</sup> (2) authorizing service repair personnel to sell MemoryCall; (3) bundling MemoryCall charges into its billing for basic service; (4) using billing inserts to promote MemoryCall without allowing competitors similar options; (5) targeting potential MemoryCall subscribers using customer lists not made available to competitors; and (6) engaging in predatory pricing of MemoryCall.<sup>90/</sup> The GPSC's findings demonstrate that the BOCs not only have an incentive and the ability to discriminate against their enhanced service competitors, but that they have made use of their ability.<sup>91/</sup>

46. Additionally, it should be noted that CompuServe recently filed two complaints with the New York Department of Public Service in which it described various access service

---

<sup>89/</sup> This is known as "unhooking" in the Commission's parlance. It should be noted that in the Computer III Remand Order the Commission indicated that "unhooking" constitutes an abuse of the BOCs' monopoly local exchange position. Computer III Remand Order, 6 FCC Rcd at 7613-14 (The Commission stated that "we are not authorizing the practice of 'unhooking,' the targeting of enhanced services sales pitches at customers who contact the BOC to order network services to use with a competitor's enhanced service.").

<sup>90/</sup> MemoryCall Order, Docket No. 4000-U at 34-35.

<sup>91/</sup> The Ninth Circuit found in California III that "[t]he MemoryCall case demonstrates 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.

problems encountered in its dealings with NYNEX. Both of the complaints explain that the service CompuServe receives from NYNEX at times is extremely poor.<sup>92/</sup> The complaints, among other things, describe situations in which CompuServe's telephone lines have been disconnected by NYNEX without authorization and where the installation of access facilities has been delayed for over a month without explanation. As with the access service problems identified in the Rutkowski Affidavit, the problems identified by CompuServe in the complaints may not have resulted from any anticompetitive motive by NYNEX. However, because service problems such as those described in the complaints can have a significant impact on CompuServe's ability to provide quality service to its customers, they do demonstrate how a BOC, if it were so inclined, could discriminate more easily against its enhanced service competitors when operating on an integrated basis.

47. In an unscientific effort to determine whether other complaints have been filed at the state level against the BOCs which might relate to anticompetitive behavior, CompuServe recently reviewed informal complaints filed with the Maryland Public Service Commission ("MPSC") since the beginning of

---

<sup>92/</sup> Letter from Vicki E. Rutkowski to Peter Sperano Concerning NYNEX Service Problems (filed February 2, 1995); Letter from Vicki E. Rutkowski to Peter Sperano Concerning NYNEX Service Problems (filed March 8, 1995). Copies of both complaints are attached as Exhibit B.

1993.<sup>93/</sup> The purpose of this review was not to develop an exhaustive list of complaints filed against Bell Atlantic or to conduct a scientific study, but merely to determine whether any complaints had been filed at the state level which would be relevant to showing the type of conduct which can injure competitors.<sup>94/</sup> This informal review indicates that, if similar reviews were to be conducted at other state regulatory agencies, evidence of similar BOC conduct likely would be discovered. Indeed, because the MFJ's interexchange restriction currently bars the BOCs from providing enhanced services across LATA boundaries,<sup>95/</sup> most complaints filed by the BOCs' competitors alleging anticompetitive conduct logically might be expected to be found at the state level. Thus, the Commission's statement in the NPRM that "no formal complaints have been filed at the [Commission] by [enhanced service providers] alleging BOC access

---

<sup>93/</sup> Maryland was chosen because of its close proximity to the Washington metropolitan area and because of the relatively easy access afforded by the MPSC to its informal complaints. Other nearby states, including Pennsylvania and Virginia, either prohibited public access to informal complaints or limited access to those complaints unless the complainant has given prior consent to public review. Obviously, prohibitions and limitations of this sort effectively prevent meaningful review of the complaint record in these states, and CompuServe suspects, in other states as well.

<sup>94/</sup> Copies of five informal complaints found during CompuServe's review of the MPSC's records are attached as Exhibit C. These complaints were filed by a range of BOC competitors, including paging operators, cable companies, and voice-mail providers, and are illustrative of the types of problems that enhanced service providers could experience.

<sup>95/</sup> See United States v. W. Elec. Co., Inc., 907 F.2d 160 (D.C. Cir. 1990).

discrimination since the Computer III Phase I Order" should not be viewed as evidence that such discrimination has not occurred.<sup>96/</sup>

48. One of the complaints found by CompuServe during its review of the MPSC's records involved a complaint filed by Freedom Page alleging that Bell Atlantic had discriminated against Freedom and other private carrier paging companies by charging them more for telephone services than it charged its own paging operations.<sup>97/</sup> Another of the complaints involved a unilateral decision by Bell Atlantic to change the type of switch used by a communications company called Enterprise.<sup>98/</sup> According to Enterprise's complaint, its telephone lines were not operative after the switch change and it was unclear whether Bell Atlantic would be able to fix the problem without again installing the old switch. Enterprise stated that "given Bell Atlantic's competitive status with our company, its ever increasing focus on non-core services, and a long history of acrimony between our companies, we would be remiss if we didn't bring this to [the MPSC's] attention promptly and forcefully."<sup>99/</sup>

---

<sup>96/</sup> NPRM at 20.

<sup>97/</sup> Letter from Marty Airhart to Daniel Gahagan Concerning Discriminatory Billing by Bell Atlantic (filed January 12, 1995).

<sup>98/</sup> Letter from Lawrence B. Werner to Fred D'Alessio Concerning Telephone Service Problems Allegedly Caused by Bell Atlantic (filed July 13, 1994) ("Enterprise Complaint").

<sup>99/</sup> Enterprise Complaint at 1.

49. Another one of the complaints involved efforts by Comcast Cablevision to restore service to at least 11 telephone lines after a storm.<sup>100/</sup> In this regard, Comcast stated in the complaint that, despite repeated efforts by Comcast's staff to get Bell Atlantic to restore service in an expeditious manner, it took Bell Atlantic over 10 days to restore service to the lines in question. Comcast's complaint also stated that responding to telephone inquiries from the public is a major part of Comcast's business and that its ability to do so was undermined by the telephone service outages. Because neighboring businesses did not experience similar service problems, Comcast speculated that Bell Atlantic "is trying to do damage to our cable business in lite [sic] of the fact that we may be competitors some day."<sup>101/</sup>

50. In another complaint, M&M Controls, Inc. stated that, beginning in November 1992, it started to experience unexplained "phantom rings" and service "cut offs."<sup>102/</sup> These problems persisted until at least June 1993 despite the fact that M&M replaced its telephone system a number of times. Bell Atlantic apparently denied responsibility for the service problems on the basis that the customer premises equipment used by M&M was not Bell Atlantic equipment. M&M indicated that "telephones are our

---

<sup>100/</sup> Letter from William Sievers to Frank Heintz Concerning Telephone Service Outages Involving Bell Atlantic (filed June 11, 1993) ("Comcast Complaint").

<sup>101/</sup> Comcast Complaint at 2.

<sup>102/</sup> Letter from R. Bruce McPhail to Frank Heintz Concerning Telephone Service Problems Allegedly Caused by Bell Atlantic (filed June 10, 1993) ("M&M Complaint").