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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

May 17, 1995

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M St. NW
Washington, DC 20006

Re: 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.

Dear Mr. Caton:

Enclosed herewith for filing are the original and nine (9) copies of MCI Telecommunications Corporation's Reply Comments in the above-captioned proceeding.

Please acknowledge receipt by affixing an appropriate notation on the copy of the MCI Reply Comments furnished for such purpose and remit same to the bearer.

Respectfully,

Michael Hydock

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington DC 20554

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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MCI REPLY COMMENTS

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May 17, 1995

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Summary

MCI, in these reply comments, reiterates its position that price cap regulatory treatment for video dialtone services is both desirable and necessary. A separate price cap basket for VDT services is required, and any revenues, investments, and expenditures associated with VDT must be excluded from the interstate rate of return calculation to determine sharing for any price cap carriers that are subject to such sharing. MCI demonstrates that VDT is a monopoly service, the only common carriage type delivery service for video in the market today. Moreover, MCI reminds the Commission that VDT will be offered by bottleneck providers of telephony access that will be tempted to use cross subsidization and predatory pricing to carve out market share. As such, price cap treatment is inherently required. Additionally, MCI demonstrates that a separate price cap basket for VDT include a productivity offset that is equal to the existing productivity offset chosen by the LEC. Given that the LECs are claiming that in excess of two thirds of the costs for deploying broadband are telephony related, to arbitrarily assign a zero productivity factor to the VDT component is insupportable.

Before the
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Price Cap Performance Review	)	
for Local Exchange Carriers;	)	CC Docket No. 94-1
Treatment of Video Dialtone Services	)	
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MCI REPLY COMMENTS

MCI Telecommunications Corporation ("MCI") hereby submits its reply comments in response to the Further Notice of Proposed Rulemaking ("Notice") in the above- captioned docket.[1] In this Notice, the Commission is seeking comments from interested parties regarding the tentative conclusion that Local Exchange Carriers (LECs) subject to price cap regulation would also have their Video Dialtone (VDT) service rates regulated under the Commission's same price cap rules.[2] To that end, the Commission released the instant Notice seeking comment on certain policy and operational issues involved in such a regulatory mechanism. In addition, the Commission has recently issued its findings in the Price Cap Performance Review, and

[1] In the Matter 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, ("Notice") released February 15, 1995.

[2] In the Matter of Telephone Company-Cable Television Cross Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266, 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, RM-8221, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, ("Reconsideration Order") released November 7, 1994.

its findings are related to MCI's Reply Comments discussed below.[3] This review, plus the initial price cap orders[4] presents the framework for evaluating the proper treatment of VDT under price caps.

Introduction

In the initial round of comments in this proceeding, responses from various industry parties fell within predictable grounds: price cap LECs generally maintain that VDT is a competitive service, and as such should not be regulated under the price cap mechanism; other parties, mainly cable companies and access ratepayers, argue that price caps and a distinct VDT basket are required to protect monopoly ratepayers and cable operators from cross-subsidization and predatory pricing, respectively. The price cap LECs further argue that if the Commissions were to rule that price caps are an appropriate mechanism for regulating VDT, then the existing trunking basket would serve as an adequate vehicle for such price cap treatment. In these reply comments, MCI will demonstrate the fallacy of the LEC arguments, and will urge the Commission to affirm its conclusion that a separate price cap basket is required for VDT services.

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[3] In the Matter Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, ("Order") released April 7, 1995.

[4] In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5FCC Rcd 6786 (1990) *(LEC Price Cap Order)*, Erratum, 5 FCC Rcd 7664 (Com. Car. Bur. 1990), *modified on recon.*, 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*).

VDT IS A COMMON CARRIAGE, MONOPOLY SERVICE AND MUST BE REGULATED PURSUANT TO A SEPARATE PRICE CAP BASKET

According to the Commission the overall policy goals of VDT include:

> ...facilitating competition in the provision of video services; promoting efficient investment in the national telecommunications infrastructure; and fostering the availability to the American public of new and diverse sources of video programming.[5]

Under this paradigm, the Commission sought to facilitate the development of a LEC-based common carriage broadband video network of sufficient capacity to provide consumers with a mechanism to receive video based signals, and to provide numerous and varied programmers with a means to transport their signals to these consumers. As the Commission viewed the landscape at that time, there was no neutral network existing that could allow a variety of programmers the opportunity to lease channel capacity on a distribution network in order to deliver signals to consumers homes. Over-the-air broadcasters in effect held monopoly control over certain frequency bands, and because of capacity constraints did not provide the level of "common carriage" necessary for full video programming competition. Cable operators held closed systems, and are often financially tied to program content providers. This did not provide a truly open vehicle for programming interests. Video dialtone was envisioned as a solution to this lack of competition. Through VDT, many assorted programming interests could essentially lease on a non-discriminatory, tariffed basis channel space on a wireline platform that would deliver their signal to a set of

[5] Reconsideration Order, at ¶ 3.

consumers. VDT essentially creates a new, non-duplicative vehicle for video programming delivery that has at its core a common carriage attribute.

In the instant proceeding, the Commission must keep in mind where there is competition and where there is effective monopoly control. Within the VDT framework, the LEC provider is indeed a monopoly provider of VDT services. LECs commenting in this proceeding wish to lump the entire video entertainment business into one homogeneous marketplace, arguing that cable, video and game rentals, over-the-air television are all part and parcel of the same market as VDT. Therefore, they argue that price caps, as an interim regulatory step on the road to full competition, can be skipped because of the existence of other video-based entities within the market place.[6] This unified clamor of LECs chanting "there already is competition", however, provides no meaningful analysis to the case of the appropriate price cap treatment of VDT services. This is true for several reasons which MCI will explore below.

Video dialtone, as a common carriage transport mechanism under Title II of the Communications Act, is required to have published, non-discriminatory tariffs. The nature of the VDT model is analogous to the traditional narrowband model: the telephone company has virtual monopoly control over a distribution mechanism that is content neutral. Moreover, the VDT transportation and distribution network is intrinsically physically and functionally tied to the monopoly narrowband voice network. The recent tariff filings of Bell Atlantic bear this relationship out -- over 67

[6] US WEST, for example, argues that the relevant market is multi-channel video programming distribution [US WEST Comments at 2.]; NYNEX [NYNEX Comments at 3] and Southwestern Bell Telephone Company (SBC) [SBC Comments at 1-2] point at the larger market discussed above by MCI.

percent of the investment of the VDT network is common to both VDT and voice.[7] It remains clear, therefore, that if the voice/narrowband network is a monopoly bottleneck, and the broadband video dialtone network is so intrinsically tied to the base monopoly network through excessive shared elements, this broadband video network must also be described as a monopoly bottleneck, suitable for price cap regulation. MCI does not believe that the 67 percent represents a proper allocation of the functional costs of the network. However, in as much as the access and local telephony ratepayer could be assessed rates that reflect something more than the stand-alone costs of the narrowband/voice network of today, comparable rate regulation should be put in place for VDT services.[8]

The VDT paradigm will become, under proper Commission oversight, the only mechanism of video/broadband distribution that is somewhat unbundled from the content provided. As discussed above, VDT will offer programming transport and delivery alternatives that are not in place today. What the Commission is proposing to be subject to price caps is a common carriage, monopoly distribution mechanism. By holding this transport under price caps, the Commission will essentially be protecting LECs from overcharging independent programmers. Moreover, given that LECs will apparently be allowed to utilize their own distribution systems for the delivery of

[7] Bell Atlantic Tariff Transmittal No. 741, D&J, Workpapers 5-3 and 5-4.

[8] MCI is fully aware that under price caps, if a carrier elects the 5.3 productivity factor, no sharing reductions could flow from expenditures on VDT. However, MCI does wish to point out that carriers can elect other productivity factors that allow for sharing. Also, since it is apparent that some VDT costs will flow through separations into the intrastate side, rate of return, flexible return, and other non "pure" price cap mechanisms can have detrimental impacts on ratepayers driven by excessive and mis-allocated investments in VDT.

content, coverage of VDT under price caps will ensure that LECs are non-discriminatory in their own use of the VDT platform. Pricing constraints under a VDT price cap mechanism will also prevent LECs from drastically lowering rates below costs in order to practice predatory pricing for their VDT services in an attempt to gain market share. The Commission must distinguish the fallacy in the LEC arguments. VDT is simply not a cable system, despite LEC arguments to the contrary. VDT is a common carriage transport mechanism, open to a multitude of programmers, and offered by a monopoly provider of telecommunications services. As such, price cap regulation is entirely appropriate.

As MCI stated in its original comments in this proceeding, the Commission has positioned price cap rules as a technique to create pricing practices that mimic those under competition.[9] However, the Commission must recognize that the entire issue of price caps becomes more problematic under a paradigm where the services to be capped are in two relatively distinct marketplaces, with two distinct patterns of competition and customer bases. The interstate services already covered by price cap regulation are offered by LECs under a virtual monopoly situation, and will continue to be for some time. While there has been some limited entrance of competitors into niche markets, the coverage of competition, in terms of the services offered and the customer base that can avail itself to these other suppliers, is extraordinarily limited. Also, the competitive framework is not yet complete; issues such as number portability, nationwide compensation structures, and universal service issues have not

[9] Notice at ¶ 7.

yet been fully implemented. VDT services, on the other hand, will be offered in a world where there is more limited pricing rules, and where there is somewhat more competitive alternatives to VDT.[10] In addition, based upon the level of network topology, financial resources, and existing technology, telephony firms will find it relatively easier to deploy video delivery than will cable operators provide switched telephone and access services. For these reasons, it is crucial that the Commission develop a separate price cap basket for VDT services, one that is designed correctly and can be used to preclude significant amounts of cross-subsidy.

THE PRODUCTIVITY FACTOR MUST REFLECT LEC COST ALLOCATION ASSUMPTIONS

Price cap LECs argue that if the Commission is to require price cap treatment of VDT service, then they should be accorded the same productivity factor that cable operators currently receive. As in the case of price cap regulation for VDT in general, the LECs argue their position in a naive manner that minimizes the inherent complexity of their request. In particular, the existing productivity offset for cable operators reflects the existing network architecture of cable systems, as well as the bundled nature of their product: both distribution and content. VDT service, on the other hand is a broadband distribution function that divorces content from the actual distribution facility. As such, there are different sets of inputs for the two different product lines.

[10] Cable firms, for example, are subject to pricing rules for certain programming tiers.

If LECs were to build proprietary, closed cable systems, MCI would understand the rationale of providing similar price cap regulatory treatment of both existing cable system operators and future LEC entrants into that particular marketplace. However, VDT does not fit that description. Rather, VDT is so intrinsically connected to existing telephony transport and loop distribution, that the existing productivity offset for telephony is appropriate for a VDT-type system. Indeed, the Commission itself characterizes VDT as an access service available to independent programmers seeking to deliver video services to end users.

Under the recently revised price cap rules, the Commission affirmed its view that the productivity offset relates to the total factor productivity differential between LECs and the United States economy as a whole. LECs have been found to have higher productivity growth than the economy as a whole, necessitating an ongoing adjustment to a GDP-PI driven price cap annual adjustment. If the Commission were to find that VDT service should be assessed a different productivity adjustment than existing telephony services, the Commission would be required to describe the differences in the factor inputs that drive the VDT process.

Recent tariff filings by Bell Atlantic and SNET suggest, however, that the provision of VDT is inherently related to the provision of telephony and access services. Under SNET's VDT tariff filing, it states that the investment in the joint telephony/video network is so intertwined between VDT and voice that 65 percent of the joint costs are assigned to telephony, in addition to the direct costs of the project assigned to telephony.[11] Likewise, Bell Atlantic assigns 67 percent of the

[11] Southern New England Telephone Tariff Transmittal No. 641, p. 17.

VDT/telephony costs to the common cost category.[12] If these allocations are utilized by the Commission in the rate setting process then it is clear that the factor inputs between voice and VDT are so similar that identical productivity offsets must be utilized.[13]

If the Commission were to grant a zero productivity offset to the VDT basket, however, to make it consistent with the cable regulations productivity offset, than the existing price cap productivity offset for the existing telephone service baskets, common line and trunking, would need to be adjusted upwards to reflect the exclusion of VDT investments from the price cap formula. This would be necessary because by assigning a zero percent productivity factor to cable, the proportion of shared, or common costs and investment of telephony and video in the local loop that were allocated to VDT would be receiving a zero productivity factor, even though the present use of the telephony loop is granted up to a 5.3 percent productivity offset. By arbitrarily assigning certain of these costs to VDT, and essentially removing this investment from the productivity offset, telephony ratepayers will not be receiving the full productivity offset to which they are entitled. Rather, they will be subsidizing VDT costs.

The interelatedness of the VDT network with the voice network under the LEC deployment scenarios illustrates the crucial nature of the Commission's review of

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[12] Bell Atlantic Tariff Transmittal No. 741, D&J, Workpapers 5-3 and 5-4.

[13] As discussed *infra.*, MCI contends that the allocations used within these aforementioned tariff transmittals are not fully justified and must be investigated thoroughly by the Commission staff before allowing these tariffs to go into effect. In particular, MCI believes that the allocation of joint and common costs between telephony and VDT is so distorted as to call into question the lawfulness of the proposed video dialtone rates.

the cost allocation process. This issue transcends the VDT paradigm, and is contained within any deployment of a video system by the LECs. For example, if the LECs were to develop a cable system rather than a VDT system, the amount of shared investment and expense between the two networks, if any, would still necessitate a thorough cost allocation process under Part 64. Under a VDT scenario, the Commission has decided to utilize the tariff review process as the vehicle for assuring that potential cross-subsidy concerns are addressed by the provisioning LEC. Under a cable system being deployed under Title VI, the cost allocation issue of the joint network is still an over-riding concern, but must be dealt with under the Part 64 rules. Moreover, given the non-periodic review of Part 64 compliance compared with tariff transmittal reviews, an accurate cost allocation review under Part 64 carries even more importance. MCI is concerned with such a review, since the Part 64 rules have not been utilized for such a potentially large split of regulated and non-regulated expenditures and investments.

Conclusion

. For the reasons discussed above, the Commission must establish a separate price cap basket for LEC VDT services. The Commission should utilize the new service rules to establish the initial rates for VDT services, and require that those services be rolled into the existing price cap formula after they have been in existence for one year. The Commission should create a new Part 69 rate category for VDT services, allowing carriers to allocate the costs of VDT directly to this bucket. Finally, the Commission must find that carriers offering VDT services should exclude the revenues, expenses, and investments of VDT from the calculation of interstate return that forms the basis for sharing and low end adjustments.

Respectfully submitted,

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May 17, 1995

Statement of Verification

I have read the foregoing and, to the best of my knowledge, information, and belief, there is good ground to support it, and it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on May 17, 1995

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I, Stan Miller, do hereby certify that copies of the foregoing Reply Comments were sent via first class mail, postage paid, to the following on this 17th day of May, 1995.

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