

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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**FEDERAL COMMUNICATIONS COMMISSION
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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

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GTE's REPLY COMMENTS

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SUMMARY

1. VDT should be subject to streamlined regulation.
2. In any case, two benchmarks should apply: (i) VDT regulation should be less burdensome than regulation of cable firms; (ii) VDT regulation should be less burdensome than regulation of AT&T.
3. Ratepayer interests would not be endangered by streamlined regulatory treatment of VDT.
4. If the FCC nonetheless decides to apply price cap regulation to VDT, the record supports a flexible plan that requires no new standards or rules.

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GTE's REPLY COMMENTS

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby offer reply comments with reference to comments submitted on the Commission's Further Notice of Proposed Rulemaking ("*Further Notice*"), FCC 95-49 (released February 15, 1995), in the proceeding captioned above regarding regulation of video dialtone ("VDT") service offered by Local Exchange Carriers ("LECs" or "exchange carriers") subject to price cap regulation.¹

DISCUSSION

I. IN ORDER TO FOSTER ITS GOAL OF AN EFFICIENTLY COMPETITIVE MARKET, THE COMMISSION SHOULD PLACE VDT SERVICES UNDER STREAMLINED REGULATION.

In its September 1994 First Report to Congress on the state of competition in video distribution services,² the Commission concluded that entrenched cable system

¹ See Telephone Company-Cable Television Cross Ownership Rules, CC Docket No. 87-266 ("*D. 87-266*") and RM-8221, Second Report and Order, 7 FCC Rcd 5781 (1992) ("*VDT Second Report*"), *appeals pending sub nom.* Mankato Citizens Tel. Co. v. FCC, No. 92-1404 (D.C. Cir. September 9, 1992), Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244 (1994) ("*VDT Reconsideration Order*").

² 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, CS Docket No. 94-48, First Report, 9 FCC Rcd 7442 (1994) (the "*D.94-48 First Report*").

operators continue to possess substantial market power in the multichannel video programming service market.³ The Commission observed that the creation of the VDT framework "along with technological advances, has spurred increased video-related activity by LECs, including several market and technical trials and twenty-four applications for permanent authority covering 8.5 million homes."⁴ Further, the Commission stressed the value of VDT offerings as "a promising source of competition":

These applications, taken together, constitute a promising source of competition to cable operators for the multichannel distribution of video programming.⁵

VDT offerings can represent an important competitive alternative to monopoly cable systems. And yet the *Further Notice* (at para. 2), on an essential facility theory,⁶ would apply dominant carrier regulation to VDT in the form of price caps. Thus, **the *Further Notice* would create the anomaly of an assumed "bottleneck" or "essential facility" when complete facilities already exist that provide an entrenched competitive service.** Clearly, the very facts recited by the Commission negate proper application of an essential facility rationale.

³ *D.94-48 First Report*, 9 FCC Rcd at 7449: "The market for the distribution of multichannel video programming remains heavily concentrated at the local level, and for most households, cable television is the only provider of multichannel video programming. Cable systems continue to have substantial market power at the local distribution level."

⁴ *D.94-48 First Report*, 9 FCC Rcd at 7496, *footnote omitted*.

⁵ *Id.*

⁶ *VDT Reconsideration Order*, 10 FCC Rcd at 339.

Incumbent cable operators are well established in every one of the areas in which GTE plans to furnish VDT. Far from being a "bottleneck facility", GTE's VDT service will begin from a base of zero subscribers with one or more well-established competitor(s) serving the entire market. Assuming success of the offering, VDT will come to function not as a sole offering but as yet another alternative video distribution medium competing against the incumbent cable operator as well as such services as Direct Broadcast Satellite service ("DBS"), Multi-Channel Multi-Distribution Service ("MMDS"), and Satellite Master Antenna Television service ("SMATV").

Together with other video suppliers, cable firms will not only furnish alternatives to the VDT offerings; they will continue to control a very large market share. Even if GTE eventually achieved its projected market share -- by no means a foregone conclusion -- this would not exceed one third.⁷ The notion that GTE, through its VDT offerings, will have a "bottleneck" that would permit restriction of market output or anticompetitive price increases is not only speculative; it is far-fetched. Competition -- vibrant and already solidly established -- will preclude any such GTE "bottleneck."

GTE and the other VDT providers maintain that long-established Commission policy requires the application of streamlined regulation to VDT.⁸ The FCC has adopted and implemented the principle that regulation should be streamlined as a

⁷ GTE projects that over the next fifteen years, its networks will connect to approximately one-third of all homes in its VDT serving areas. Response of GTE, W-P-C-6955, 6956, 6957, 6958, December 16, 1994, Attachment 1.

⁸ U S West at 2; Southwestern Bell at 2; BellSouth at 2; USTA at 1; NYNEX at 1; Bell Atlantic at 1; Rochester at 3.

market becomes increasingly competitive.⁹ Consistent application of this principle would subject VDT providers to no more than streamlined "non-dominant" regulation.

In summary: VDT should be subject to streamlined regulation.

II. IN ANY CASE, TWO BENCHMARKS SHOULD APPLY: VDT REGULATION SHOULD BE LESS BURDENSOME THAN REGULATION OF CABLE FIRMS OR AT&T.

If the Commission continues to insist on dominant regulation of VDT, the foregoing discussion should lead to adopting and applying two benchmarks that should guide Commission policy:

First: VDT price regulation should be less burdensome than that which binds cable systems, recognized by the Commission as monopolies.

Second: VDT price regulation should be less burdensome than that which applies to AT&T, which dominates the interexchange market.

GTE agrees with the conclusion of Cox (at 22) on the "regulatory parity and competitive equity mandate that the same rules [should] apply uniformly to cable operators and video service providers." The Commission has already concluded that VDT services will function as an effective competitor to existing cable offerings. Indeed, under the "effective competition" test, competition at a certain level will result in the cable operator escaping regulatory oversight of its charges for video programming services.¹⁰

⁹ Thus, AT&T has been largely relieved of regulation. The Commission reached the conclusion that commercial services provided by AT&T should be removed from price caps and be made subject to streamlined regulation. *See Revisions to Price Cap Rules for AT&T Corp.*, Report and Order, CC Docket 93-197, FCC 95-118 (released January 12, 1995) ("*AT&T Price Cap Report and Order*").

¹⁰ *See* 47 U.S.C. Sections 543(a)(2) and 543(l)(1).

Beginning on day one of VDT roll-out, there would be no pricing constraints on VDT under this effective competition test if it applied to exchange carriers. Commission policy should take this into account by making sure exchange carriers are not subject to greater constraints than cable firms meeting the effective competition test. As Bell Atlantic (at 4) observes, it would be "bizarre" to free the entrenched cable operator from regulatory constraints while leaving the fledgling entrant subject to extensive pricing scrutiny.

For similar reasons, VDT regulation should be no more burdensome than what applies to AT&T's commercial services.¹¹ AT&T (at 4) claims that in order to alleviate any potential for the subsidization of VDT by other telephony services, a separate price cap basket and subcategory pricing constraints must be created for VDT.¹² The Commission released AT&T's commercial services from price cap regulation upon a showing that they face substantial market competition. And yet AT&T has far greater market strength in any of its markets than a fledgling VDT offering in an area already served by a cable firm. To be consistent with its own analysis, the Commission should subject VDT to no more than AT&T's regulation as a benchmark.

In summary: In any case, two benchmarks should apply: (i) VDT regulation should be less burdensome than regulation of cable firms; (ii) VDT regulation should be less burdensome than regulation of AT&T.

¹¹ *AT&T Price Cap Report and Order.*

¹² *See also MCI at 5.*

III. **STREAMLINED REGULATION OF VDT WOULD PRESENT NO DANGER TO RATEPAYERS.**

Streamlined regulatory treatment would pose no threat to ratepayers of basic telephone and access services. To the same extent that AT&T's residential services cannot be used to subsidize its commercial services subject to streamlined regulation, exchange carriers are precluded from subsidizing VDT offerings with services contained in the interstate price cap basket for access services or services subject to state rate regulation. Thus, in its recent approval of GTE's Section 214 applications, the Common Carrier Bureau said that it was not persuaded "to take action at this time in response to concerns that telephone rates will increase or that under price-cap regulatory schemes, ratepayers may experience rate increases as a result of GTE's proposals."¹³ The Bureau noted that state commissions possess adequate tools to insure that VDT costs do not impact local telephone rates. Further, VDT could not be used to justify increases in LEC access service prices because rate changes for access offerings are subject to price cap rules and are not determined by changes in cost.¹⁴

Given that existing regulatory tools fully protect ratepayers from cross-subsidization and discriminatory conduct, the real public interest question in this proceeding should be whether Commission policy promotes competition with cable firms' monopolization of video markets. Demands for still more detailed scrutiny of LEC

¹³ Applications of Contel of Virginia Inc., GTE Florida, Inc., GTE California, Inc., GTE Hawaiian Telephone Co., Inc., W-P-C-6955, 6956, 6957, 6958, Order and Authorization, DA 95-1012 (released May 5, 1995) ("*GTE 214 Authorization*") at para. 99.

¹⁴ *Id.* at para. 100.

competitive offerings -- coming from an entrenched monopoly that above all seeks to preclude any competitive challenge -- are not worthy of consideration.

By persistently advocating ever-more regulatory barriers to market entry and ever-greater regulatory burdens on new market entrants, the cable industry is seeking to deter exchange carriers from effective competitive entry. If consumers are to enjoy alternative video distribution media as intended by the Commission, the FCC must not impose on competitive market entrants regulatory barriers more burdensome than what applies to the entrenched monopoly.

In summary: Ratepayer interests would not be endangered by streamlined regulatory treatment of VDT.

IV. TO THE EXTENT PRICE CAPS APPLIES TO VDT, THE RECORD SUPPORTS A FLEXIBLE PRICE CAP PLAN.

GTE (at 12-21) advocates a flexible regulatory approach to VDT as paramount to the achievement of the Commission's goal of facilitating competition, promoting efficient investment and expanding the availability of new and diverse programming sources. If the Commission insists on applying traditional dominant carrier regulation to non-dominant VDT providers, then this should be structured in a way that would still allow VDT to compete effectively with established cable firms. Therefore, a price cap plan for VDT should encompass a separate basket for VDT services with no subcategories, continued reliance on the new service pricing rules, and should not reflect a productivity factor.

A separate basket for VDT is supported by comments from a wide range of perspectives.¹⁵ Moreover, the imposition of such a basket should only be temporary.¹⁶

¹⁵ For example, AT&T at 4, GSA at 3, NCTA at 6, USTA at 4.

If VDT services are initially made subject to price caps, the Commission should move to adopt criteria for allowing services that are subject to significant competition, such as VDT, to be streamlined.

No commenter has demonstrated a compelling need for disaggregated service elements and categories within a VDT price cap basket. Again, the competitive nature of video distribution markets will constrain VDT price levels and rate changes. Under these circumstances, there is no need to design artificial pricing constraints on individual elements in order to ensure rate stability. Further, the Commission's requirements under the Open Network Architecture rules (now applicable to GTE)¹⁷ will insure that rate structures proposed by VDT will be unbundled sufficiently to permit network users to obtain only those elements that are needed to accommodate their needs.

There is also strong support among the filed comments for the adoption of a price cap plan with no productivity offset for VDT.¹⁸ It is very significant that the cable industry favors this approach because it will work to achieve greater parity in the regulatory treatment of cable and telephony.¹⁹ There is no factual basis to justify applying to VDT productivity factors set for access and interexchange services.

¹⁶ Southwestern Bell (at 33).

¹⁷ Application of Open Network Architecture and Nondiscrimination Safeguards to GTE Corporation, CC Docket No. 92-256, Report and Order, 9 FCC Rcd 4922 (1994).

¹⁸ See, Ad Hoc at 12, NYNEX at 7, United at 3, U S West at 13.

¹⁹ Cox at 22, NCTA at 11.

regulatory treatment of cable and telephony.¹⁹ There is no factual basis to justify applying to VDT productivity factors set for access and interexchange services.

The Commission's new services test is also recognized by the majority of commenters as sufficient to establish new rates for VDT.²⁰ By requiring LECs to identify the direct costs of the service and allocate a reasonable portion of shared and overhead costs to VDT, the Commission would be equipped to make a determination in conventional terms of whether VDT rates are "reasonable" and are not "predatory." There is no reason to create any new standards or rules relative to the pricing of VDT services.

In summary: If the FCC nonetheless decides to apply price cap regulation to VDT, the record requires a flexible plan that requires no new standards or rules.

Respectfully submitted,

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¹⁹ Cox at 22, NCTA at 11.

²⁰ Southwestern Bell at 6, AT&T at 5, NYNEX at 8-9, BellSouth at 11, GSA at 5.

Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "GTE's Reply Comments" have been mailed by first class United States mail, postage prepaid, on the 17th day of May, 1995 to all parties of record.


Ann D. Berkowitz