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April 7, 1995

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

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

Dear Mr. Caton:

Pursuant to Sections 1.415 and 1.419 of the Commission's Rules, attached please find an original and 4 copies of the Ad Hoc Telecommunications Users Committee in the above-captioned matter. Please date stamp the additional copy and return it with our messenger.

If you have any questions regarding this filing, please do not hesitate to call.

Sincerely,

James S. Blaszak
D. E. Boehling

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
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 THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

AD HOC TELECOMMUNICATIONS
USERS COMMITTEE

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TABLE OF CONTENTS

SUMMARY iii

INTRODUCTION 1

I. BENEFITS ATTRIBUTABLE TO REPLACING THE SEPARATE SUBSIDIARY REQUIREMENT WITH NONSTRUCTURAL SAFEGUARDS ARE ELUSIVE AT BEST 5

A. Changes in the Telecommunications Network Have Diminished the Putative Efficiencies or Economies of Scope Believed to Flow From Integration 6

B. The BOCs Should Not Be Allowed To Gain Economies of Scope By Using Their Monopoly Local Telephone Service Personnel to Jointly Market BOC-Provided Enhanced Services Because Doing So Would Harm Non-Affiliated ESPs 9

C. Removal of the MFJ Restriction on BOC Provision of Information Services and the Natural Growth of the Market Is Just As Likely To Have Caused Growth in BOC Provision Enhanced Services In Recent Years As Integration of BOC Provided Basic and Enhanced Services 11

II. THE COSTS OF REPLACING STRUCTURAL SEPARATION WITH NONSTRUCTURAL SAFEGUARDS ARE SUBSTANTIAL 13

A. Nonstructural Safeguards are Ineffective at Reducing the Risk of BOC Cross-Subsidization of its Enhanced Services with Revenues From Its Monopoly Services 14

B. The Commission's Nonstructural Safeguards Have Not Prevented BOCs From Engaging in Access Discrimination 17

III. THE COSTS OF NONSTRUCTURAL SEPARATION OUTWEIGH ITS BENEFITS, THE COMMISSION SHOULD READOPT STRUCTURAL SEPARATION FOR BOC PROVISION OF ALL ENHANCED SERVICES 18

A. Lifting the Structural Separation Requirement Would Impose Significant Costs on Competing ESPs and the Public But Offers No Apparent Benefits to the BOCs or the Public 18

B. The Commission Should Place Structural Separation Requirements on All BOC-Provided Enhanced Services 21

CONCLUSION 23

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SUMMARY

The Commission issued the Notice after the Ninth Circuit for the second time vacated and remanded its decision to replace rules requiring structural separation of a BOC's basic and enhanced services with rules that would permit a BOC to integrate those services subject to nonstructural safeguards. The Ninth Circuit which found fault with the Commission's cost/benefit analysis thus provided the Commission with an opportunity to rigorously reassess the costs and benefits of integration.

The Commission can no longer reasonably conclude - as it did in the *BOC Safeguards Order* - that integration will produce significant public benefit. Since the Commission released the *BOC Safeguards Order,* the architecture of the public switched telephone network has changed dramatically. With the aggressive introduction of SS7 and AIN technology by the BOCs, network intelligence - which is the basis for developing new enhanced services - is no longer resident in central office switches, but concentrated in remote databases. Thus, any operational efficiencies that may have existed in 1991 have been almost completely eliminated.

There is no evidence of a causal link between the growth in the enhanced services market and lifting of structural separation. Other variables, such as the elimination of the MFJ's prohibition against BOC provision of information services, are just as likely to be the cause of changes in the market.

Although the Commission views joint marketing as a benefit of integration, the Committee believes it to be a significant cost. Joint marketing allows the BOCs to exploit the relationship that they have with virtually every resident and business in their service area as a result of their status as the entrenched and, in most areas, only provider of local telephone service to gain an unfair advantage in the enhanced services marketplace.

The Commission's conclusion in the *BOC Safeguards Order* that there is minimal risk to lifting structural separation requirements is wrong. The nonstructural safeguards imposed fail to protect adequately against cross-subsidization and access discrimination. The Commission's cost allocation requirements and accounting safeguards, including the requirement of independent audits and threat of FCC audits, are ineffective. BOCs have been found to have - and there is no reason to believe that they will not continue to - violate these rules. Until such violations are discovered, the public suffers.

The costs of integration are significant, while the benefits nonexistent. The Committee therefore urges the Commission to re-establish the structural separation requirement for BOC-provided enhanced services, because doing so more effectively guards against BOCs gaining an unfair advantage in the enhanced services market, and will not unfairly inhibit BOC development and provision of enhanced services.

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Washington, D.C. 20554

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

COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee (the "Committee"), pursuant to Section 1.415 of the rules of the Federal Communications Commission (the "Commission" or the "FCC"), 47 C.F.R. § 1.415 (1994), hereby submits its comments on the Notice of Proposed Rulemaking, FCC 95-48 (released February 21, 1995) ("Notice"), in the captioned proceeding.

INTRODUCTION

The Committee is an unincorporated entity that represents its members' interests regarding telecommunications matters before the Commission and other governmental authorities. It is comprised of a substantial number of large corporations whose use, both individually and collectively, of interstate telecommunications facilities and networks is extensive. As large users of telecommunications services, Committee members are concerned about cross-subsidization of BOC enhanced services with monopoly revenues, which would increase their costs for BOC monopoly services and have an

adverse impact on competition in the enhanced services market. The Committee therefore has a direct and immediate interest in the captioned proceeding.

The Notice is the product of the decision by the United States Court of Appeals for the Ninth Circuit ("Ninth Circuit")[1] to vacate in part and remand the Commission's *BOC Safeguards Order*,[2] which the FCC issued in response to the Ninth Circuit's vacation and remand[3] of the Commission's principal orders in the *Third Computer Inquiry*.[4]

In the *BOC Safeguards Order*, the Commission again decided -- as it had in the *Third Computer Inquiry* -- to permit the Bell Operating Companies ("BOCs") to integrate their basic and enhanced service operations, subject to a variety of nonstructural safeguards, rather than requiring the BOCs to provide enhanced services only through fully separate subsidiaries.[5] The Commission's

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1 *California v. FCC*, 39 F.3d 919 (9th Cir. 1994).

2 *Computer III Remand Proceedings: Bell Operating Co. Safeguards & Tier 1 Local Exchange Co. Safeguards*, 6 FCC Rcd 7571 (1991) ("*BOC Safeguards Order*").

3 *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990).

4 *Amendment of Sections 64.702 of the Comm'n's Rules & Regs (Third Computer Inquiry)*, 104 F.C.C.2d 958 (1986) ("Phase I Order"), *on recon.*, 2 FCC Rcd 3035 (1987) ('Phase I Reconsideration"), *on further recon.*, 3 FCC Rcd 1135 (1988), *on second further recon.*, 4 FCC Rcd 5927 (1989); 2 FCC Rcd 3072 (1987) ("Phase II Order"), *on recon.*, 3 FCC Rcd 1150 (1988). Additional *Third Computer Inquiry* decisions include the Phase II Order, *on further recon.*, 4 FCC Rcd 5927 (1989), *on second further recon.*, 4 FCC Rcd 5927 (1989).

5 *Amendment of Section 64.702 of the Comm'n's Rules & Regs (Second Computer Inquiry)*, 77 F.C.C.2d 384 (1980) ("Computer II Final Decision"), *on recon.*, 88 F.C.C.2d 512 (1981) ("Computer II Reconsideration), *aff'd sub nom., Computer & Communications Industry Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

decision to replace structural separation with nonstructural safeguards was based on its belief that

> nonstructural safeguards would permit the BOCs to take advantage of *operational efficiencies* of integration, facilitate BOC provision of enhanced services, engage in joint marketing of basic and enhanced services, and will result in a greater provision of enhanced services, especially in the mass market.[6]

The Commission recognized that this change might result in a "diminution in protection against cost-subsidization," but found this cost to be "outweighed by the benefits of integration."[7]

In reaching its decision to lift structural separation and adopt nonstructural safeguards in its place, the Commission considered the risk that BOCs would cross-subsidize their enhanced services with revenues from their monopoly services and the risk that BOC would discriminate against competing enhanced services providers ("ESPs") in access to, and the type and quality of BOC services that underlie enhanced services.[8] To guard against cross-subsidization, the Commission adopted cost allocation and accounting measures.[9]

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6 *BOC Safeguards Order,* 6 FCC Rcd at 7621 (emphasis added).

7 *Id.* at 7622.

8 *E.g., Id.* at 7575.

9 *Id.* at 7578.

With respect to the access discrimination danger, the Commission adopted the following nonstructural safeguards.[10] First, pending implementation of Open Network Architecture ("ONA"), the Commission would allow BOCs to integrate certain of their enhanced services operations with their basic services upon approval of service-specific Comparably Efficient Interconnection ("CEI") plans. Second, the Commission would eliminate the CEI service-specific rules and allow BOCs to integrate all of their enhanced services with their basic services upon implementation of the BOCs' initial ONA plans, which generally were to effect fundamental unbundling of network functionalities. Third, upon implementation of ONA and the elimination of the structural separation requirement, BOCs would be required to submit annual reports attesting that they had not discriminated against competitive ESPs in the provision of basic network services or in the installation, maintenance or repair of such services. Fourth, BOCs would be required to disclose changes to their telecommunications network that would affect the provision of enhanced services. Finally, restrictions were imposed on the use of customer proprietary network information ("CPNI") by BOC marketing personnel.

In vacating and remanding the *BOC Safeguards Order*, the Ninth Circuit questioned the FCC's cost/benefit analysis for removing structural separation in light of the fact that the ONA plans approved by the Commission

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10 *BOC Safeguards Order*, 6 FCC Rcd at 7597-98.

do not fundamentally unbundle network functionalities.[11] In ordering a reassessment of the costs and benefits of eliminating structural separation in favor of a nonstructural safeguard regime, however, the Ninth Circuit has provided an opportunity to reexamine all of the costs of the new regime, including the increased risk of cross-subsidization.[12] The *Notice* therefore seeks comment not only on whether nonstructural safeguards provide sufficient protection against access discrimination to justify lifting the structural separation requirement, but also whether structural separation should be reimposed for some or all enhanced services.[13] Perhaps, the Commission now will rethink critically its decision to eliminate the structural separation requirement.

I. BENEFITS ATTRIBUTABLE TO REPLACING THE SEPARATE SUBSIDIARY REQUIREMENT WITH NONSTRUCTURAL SAFEGUARDS ARE ELUSIVE AT BEST.

In the *BOC Safeguards Order* -- as in the *Third Computer Inquiry* orders -- the Commission used all of the appropriate buzzwords in describing the relative costs and benefits of replacing structural separation with nonstructural safeguards. The Commission concluded that the separation and/or duplication of facilities and personnel under structural separation results in losses of financial and operational efficiencies and economies of scope,[14] decreased

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11 *California v. FCC,* 39 F.3d at 928-30.

12 *Notice* at ¶¶ 36-40.

13 *Notice* at ¶ 2.

14 *E.g., BOC Safeguards Order,* 6 FCC Rcd at 7622.

innovation and reduced service availability.[15] Conversely, it found that integrating the BOCs' basic and enhanced services subject to nonstructural safeguards would enable a more efficient use of BOC resources and produce cost savings through avoidance of duplication of facilities,[16] which in turn facilitate BOC provision of enhanced services.[17] To put it plainly the Commission's cost/benefit analysis was general in nature and not rigorous.[18]

A. Changes in the Telecommunications Network Have Diminished the Putative Efficiencies or Economies of Scope Believed to Flow From Integration.

The Commission's cost/benefit analysis in the *BOC Safeguards Order* turned in large part on its finding that "a *major* benefit of adopting nonstructural safeguards is that this course would permit the BOCs to take advantage of *operational* efficiencies of integration."[19] "Efficiencies of integration" -- particularly operational efficiencies -- with respect to BOC operations, the Commission acknowledged, are derived from collocating BOC enhanced services equipment with or into its network of basic transmission

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15 *Id.* at 7575, 7614.

16 *Id.* at 7575, 7617.

17 *E.g., BOC Safeguards Order,* 6 FCC Rcd at 7621.

18 The Commission addresses the costs of nonstructural safeguards briefly and generally. It describes them as the risk of anticompetitive conduct by the BOCs, and dismisses the risk as minimal given the safeguards imposed. *Id.* at 7576.

19 *Id.* at 7621 (emphasis added).

facilities and switches, rather than providing such services from remotely located facilities as required under structural separation.[20]

The efficiencies of integration -- and the benefit they bring to the analysis -- thus depend in large part on where the functions and features underlying the provision of enhanced services reside within the BOCs' networks.[21] When the Commission first considered this issue in 1986 (and to a limited extent when it reconsidered the issue in 1991), the telecommunications network was dominated by stored program control central office switches, each of which contained the network's intelligence, *i.e.,* software that enabled the switch to provide certain features and functions[22] and operated essentially independently of others.[23] New services relying on network features and functions had to be implemented in each switch -- a costly process. Integration in this network environment therefore arguably created certain operational efficiencies.

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20 *Third Computer Inquiry,* 104 F.C.C.2d at ¶¶ 79-81, 89-91.

21 The Committee has previously examined the costs and benefits of integration, including the claimed operational efficiencies. For an in depth discussion of this issue, *see Computer III Remand Proceedings: Bell Operating Co. Safeguards & Tier 1 Local Exchange Co. Safeguards,* CC Docket No. 90-623, Comments of the Ad Hoc Telecommunications Users Committee at 8-14 (March 8, 1991) ("Ad Hoc Comments").

22 *Intelligent Networks,* Notice of Inquiry, 6 FCC Rcd 7256 (1991).

23 *See, e.g.,* Reply Affidavits in Support of Section VII Motions for Removal of the Section II(D)(1). Restriction on the Provision of Information Services, Vol. II, Aff. of Robert W. Hines, filed in *United States v. Western Elec., Co.,* Case No. 82-0192 (DDC) on Jan. 18, 1991; *Intelligent Networks,* 6 FCC Rcd at 7256-57.

The network architecture of today, however, is vastly different. Over the past several years, BOCs have been aggressively deploying Common Channel Signalling System 7 ("CCSS7") and the Advanced Intelligent Network ("AIN").[24] With AIN, network intelligence is moved out of the central office switch to a centralized database.[25] The database is a *remote* computer *external* to the central office switch (rather than stored within the switch), which provides the features and functions underlying the introduction of new services,[26] and permits deployment of new services by making changes to the centralized database rather than by reprogramming individual central office switches.[27] In this environment, BOCs -- like non-affiliated ESPs -- will provide enhanced services from remote locations. Central office integration will no longer produce efficiencies or even significant cost savings because the central office will provide only basic call processing pursuant to instruction from remote databases.[28] Thus, the deployment of AIN has virtually eliminated the

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[24] By 1994, BOCs had deployed SS7 technology in almost 90% of the central offices in the country, and projected to continue implementing the technology. *In the Matter of Filing and Review of Open Network Architecture Plans*, CC Docket 88-2 Phase I: Annual Report of Ameritech Attachment 3, p.1, 81%, (filed April 15, 1994); Southwestern Bell Telephone Company's Annual ONA Report, Exhibit C, p. 1, 64%, (filed April 15, 1994); Annual ONA Report of U S West Communications, Inc., Appendix D, p. 17, 82.2%, (filed April 15, 1994); Amendments to Bell Atlantic's ONA Plan, Appendix C, p. 1, 99%, (filed April 15, 1994); Erratum to April 15, 1994 ONA Report of Pacific Bell and Nevada Bell, Appendix E, p. 2, 96% Pacific Bell, 89% Nevada Bell, (filed May 5, 1994); Bellsouth 91%, M.J. Richter, *SS7 Migration: Local Carriers Are Near Destination the Ongoing Trek Toward Intelligent Networking Technologies has led LEC's Close to Full SS7 Deployment*, COMMUNICATIONS WEEK, Jan. 24, 1994, at 4A.

[25] *Intelligent Network,* Notice of Proposed Rulemaking, 8 FCC Rcd 6813, 6814 (1993).

[26] *Intelligent Network,* 6 FCC Rcd at 7257.

[27] *Intelligent Network,* 8 FCC Rcd at 6813.

[28] *See Ad Hoc Comments* at 15-16.

operational efficiencies that may and have been attributable to providing enhanced services and basic services from the same central offices.

B. The BOCs Should Not Be Allowed to Gain Economies of Scope By Using Their Monopoly Local Telephone Service Personnel to Jointly Market BOC-Provided Enhanced Services Because Doing So Would Harm Non-Affiliated ESPs.

The Commission attempted to bolster its cost/benefit analysis by citing the benefits to be derived from allowing BOCs use personnel to jointly market basic and enhanced services.[29] Such economies are fundamentally different than the operational efficiencies of integration described above, would allow the BOCs to exploit their monopoly franchises to the detriment of non-affiliated ESPs and the public, and should therefor weigh against -- not in favor of -- lifting structural separation.

The operational efficiencies of integration described above would -- if they in fact existed -- be "true" efficiencies because they would utilize resources in the public switched telephone network to provide "new" services, *e.g.*, enhanced services, and take advantage of the network's capabilities. Generally speaking, operational efficiencies would increase the output of the public switched network. The economies of scope that arise from allowing BOC personnel to jointly market BOC basic and enhanced services, on the other hand, are simply a cost sharing mechanism. Joint marketing does not improve output of BOCs' personnel and, thus, creates no "true" efficiencies.

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[29] *BOC Safeguards Order*, 6 FCC Rcd at 7575, 7621.

Most disturbingly, joint marketing of basic and enhanced services would permit BOCs to exploit their monopoly franchises to achieve an unfair advantage in an unregulated market. Despite claims about emerging competition in the local telephone services market, BOCs at present provide local telephone service to virtually all residents and businesses in their service regions. This relationship gives BOCs - and BOCs alone - the opportunity to reach a large pool of potential customers for BOC-provided enhanced services at little (if any) cost. Non-affiliated ESPs, which would be competing with the BOCs, must expend significant resources to reach their target market. Permitting BOCs personnel to jointly market basic and enhanced services, therefore, would place competing ESPs at a competitive disadvantage.

The economies of scope produced by BOC joint marketing should be considered a "cost" -- not a "benefit" -- of replacing structural separation with integration of BOC-provided basic and enhanced services. Allowing BOCs to engage in joint marketing of basic and enhanced services would *not* create any "true" efficiencies, it *would,* however, give the BOCs an unfair advantage arising from the relationship that they have with virtually every person in their service as local telephone service providers.

C. Removal of the MFJ Restriction on BOC Provision of Information Services and the Natural Growth of the Market Is Just As Likely To Have Caused Growth in BOC Provision Enhanced Services In Recent Years As Integration of BOC Provided Basic and Enhanced Services.

In the *Notice*, the Commission cited, apparently as support for its prior findings regarding the benefits of integration, "a rapid expansion of BOC enhanced services, and with continued growth in the availability of enhanced services" since BOCs were permitted to integrate their basic and enhanced services operations.[30] While the Commission's statement that these events "coincided" may be accurate, so did numerous other events. There is no "evidence" of a causal link between elimination of the structural separation requirement and the growth of enhanced services. Perhaps the most important event -- and the one most likely to be the cause of the increase in BOC-provided enhanced services -- was not action by this Commission, but that taken by the courts.

In 1984, AT&T and the Department of Justice entered into the Modification of Final Judgment ("MFJ") to settle an antitrust dispute. The MFJ prohibited the BOCs from providing information services, which were defined as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information which may be conveyed via telecommunications . . . .".[31] The Commission itself acknowledged

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30 *Notice* at ¶ 37.

31 *US v. AT&T,* 552 F. Supp. 131, 229 (1982).

that this definition covered most enhanced services, and that BOCs were thus prohibited from providing enhanced services -- whether on a structurally separate or integrated basis.[32] The MFJ's prohibition against BOC transmission of information was removed in 1987,[33] but the prohibition against BOC generation of information remained in effect until July 1991.[34]

The Notice exaggerates the growth in BOC-provided enhanced services caused by the lifting of structural separation.[35] In 1990, according to the *Notice*, the BOCs reported only 160,000 customers, while in 1994, they claimed to be providing provided enhanced services to approximately five million customers. The Commission's reference, however, to the number of BOC customers in 1990 is misleading. In 1990, the BOCs could not provide content-based information services. It is not surprising that the BOCs had relatively few enhanced services customers in 1990. In 1991, however, the court eliminated the MFJ's prohibition on BOC provision of content-based information services. Removal of this prohibition opened new markets to the BOCs. This event is just as - if not more - likely to have caused the increase in BOC enhanced services customers as the lifting of structural separation.

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32 *See, e.g., Third Computer Inquiry,* 104 F.C.C.2d at 977; 2 FCC Rcd at 3095.

33 *US v. Western Electric Co.,* 673 F. Supp. 525 (1987).

34 *US v. Western Electric Co.,* 767 F. Supp. 308 (1991).

35 *Notice* at ¶ 37.

The growth in BOC enhances services customers between 1990 and 1994 may also be attributable in large part to growth in consumer awareness of and demand for such services. It is not unusual for initial product or service offerings to start out slowly, but grow quickly as consumer awareness increases. Take the Internet as an example. In 1991, only about one million people were "surfing the Net."[36] By 1994, that number had skyrocketed to over thirty million.[37]

The growth in BOC enhanced service subscribership may have occurred *regardless* of the Commission's decision to lift the structural separation requirement. The Commission's strong suggestion that eliminating structural separation caused the increase in BOC provision of enhanced services between 1990 and 1994 is pure speculation, and should carry little if any weight in the Commission's cost/benefit analysis.

II. THE COSTS OF REPLACING STRUCTURAL SEPARATION WITH NONSTRUCTURAL SAFEGUARDS ARE SUBSTANTIAL.

While the putative benefits of removing the structural separation requirement have either diminished or never existed to any meaningful degree, the costs of relying on nonstructural safeguards have become more obvious.

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[36] *Latest Estimates of Internet Growth,* ONLINE NEWSLETTER, Nov. 1994, at No. 11, Vol. 15.

[37] *See, e.g.,* Tim Friend, *Patients find 'Direct Line" to Doctors,* USA TODAY, Feb. 8, 1995, at 1A; George Gilder, *Mike Milken and Two Trillion Dollar Opportunity Telecom,* FORBES, Apr. 10, 1995, at 104; *NETCOM Subscriber Base Surpasses 70,000; Six Times More Subscribers than a Year Ago,* BUSINESS WIRE, Jan. 17, 1995; David Molter, *Is It Worth Going Online?,* BUSINESS DATELINE; EXECUTIVE REPORT, Mar. 1995, at Vol. 13, No. 7, Sec. 1, p. 18.

A. Nonstructural Safeguards are Ineffective at Reducing the Risk of BOC Cross-Subsidization of its Enhanced Services With Revenues From Its Monopoly Services.

In the *BOC Safeguards Order*, the Commission imposed three nonstructural safeguards designed to prevent BOCs from engaging in improper cross-subsidization of their enhanced services: (1) treatment of enhanced services as unregulated activities for accounting and jurisdictional separations purposes; (2) independent audits; and (3) quantifying effects of cost account manual changes when such changes are submitted to the Commission.[38] These safeguards have not been effective.[39]

The Commission's reliance on independent audits of the BOCs' books and the threat of FCC audits does not protect against cross-subsidization.[40] Only two weeks after the Commission adopted the *Notice*,

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38 *BOC Safeguards Order*, 6 FCC Rcd at *7576-77*.

39 *Id.* at 7578.

40 *See Ad Hoc Comments* at 19-27. Even if audits were effective to ensure that the BOCs comply with the Commission's cost allocation and accounting rules, they would be ineffective at protecting against cross-subsidization because of problems inherent in those rules. The Commission's cost allocation rules allocate costs between regulated and enhanced services "after the fact," which generally results in an overallocation of costs to regulated services. For example, a BOC may decide to implement AIN so that it can provide enhanced video gateways and other "supped-up" services needed to compete with entrenched cable TV systems, while it may have concluded that implementing AIN to upgrade its regulated services was not necessary. After upgrading its facilities, however, the BOC would likely choose to use the platform for both its regulated and unregulated services. The Commission's rules require the BOC to allocate the costs of AIN to the regulated and unregulated sides of the business based on relative use. Because the volumes of regulated traffic greatly exceed those of unregulated traffic, the vast majority of AIN's costs will be assigned to regulated services. Moreover, under the Commission's rules the price that a BOC may charge for its regulated services is (or was prior to price caps, which was established using rates set under a rate of return regime) determined by its costs, including excess capacity. Excess capacity costs are allocated based on relative use by regulated and unregulated service. As a result, most excess capacity costs are allocated to regulated services despite the fact that they have little need for such capacity. Their demand is

Orders to Show Cause were issued against *every* BOC for apparent violations of the FCC's accounting rules and reporting requirements with respect to the common line pool.[41] The Commission stated:

> Enforcing our accounting rules and reporting requirements is essential for the Commission to carry out its statutory obligations to ensure that rates for telecommunications services remain just and reasonable. Our ability to carry out these obligations is impaired if we cannot rely upon the information that carriers are required to submit about the costs of their operations and their allocations of those costs, or if those allocations are made improperly.[42]

Moreover, the Commission admitted that its confidence that the BOCs' "accounts accurately reflect Commission-mandated accounting practices and reveal the true and lawful costs of [the BOCs'] interstate services" was "seriously undermine[d]."[43] The Commission should not rely on the BOCs to self-regulate when they have substantial incentive and ability to evade the Commission's safeguards.

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generally stable and growth is predictable. By contrast, unregulated services are allocated little of the excess capacity costs and place high value on it.

[41] *Ameritech Tel. Operating Co's.*, Order to Show Cause, (Released March 3, 1995) ("Ameritech Show Cause Order"); *Bell Atlantic Tel. Operating Co's.*, Order to Show Cause, (Released March 3, 1995) ("Bell Atlantic Show Cause Order"); *Bell South Tel. Operating Co's.*, Order to Show Cause, (Released March 3, 1995) ("Bell South Show Cause Order"); *NYNEX Tel. Operating Co's.*, Order to Show Cause, (Released March 3, 1995) ("NYNEX Show Cause Order"); *Pacific Bell*, Order to Show Cause, (Released March 3, 1995) ("Pacific Bell Show Cause Order"); *Southwestern Bell Tel. Co.*, Order to Show Cause, (Released March 3, 1995) ("Southwestern Show Cause Order"); *US West Comm., Inc.*, Order to Show Cause, (Released March 3, 1995) ("US West Show Cause Order').

[42] *See, e.g., Ameritech Show Cause Order* at ¶ 2.

[43] *See, e.g., Bell Atlantic Show Cause Order* at ¶ 7.

The possibility of a Commission audit is not a obvious threat. The Commission's resources are severely constrained at present and may be further taxed as government is "right-sized." It simply does not have staff available to perform on-site audits.[44]

Even assuming that the FCC were to order such audits, any violations discovered may have begun long ago and imposed substantial costs in the interim. For example, a federal-state joint audit of Southwestern Bell was only recently concluded, although the audit covered calendar years 1989 through 1992.[45] While the audits underlying the recently released Show Cause Orders were performed by an outside auditor, not the Commission, they uncovered violations occurring between 1988 and 1989. The BOCs therefore got away with improperly shifting costs among various state and federally regulated services for almost six years, during which time the rates for regulated services were excessive.[46]

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[44] Letter from Randolph J. May, Counsel for CompuServe, Inc., to Richard Rosen, Chief, Comm. & Finance Section, Antitrust Division, U.S. Dept. of Justice, *Re: Bell Co's. Joint Motion to Waive Interexchange Restriction to Provide Info. Svcs. Across LATA Boundaries* (W186) at 9 (October 29, 1993).

[45] *Southwestern Bell Show Cause Order* at 2.

[46] While structural separation does not eliminate the risk of cross-subsidization, it increases the likelihood of detecting it . *See Southwestern Bell Show Cause Order* (violation of affiliate transaction rules); *New York Tel. Co., New England Tel. & Tel. Co.,* 5 FCC Rcd 5892 (1990), *on recon.,* 6 FCC Rcd 3303 (1991) (same).

B. The Commission's Nonstructural Safeguards Have Not Prevented BOCs From Engaging in Access Discrimination.

In the *Notice*, the Commission listed several measures that it had implemented to protect against BOC access discrimination as part of its replacement of structural separation with nonstructural safeguards.[47] These included ONA, CEI "equal access" requirements, network disclosure requirements, use restrictions on CPNI, and quality, installation and maintenance reporting requirements.[48] While these measures are somewhat beneficial if in addition to, rather than in lieu of, structural separation, they are not sufficient to outweigh the risks of access discrimination by the BOCs.

First, as the Ninth Circuit found in *California II,* the ONA implemented by the Commission is not that upon which the structural separation requirements were intended to be lifted. Approval of the BOCs' initial ONA plans did nothing more than allow the BOCs to escape the CEI prior approval process. The BOCs ONA plans did not fundamentally unbundle network functionalities. While it is true that an ESP may request a new "basic service element," and is entitled to it if it is technologically and financially feasible[49] the BOCs alone possess the knowledge that allows them to justify any denial of a request -- they can claim that a function is technically infeasible or too costly because they alone are privy to the intricacies of their networks. While ESPs can arguably turn to the

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47 *Notice* at ¶ 5.

48 *Notice* at ¶ 5.

49 *E.g.*, *Notice* at ¶ 20.

industry committees for advice concerning the feasibility of an offering, the process can take years, the outcome has no binding effect, and the BOCs can still claim that their networks are unique and unable to implement the request.

Nor does the ONA amendment process solve this problem. It leaves control over when BSEs will be offered to the whim of the BOCs. They need only provide the tariffed service offering when they introduce a new service. Thereby granting themselves a headstart in the market for any new enhanced service.

III. THE COSTS OF NONSTRUCTURAL SEPARATION OUTWEIGH ITS BENEFITS, THE COMMISSION SHOULD READOPT STRUCTURAL SEPARATION FOR BOC PROVISION OF ALL ENHANCED SERVICES.

A. Lifting the Structural Separation Requirement Would Impose Significant Costs on Competing ESPs and the Public But Offers No Apparent Benefits to the BOCs or the Public.

As detailed above, allowing BOCs to integrate their basic and enhanced services would impose significant costs on the enhanced services marketplace and the public. Integration would make it easier for BOCs to engage in improper cross-subsidization of their enhanced services, and nonstructural safeguards would not adequately protect against such behavior. Joint marketing of a BOCs' basic and enhanced services would provide an unfair competitive advantage. While lifting structural separation would produce neither operational efficiencies nor economies of scope not attributable solely to the BOCs' position as the monopoly provider of local telephone service. The costs of integration thus far exceed its benefits, and the Commission should reestablish structural separation.

Requiring BOCs to establish separate subsidiaries to provide enhances services will not unfairly inhibit their ability to compete in the enhanced services market. The economic efficiencies claimed to result from integration either do not exist or are available to the BOCs alone as a result of their local monopoly franchises. Structural separation will therefore place the BOCs on equal footing with non-affiliated ESPs, who are unable to share costs with a monopoly service.

Lawmakers apparently share the Committee's calculation of the costs and benefits of integration. Senate Bill S. 652 finds that "Competition, not regulation, is the best way to spur innovation and the development of new services," Section 5(1), both the Republican and Democrat drafts of the Senate's telecommunications bill would permit BOCs to engage in the provision of enhanced services -- referred to in the legislation as information services -- only if they do so through a separate subsidiary. Section 252(a)(1) of S. 652 states in relevant part:

> A Bell operating company (including its subsidiaries and affiliates) which provides telephone exchange service may not provide . . . [information services[50] . . . other than any information service a Bell operating company was authorized to provide before July 24, 1991] unless it provides that service through a subsidiary that (A) is separate from any operating company entity that provides telephone exchange service . . . .

The legislation goes on to require that a separate subsidiary:

> (1) shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate and apart

[50] "Information services" defined in the legislation to have the meaning the FCC has given "enhanced services." Section 8(b)(pp). *Compare* 47 C.F.R. § 64.702.