Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
	)	
Price Cap Performance Review	)	
for Local Exchange Carriers;	)	CC Docket No. 94-1
Treatment of Video Dialtone Services	)	
Under Price Cap Regulation	)	

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COMMENTS

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SUMMARY

As the Commission has recognized in its report on competition in the delivery of video programming, there is no such thing as a market for video dialtone ("VDT") service. The relevant market is the market for multi-channel video programming distribution ("MVPD"). Presently, U S WEST has a zero market share and no market power in the MVPD market. As such, it is impossible to reconcile the Commission's decision to apply price cap regulation to VDT service with economic reality. U S WEST disagreed with the Commission when it first adopted this position in its VDT Order on Reconsideration and continues to do so.

U S WEST's position and comments in this proceeding are predicated on the belief that VDT is a competitive service which should be removed from price cap regulation at the earliest possible date. Assuming that the Commission holds firm in its position to apply price cap regulation to VDT service, it should take the following steps on implementation:

- Create a separate price cap basket for VDT services.
- Apply a zero productivity offset to the price cap basket.
- Exclude the VDT basket from all sharing and low end adjustment calculations.
- Limit exogenous cost treatment to VDT-specific exogenous costs.
- Require a full calendar year of demand before rolling VDT into a price cap basket.
- Allow LECs increased pricing flexibility for VDT services during the period from introduction to incorporation into price caps.

These steps will largely segregate VDT services from other price cap services and lay the foundation for removing VDT from price cap regulation at the earliest possible date.

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COMMENTS

U S WEST Communications, Inc. ("U S WEST"), through counsel and pursuant to the Federal Communications Commission's ("Commission") Further Notice of Proposed Rulemaking ("Notice"),[1] hereby submits its comments on the application of price cap regulation to video dialtone (or "VDT") service.

I. INTRODUCTION

As the Notice explains, the Commission concluded in its Video Dialtone Order on Reconsideration that local exchange carrier ("LEC") video dialtone services should be subject to price cap regulation.[2] The Commission asserted that price cap regulation would serve its goals of increasing video service competition,

[1]See In the Matter of Price Cap Performance Review for Local Exchange Carriers: Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, FCC 95-49, rel. Feb. 15, 1995 ("Notice").

[2]In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58 and Amendments of Parts 32, 36, 61, 64, and 69 of the Commission's Rules to Establish and Implement Regulatory Procedures for Video Dialtone Service, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd. 244 (1994) ("Video Dialtone Order on Reconsideration").

increasing investment in telecommunications, and promoting greater diversity of video programming in addition to protecting telephone ratepayers from cross-subsidization.[3] U S WEST disagreed with the Commission's findings on subjecting VDT service to price cap regulation in its Order on Reconsideration and continues to do so.[4] As U S WEST demonstrates below, U S WEST has no market share or market power in the market for multichannel video programming distribution (or "MVPD").[5] The presence of a dominant incumbent service provider (i.e., cable companies) in combination with U S WEST's and other LECs' lack of market power would indicate that regulation of VDT service is not necessary. At best, VDT service should be subject to no greater regulation than that applied to other nondominant services (i.e., streamlined regulation).[6]

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[3]Id.

[4]U S WEST has sought judicial review of the Commission's findings on the need for price cap regulation of video dialtone service. U S WEST v. FCC, No. 95-1101 (D.C. Cir. petition for review filed Feb. 10, 1995).

[5]The Commission has held that monopoly-type regulation like that contained in Title II is appropriate only for carriers possessing market power. Market power, the Commission has declared, requires "the ability to raise prices by restricting output." In the Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, Fourth Report and Order, 95 FCC 2d 554, 558 ¶ 7 (1983) ("Fourth Report and Order"), quoting P. Areeda & D. Turner Antitrust Law 322 (1978). See also First Report and Order, 85 FCC 2d 1, 10 ¶ 26 ("We will consider a carrier to be dominant if it has market power (i.e., power to control price)"; Second Report and Order, 91 FCC 2d 59-60 ¶ 1 (1982) ("[W]e classif[y] carriers as either dominant or non-dominant depending on their power to control price in the marketplace."); Fourth Report and Order, 95 FCC 2d at 558 ¶ 8 (The "consistent definition of market power focuses on the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable.") (footnote omitted).

[6]The claim that price cap regulation serves the Commission's VDT goals hardly justifies imposing such regulation if there is a much better and less restrictive means of achieving the goals -- that is, subjecting VDT service to the same level of regulation as any other service that the Commission has found to be a nondominant service. The fact that a carrier may be found to be a "dominant" provider of services in one market does not imply that it cannot be classified as a "non-dominant" provider in another market. The Commission found AT&T to be a nondominant provider of non-IMTS

In the comments that follow, U S WEST responds to Commission inquiries in the Notice. This in no way implies that U S WEST accepts the proposition that VDT service should be subject to price cap regulation. U S WEST does not. U S WEST's position and responses are predicated on U S WEST's belief that VDT is a competitive service which should be removed from price cap regulation at the earliest possible date.

II. LECS HAVE NEITHER MARKET POWER NOR MARKET SHARE IN THE MVPD MARKET

The Commission grounded its decision to apply price cap regulation to VDT service on its conclusion, asserted with no supporting legal authority or accompanying market analysis, that:

> [C]arriers offering video dialtone service maintain control over an essential bottleneck facility, i.e., the basic platform, and consequently retain control over the price of access to that platform.[7]

The misguidedness of this conclusion, together with the damper that the resulting excessive regulation imposes on the development of competition in the relevant market, compels U S WEST to address that conclusion here, as a foundational matter, before discussion of any particular application of price caps to its video dialtone

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(International Message Telephone Service) even though AT&T was found to be a dominant provider of IMTS. See In the Matter of International Competitive Carrier Policies, 102 FCC 2d 812, 830-38 (1985); see also In the Matter of American Telephone & Telegraph (AT&T) Application under Section 214 of the Communications Act for authority to acquire certain lines of Western Union Corporation (WU), Memorandum Opinion and Order, 6 FCC Rcd. 115 (1990).

[7]Video Dialtone Order on Reconsideration, 10 FCC Rcd. at. 339 ¶ 205. The Commission defines the "basic platform" as "a common carriage transmission service, coupled with the means by which consumers can access any or all video program providers making use of the platform." Id. at 251 n. 17, citing to the Second Report and Order, 7 FCC Rcd. at 5783 ¶ 2 n. 3.

service. The Commission's conclusion that the "basic platform" of LEC video dial-tone service is somehow an "essential facility" to justify the imposition of price caps is wholly inconsistent with meaningful economic market analysis, antitrust principles, and the Commission's own writings.

For the above reasons, U S WEST here reconfirms its consistent opposition to unnecessary over-regulation that stems from such erroneous conclusions and that works to impede market development.[8] To affix the "essential bottleneck" label to any facility without comprehensive consideration of the economic realities of the market, as the Commission appears to have done, is meaningless and, when asserted as the basis for regulation, diminishes rather than fosters consumer welfare.

Rate regulation serves to constrain the ability of a firm otherwise to exercise market power. The Commission has recognized that market power is "the ability to restrict output or raise price over what would prevail in a competitive market, and maintain it over time."[9] Price cap regulation is a type of rate regulation that seeks to incent firms to operate efficiently, while still curtailing exercise of market power that would occur absent regulation. If a firm lacks market power, then imposition of rate regulation, including price caps, is unnecessary and constricts the freedom

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[8]See, e.g., Comments of U S WEST filed Dec. 16, 1994, CC Docket No. 87-266, RM-8221 at 2-5. See also Opposition of U S WEST filed Aug. 12, 1993, File No. W-P-C-6868 at 9-12 and Comments of U S WEST filed May 21, 1993, RM-8221 at 4-6.

[9]In the Matter of Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, Report, 5 FCC Rcd. 4962, 4968 n. 19 (1990). For additional citations see Market Power: An Antitrust Application for the LEC Price Caps Review, filed as Attachment 1 to Comments of U S WEST filed May 9, 1994, CC Docket No 94-1 at 2 ("Market Power").

that such a firm needs to compete effectively against firms better established and more experienced in the market.[10] To the extent that the Commission's goal is to regulate only to the minimum extent necessary and otherwise to permit market forces to operate, imposition of price cap regulation on a firm that has no ability to exercise market power thwarts the Commission's goals.

The concept of an "essential bottleneck facility" that the Commission invoked to underpin its decision to impose price caps regulation on video dialtone service comes from antitrust law.[11] The leading antitrust treatise explains:

> An essential facility is, at minimum, a resource possessed by the [owner firm] that is vital to the competitive viability of the [firm seeking access]. Obviously, the [owner firm's] resource is not vital if an equivalent is available from other sources. Nor is it essential if the [firm seeking access] can compete effectively without it. The [firm seeking access] must show that the desired resource is not just helpful but vital to his competitive viability.[12]

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[10]The Commission's original Notice of Proposed Rulemaking in this docket confirms the connection between market power and the need to impose regulation: "The most likely basis for applying more streamlined regulation to LECs is that the LECs' market power has been reduced, and competition has increased." In the Matter of Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, 9 FCC Rcd. 1687, 1705 ¶ 95 (1994). There, the Commission addressed the market position LECs maintain today in traditional telephony markets (local exchange, access, etc.), as those markets transition from historical regulated monopoly to open competition. Even in those telephony markets, where LECs traditionally have held a "natural monopoly" role (in stark contrast to their new entrant role in the market at issue here), a determination of whether and, if so, to what extent LEC networks today are a "bottleneck" or otherwise convey market power requires focused scrutiny and analysis. See Market Power, passim. As explained more fully below, the Commission's own analysis that examines the economic realities makes clear that video dialtone does not fall within any traditional telephony market. Rather, video dialtone comes within the market of multichannel video programming distribution, a market that U S WEST has never before participated in. U S WEST seeks to enter the MVPD market as a nascent competitor against the entrenched cable provider. The Commission's decision to force U S WEST to comply with the full panoply of price caps regulations as it attempts to enter this new market ignores the reality of U S WEST's position and raises significant entry impediments.

[11]See, e.g., Otter Tail Power Co. v. U.S., 410 U.S. 366 (1973); MCI v. AT&T, 708 F.2d 1081 (7th Cir.), cert. denied, 464 U.S. 891 (1983).

[12]P. Areeda & H. Hovenkamp, Antitrust Law (1989 Supp.) ¶ 736.2 at p. 723.

The essential facilities antitrust doctrine provides an analytical construct to measure market power.[13] Put differently, denial of access to an essential facility is a form of exercise of market power. As such, the essential facilities concept, like any measurement of market power, is meaningful only when applied in the context of a relevant economic market.[14] To measure market power, whether through application of the essential facilities doctrine or otherwise, a necessary starting point is the definition of the relevant market through the identification of alternative economic substitutes.[15] Simply put, a facility is not "essential" to competition if an alternative is available to rivals as a substitute from another source in the market.[16]

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[13]E.g., Aspen Skiing Corp. v. Aspen Highlands, 738 F.2d 1509 (10th Cir.), aff'd on other grounds, 472 U.S. 585 (1985).

[14]See Market Power at Sec. V, at 14-20, "Market Power Measurement Begins with Market Definition," citing numerous antitrust cases and Commission decisions.

[15]See id. Indeed, the very day following the release of the Video Dialtone Order on Reconsideration, the Commission released its Second Memorandum Opinion and Order on Revision of Radio Rules and Policies. See In re Revision of Radio Rules and Policies, Second Memorandum Opinion and Order on Revision of Radio Rules and Policies, 9 FCC Rcd. 7183 (1994) ("Radio Order"). There again, the Commission reconfirmed the imperative need to define the relevant market to evaluate "bottleneck" market power and to protect the public interest:

> The Competition aspect of the public interest primarily relates to protecting consumers and companies possibly subject to bottleneck monopolies due to the potential abuse of market power by a firm or group of firms. The purpose of a competitive analysis is to determine whether in fact a firm or group of firms have and exercise such market power. Horizontal market share or concentration and barriers to entry are key factors in determining whether market power exists. . . . [Where] entry barriers are significant . . . market share and concentration ratios may be more important in evaluating market power.
>
> Market share and concentration can only be assessed after relevant markets are determined. As a result, the first step in a competitive analysis is to define the relevant product and geographic markets. The Supreme Court has stated that in defining a product for antitrust law purposes, "no more definite rule can be declared than that commodities *reasonably interchangeable by consumers for the same purposes*" constitute one product market.

Radio Order, at 5-6, ¶¶ 9-10 (citations and footnotes omitted).

[16]E.g., Flip Side Productions, Inc. v. Jam Productions, Ltd., 843 F.2d 1024, 1034 (7th Cir. 1988), cert.

The Commission's own pronouncements confirm that video dialtone service alone does not constitute a relevant product market. Rather, video dialtone service is one of several reasonably interchangeable substitutes in the market for multichannel video programming distribution (MVPD). The Commission comprehensively addressed the appropriate market definition of the very market at issue here in its recent Video Competition Report[17] (including extensive discussion of **potential** competitive impact of video dialtone on ability of cable operators to exercise market power.[18] The Commission's evaluation in the Video Competition Report makes clear that the relevant product market containing video dialtone service, properly derived from analysis of existing economic substitutes, is "the market for delivery of video programming."[19]

In that Report, the Commission appropriately listed and detailed the status of existing and potential competitors in the defined relevant market.[20] The Commission first recognized the present day competitive impact of cable overbuilders, Home Satellite Services (including both DBS and HSD services), Multipoint Multi-

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denied, 488 U.S. 909 (1988). See also, Comments of U S WEST filed May 9, 1994, CC Docket No 94-1, at Attachment 2 "A Facility is "Essential" Only When Alternatives are Not Feasible," at 1.

[17]In the Matter of Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, First Report, 9 FCC Rcd. 7442, 7462-68 ¶¶ 37-53 (1994) ("Video Competition Report").

[18]Id. at 7495-7505 ¶¶ 103-120.

[19]Id. at 7467 ¶ 49. The Commission also expressly recognized the evolutionary nature of relevant product market with the advent of new technologies. Id. at 7463-64¶ 42.

[20]Id. at 7468-7510 ¶¶ 54-135.

channel Distribution Service (MMDS), Satellite Master Antenna Television Systems (SMATV), and broadcast television services. The data set forth in the Video Competition Report makes apparent that each of these players has a current market presence that far exceeds that of U S WEST's video dialtone service.[21] The Commission's Video Competition Report next identified potential competitors and actual competitors of lesser effect in constraining cable television operators existing market power. Those players include Local Multipoint Distribution Service (LMDS), Low Power Television (LPTV), Electric Utilities, Video Cassette Recorders (VCRs), and Local Exchange Carrier Entry through video dialtone.[22] The thorough market-based consideration in this Commission Report confirms that, far from

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[21]As of September 9, 1994, DBS equipment was available in 23 states and approximately 40,000 households were receiving programming via DBS. DirecTV expects that DBS equipment will be available throughout the continental US by early November, 1994 (id. at 7475 ¶ 65). This market position far exceeds the present posture of any LEC video dialtone service.

Approximately 4 million HSD users exist, with approximately half subscribing to programming services. Almost all recent HSD buyers are choosing to subscribe to programming service. Reports indicate that HSD use may be increasing. (Id. at 7480 ¶ 73). Video dialtone services are a minuscule presence by comparison.

MMDS has increased subscribership from 50 systems serving 300,000 subscribers in 1990, to 143 systems serving 550,000 by June 1994, with growth projected through the end of the decade. (Id. at 7482-83 ¶ 79). Video dialtone service maintains a just-emerging market position at present that cannot compare.

SMATV systems are estimated at 3000-4000 nationwide. As of August 15, 1994, approximately 1 million subscribers received SMATV service, with approximately 1.03 million projected by the end of 1994 and 1.10 by 1995. Id. at 7488-89 ¶ 92. LECs have vast ground to cover before reaching the 1 million subscriber level.

Broadcast TV stations "are, and always have been, significant suppliers in the market for delivered video programming." (Id. at 7492 ¶ 97). More than one-third of all households that could subscribe to cable service elected not to, which indicates that for a significant number of viewers, broadcast TV satisfies their demand for video programming. Id. By contrast, video dialtone has yet to provide buyers an added alternative to the dominant cable providers.

[22]Id. at 7495-7510 ¶¶ 103-134.

maintaining monopoly control over an "essential facility" (as the Commission later baldly purports in its VDT Order on Reconsideration) in actuality, U S WEST and other LEC video dialtone services are merely potential new competitors that present "a promising source of competition to cable operators for the multichannel distribution of video programming."[23]

Significantly, the Video Competition Report itself was necessitated by the Congressional determination that cable operators maintain market power in the MVPD market.[24] Video dialtone service would work to bring forth an additional source of competition to erode the power of the incumbent cable companies. It would diminish, not compound, existing market power in the MVPD product market.[25]

It is nothing short of nonsensical to say that a firm, like U S WEST, controls access to an "essential bottleneck facility," when that firm has zero market share in

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[23]Id. at 7496 ¶ 104.

[24]See 47 USC § 548(g).

[25]The Commission's reference to LEC basic platform facilities as "essential bottlenecks" in the Commission's Video Dialtone Order on Reconsideration even creates internal inconsistency with the remainder of that Order. Throughout the Video Dialtone Order on Reconsideration, the Commission refers to the "market for delivery of video programming," noting, for instance, that "the dominance of cable systems in the multichannel distribution of video programming -- remains largely unchanged."[25] Indeed, elsewhere in the Order, the Commission specifically contrasts the relative market positions of cable and video dialtone, describing, for instance, that "...significantly, the cable operator, not the telephone company will be the incumbent video programming provider in the market." Video Dialtone Order on Reconsideration, 10 FCC Rcd. at 357 ¶ 242. This recognition of the incumbency of cable in the relevant market in the same Order in which the Commission somehow considers LECs to control an essential facility is, at least, difficult to square.

the relevant product market (MVPD) -- a market that already contains multiple existing providers, all of whom obviously have market shares greater than zero.[26]

The very essence of an essential facility is that denial of access to it eliminates, or at least "severely handicaps," competition by rivals.[27] The MVPD market currently is operating at full tilt without any existing access to U S WEST's video dialtone basic platform. Programmers and advertisers now have multiple providers to choose from, with cable television systems holding the dominant position.[28] Consumers have existing choices for video programming delivered to their homes, again with cable in the preeminent role. The fact that U S WEST's video dialtone service will present one more choice of outlets for programmers and advertisers and one more option for consumers to obtain video service in no way makes it an "essential bottleneck" in any meaningful sense of the term. To the extent that U S WEST can viably offer video dialtone service, it will have no ability to exercise market power whatsoever. If U S WEST attempted to restrict output or increase price anticompetitively, buyers simply would shift their purchases away from U S WEST to other

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[26]As the Commission's nearly contemporaneous Radio Order states, the Commission considers "horizontal market share or concentration "key factors in determining whether market power exists," especially where, as here, "entry barriers are significant." See also, Video Competition Report, passim, detailing various barriers to the MVPD market entry.

[27]See Alaska Airlines, et al. v. United Airlines, et al., 948 F.2d 536, 546 (9th Cir. 1991), cert. denied, 112 S. Ct. 1603 (1992)("a facility that is controlled by a single firm will be considered "essential" only if control of the facility carries with it the power to eliminate competition.") and Twin Laboratories, Inc. v. Weider Health & Fitness, 900 F.2d 566, 570 (2d Cir. 1990)("severe handicap" standard).

[28]In addition to the alternative technologies discussed in the Video Competition Report, independent programmers also can take advantage of the "leased access" provisions to gain direct access to cable systems. Section 612 of the 1984 Cable Act, 47 USC § 532, and refined by Sec. 9 of the 1992 Cable Act. Unlike cable, video dialtone is a common carriage service (regardless of the application of price caps), LECs must provide access to multiple programmers on nondiscriminatory terms.

MVPDs, making any such price increase unprofitable to U S WEST.[29] That reality is the crux of a lack of market power. In short, a video dialtone basic platform is not in any way an essential bottleneck facility in a properly defined product market.

The Commission's inaccurate use of the "essential bottleneck facility" term in the VDT Order on Reconsideration as a basis to impose price caps on LEC video dialtone services can only stem from a somewhat "knee jerk" reaction developed through historical perception that LEC networks are "bottlenecks." Whatever applicability that label may have to LEC networks as the utility provider in traditional telephony markets, it is distinctly inapplicable here in the MVPD market. As demonstrated in the above discussion of the Commission's MVPD analysis, LEC "basic platform" facilities are not, as a matter of economic reality, in any way "essential" to the provision of video programming distribution services. Courts have noted in assessing the question of utility market power, historical thinking about regulated "natural monopolies" cannot serve as the foundation for an inference of

[29]U S WEST could not successfully engage in predatory pricing through cross subsidy of not-yet-competitive telecommunications services because those services remain subject to the full scope of regulatory restrictions. See Market Power, 26 n.24, and accompanying text. Further, video dialtone and other LEC services are subject to rigorous cost allocation regulations that preclude cross-subsidy. Nor could U S WEST price video dialtone predatorally (without cross-subsidy) with a view to recouping losses through supra-competitive profits after driving out rivals. First, the durable, immobile nature of competing networks (especially cable television) means that any attempt to recoup would lead the rival to resume service. Second, most of the rivals whom U S WEST might attempt to eliminate through predatory tactics are financially secure enough to sustain losses without exiting the market. See id. at 27 n.25, and accompanying text. Finally, prior analysis submitted by U S WEST demonstrates that leveraging market position from adjacent markets in which U S WEST participates is not viable. See U S WEST's Comments to the Further Notice of Proposed Rulemaking in this docket, at Attachment 3: "LECs Cannot Improperly Leverage Market Power into Other Markets."

market power when economic reality dictates that the market can accommodate several competing firms.[30]

Having dispelled the idea the U S WEST would control an "essential facility" in any meaningful sense in the provision of MVPD, this "bottleneck" quotation from the VDT Reconsideration Order reduces to the unremarkable proposition that U S WEST, like any other non-cable MVPD competitor, can determine the price of its own video dialtone service offering, constrained by the conditions of the market-place. Power over the price of one's own service does not, of course, translate to market power.

III. APPLICATION OF PRICE CAP REGULATION TO VDT SERVICE

As the foregoing demonstrates, price cap regulation of video dialtone service is unwarranted and will impede the competitive process. However, assuming that the Commission persists in subjecting VDT service to price cap regulation at the present time, it should do so in the following manner. This will best position VDT services for removal from price cap regulation at the earliest possible date when it becomes apparent to all that VDT service is a highly competitive service in a market where LECs have no market power.

A. A Separate Price Cap Basket Should be Created for VDT Services

The creation of a separate price cap basket for VDT services will allay any concerns over cross-subsidization. A separate VDT basket will "wall-off"

[30]See, e.g., Town of Concord v. Boston Edison Co., 915 F.2d 17, 31 (1st Cir. 1990)(Breyer, J.), cert. denied, 499 U.S. 931 (1991).

competitive VDT services from all other LEC telecommunications services. VDT price changes will have no effect on the PCIs or APIs of other baskets -- eliminating any possibility of cross-subsidization.

LECs should be allowed to modify the prices of VDT services as they see fit as long as these prices, as a whole, do not exceed the VDT basket's PCI.[31] No additional service categories or bands are necessary. Given the newness of VDT services, it remains to be seen as to what services will actually make up the VDT basket. It would be both premature and counterproductive to establish service categories at this early date.

B. There Is No Basis for Applying A Productivity Offset to the VDT Basket

VDT services represent a totally new class of services for LECs with different customers than telecommunications services and different technology. As such, there is no history or record from which to derive a productivity offset. The only assumption that is reasonable is that VDT productivity will grow at a rate similar to that of the overall U.S. economy. This rate is already reflected in the GNP-PI. Similarly, there is no basis for adopting a consumer productivity dividend in the absence of any history or record. It would be purely speculative to apply anything other than a zero productivity offset to the VDT basket. The Commission did not

[31]The Commission recognized the need for pricing flexibility in competitive markets when it adopted streamlined regulation for AT&T's Basket 3 services. In its Order, the Commission observed that existing tariff rules "den[ied] AT&T the full pricing flexibility needed to react to market conditions and customer demands and thereby diminish its ability to compete as a full-fledged competitor" In the Matter of Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd. 5880, 5895 ¶ 80 (1991). The same observation holds true for LEC VDT services.

incorporate a productivity offset in its cable price cap plan because there was no factual support for it[32] and should not do so here.

Furthermore, there is precedent for using a separate productivity factor for an individual basket. The Commission has employed a different productivity offset for LEC interexchange services since the adoption of price caps.[33] In that case, the Commission employed the same productivity offset that has been applied to AT&T's interexchange services which are competitive alternatives to LEC interexchange services. Thus, the use of a zero productivity offset would comport with the Commission's action in the cable proceeding and the treatment of LEC interexchange services.

C. The VDT Basket Should Be Excluded From All Calculations Of Interstate Earnings For Sharing Purposes

The Commission adopted the sharing and low-end adjustment mechanisms in its original price cap plan as a "backstop" to guard against errors/unanticipated impacts from the selection of the productivity offset.[34] If the Commission employs a zero productivity offset, as U S WEST recommends, it also would be appropriate to exclude the VDT basket from any sharing and low-end adjustment calculations.

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[32] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992--Rate Regulation, Memorandum Opinion and Order, 9 FCC Rcd. 5760, 5761 (1994).

[33] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786 ¶ 13 (1990) ("LEC Price Cap Order").

[34] Id. at 6801 ¶¶ 120-21.

Furthermore, excluding the VDT basket from sharing calculations would avoid the inevitable charges of earnings manipulation and cross-subsidization that arise in sharing discussions. It also should pave the way for removing VDT services from price cap regulation at the earliest possible date.

D. Only VDT-Specific Exogenous Costs Should Be Applied to the VDT Basket

One element of the LEC price cap plan that has been the subject of much debate is the treatment of exogenous costs. The Commission's interim plan continues to include an exogenous cost element despite U S WEST's recommendation that it be eliminated.[35] Thus, it is quite probable that exogenous costs will still exist when VDT services are rolled into price cap tariffs.

As stated above, VDT services differ significantly from traditional access services both in terms of market and technological characteristics. As a result, U S WEST recommended above that a separate price cap basket be created for VDT services. Similarly, a different productivity offset and exclusion from sharing were proposed for the VDT basket. The same logic applies with respect to exogenous costs. Most exogenous cost changes have been uniformly spread across all price cap baskets. This approach would not make a lot of sense with respect to VDT services where many, if not most, of the potential exogenous costs[36] would arise as a result of the unique nature of VDT service. It would be inappropriate to spread these costs

[35]Comments of U S WEST filed herein, May 12, 1994 at 46-47.

[36]E.g., costs associated with any possible "must carry" requirements.

across other baskets containing telecommunications services. Likewise, it would be inappropriate to subject VDT services to allocations from unrelated exogenous costs. Therefore, U S WEST recommends that only VDT-specific exogenous costs be applied to the VDT basket and no general allocations of exogenous costs be applied to the VDT basket.

E. The Commission's New Service Rules Should Not Be Applied to VDT Services In Their Present Form

Video dialtone truly is a "new" service for LECs. This distinguishes it from the vast majority of other services which are classified as new services under the Commission's price cap rules.[37] VDT service does not represent a new pricing option nor is it a close substitute for other services which LECs currently provide. However, it is a close substitute for existing cable services and services that cable companies are expected to provide in the future. As a result, demand characteristics and growth patterns of VDT services are expected to differ significantly from those of conventional new services under price cap regulation. Because of these differences and the fact that VDT service, in all likelihood, will be assigned to a separate basket, it is critical that the new service rules be modified as they are applied to VDT service.

The new service rules should be modified both with regard to the time period before a new service is moved into a price cap basket and the pricing flexibility allowed during this period. First, U S WEST recommends that LECs have a

[37] Lec Price Cap Order, 5 FCC Rcd. at 6825 ¶¶ 315-21.

minimum of one full calendar year of demand before VDT is rolled into a price cap basket. Currently, new services are included in price caps "in the first annual price cap tariff filing after the completion of the base year in which the new service becomes effective."[38] This means that a new service may have anywhere from a maximum of one year's demand to a minimum of a single day's demand before it becomes subject to price cap regulation.

The application of the price cap rules can lead to anomalous results when very low non-representative historical demand figures are used for calculations. The fewer the number of services in a price cap basket, the more skewed the impact of low demand figures. As such, the Commission should require LECs to have a minimum of 12 months of historical demand before VDT services become subject to price cap regulation.

Secondly, it is imperative that LECs have pricing flexibility for VDT services during the period between introduction and incorporation into price caps. The Commission's new services rules require that initial LEC VDT tariffs be cost supported.[39] Satisfaction of this requirement for initial LEC VDT tariffs should be sufficient to alleviate any Commission concerns with respect to LEC VDT prices.[40]

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[38]LEC Price Cap Order, 5 FCC Rcd. at 6825 ¶ 319.

[39]VDT Order on Reconsideration, 10 FCC Rcd. at 340-47 ¶¶ 206-223.

[40]However, U S WEST fails to comprehend the need for detailed cost support for a competitive service such as VDT service. The Commission has repeatedly determined that traditional tariff regulation is unnecessary in order to ensure lawful rates in a competitive environment -- in fact it would be counter-productive. In the Matter of Tariff Filing Requirements for Interstate Common Carriers, Report and Order, 7 FCC Rcd. 8072, 8073-79 (1992). Also see In the Matter of Policy and Rules concerning rates for competitive common carrier services and facilities authorizations therefor, Notice of

LECs should not be required to go through the same lengthy tariff review exercise if they find a need to modify their VDT prices during the period before VDT becomes subject to price cap regulation. The Commission should permit LECs to modify their rates on 14-days notice if the new rates fall within the floor and ceiling range established in a LEC's original VDT cost showing. This would allow LECs a modicum of flexibility to respond to pricing initiatives of incumbent cable operators. The Commission will all but "tie the hands" of LECs if it does not allow them this level of pricing flexibility.

IV. CONCLUSION

If the Commission subjects VDT service to price cap regulation, it should do so as described above.

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April 17, 1995

Inquiry and Proposed Rulemaking, 77 FCC 2d 308, 358-59 (1979).

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 17th day of April, 1995, I have caused a copy of the foregoing **COMMENTS** to be served via hand-delivery, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

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