

BELLSOUTH

Karen B. Possner
Executive Director
Legislative & Regulatory Policy

EX PARTE OR LATE FILED

Suite 900
1122 21st Street, N.W.
Washington, D.C. 20036-3351
202 463-4160
202 463-4196 (fax)
Internet: possner.karen@bsc.bls.com

July 21, 1995

DOCKET FILE COPY ORIGINAL

Ex Parte

RECEIVED

JUL 21 1995

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: CC Docket Nos. 87-266 and 94-1

Dear Mr. Caton:

The attached letter from David J. Markey of BellSouth was delivered to the offices of Chairman Hundt, Commissioner Quello, Commissioner Barrett, Commissioner Ness and Commissioner Chong today in connection with the above-referenced proceedings.

Please direct any questions you may have to the undersigned.

Sincerely,

Karen B. Possner 

Attachment

cc: **Chairman Hundt**
Commissioner Quello
Commissioner Barrett
Commissioner Ness
Commissioner Chong



David J. Markey
Vice President-
Governmental Affairs

1133 21st Street, N.W.
Suite 900
Washington, D.C. 20036
202 463-4101

July 21, 1995

The Honorable Reed E. Hundt
Chairman
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Re: CC Docket No. 87-266
CC Docket No. 94-1

Dear Mr. Chairman:

In a June 28, 1995 letter to you and the other Commissioners, James O. Robbins of Cox Communications, Inc. ("Cox") requests that the Commission substantially revise its cost allocation rules to prevent alleged cross-subsidy of video dialtone service by telephone ratepayers. Cox attached a "white paper" by Snavely, King & Associates, Inc. ("Snavely King") that purports to "debunk" the assertion that price cap regulation of the LECs removes "their incentive to cross subsidize new services from their monopoly rate base."

With all due respect, Cox's letter and the Snavely King paper are based on a factual predicate that is very far fetched, and their analysis exhibits a profound ignorance of the Commission's price cap, jurisdictional separations and cost allocation rules. Furthermore, the "solutions" proposed by Cox are neither necessary nor desirable.

Snavely King begins its analysis from a false premise. It asserts, without citing any factual support, that LEC video dialtone systems are not profitable, under recover common video/telephony costs and corporate overheads, and thus are heavily cross-subsidized by telephony services. The Commission has made it clear that through its tariff review process it will require that video dialtone systems recover their direct costs, a reasonable share of common costs, and a contribution to corporate overheads. Any service that meets this test more than satisfies economic criteria for prices that are free of cross-subsidy.

Snavely King next argues that federal price cap regulation is insufficient to protect telephony customers from cross-subsidy due to the jurisdictional separations process.

Section 410 of the Communications Act requires the jurisdictional separation of "common carrier property and expenses." Both traditional telephony and video dialtone are regulated common carrier communications offerings, and thus the costs associated with both must be jurisdictionally separated. Although the Commission initially held that video dialtone costs would be directly assigned to the interstate jurisdiction, it later held, correctly, that the video dialtone platform can be used for both interstate and intrastate services, and thus that the costs should be separated. State regulation is responsible for protecting intrastate telephone customers against cross-subsidy.

Cox argues that state regulators will be unable to protect intrastate ratepayers because "many state regulators face changes in state laws which, under reform of state price caps, forbid the collection of cost and revenue data needed to address the local VDT cross-subsidy issues." If Cox is pointing to changes in state laws such as those recently enacted in Georgia and Florida, the concern expressed is without merit. If states adopt pure price regulation, as have Tennessee, Florida, Georgia and North Carolina within the BellSouth region, any shift in costs from the interstate to the intrastate jurisdiction would have no impact on state ratepayers. With pure price regulation in both the interstate and intrastate jurisdictions, jurisdictional cost shifts become meaningless to consumers. Even in states that have adopted forms of incentive regulation other than pure price regulation, such as Alabama, Mississippi, Kentucky, Louisiana and South Carolina, the incentive to cross-subsidize video dialtone from conventional telephony is greatly reduced.

Cox and Snavelly King propose to resolve their contrived jurisdictional separations issue by amending the Commission's Part 64 rules "to separate all video dialtone costs from telephone costs before these costs are separated by jurisdiction." This request is wholly inappropriate. The Part 64 rules are designed to separate the cost of regulated carrier operations from the cost of nonregulated operations. Since both video dialtone and traditional telephony are regulated common carrier communications services, it would be a misapplication of the principles behind the Part 64 rules to use those rules to isolate video dialtone costs. In addition, the Part 36 rules separate costs by plant category, not by services. The separations rules do not preclude state regulators from identifying video dialtone costs and ensuring that intrastate telephone customers are not burdened. As noted above, if state regulators adopt pure price regulation, the separation of costs between jurisdictions becomes largely irrelevant to the prices charged to customers.

Snavelly King argues that because of the "early unprofitability" of video dialtone, price cap LECs "will choose the lowest productivity offset available, unless this choice will cause it to lower rates more through sharing than it avoids by choosing a low productivity offset." Snavelly King obviously does not understand the LEC price cap plan. The current LEC price cap plan was designed with strong financial incentives to select the highest productivity offset that a carrier reasonably believes it can achieve. To the extent that Cox and Snavelly King observe that the sharing mechanism can dampen incentives to increase productivity, they

merely state the obvious. BellSouth agrees that the elimination of the sharing mechanism would give carriers an unambiguous incentive to improve productivity, and hence profitability.

Snavely King next offers a hypothetical case in which a price cap carrier deploys video dialtone in a way that drives the carrier's interstate earnings from 13.65 percent to 11.10 percent in three years. There are no data offered to support this hypothesis for obvious reasons. No carrier management would embark on a course of conduct that would so adversely affect shareholder value. If a carrier perceived that the deployment of video dialtone would have such an adverse impact on shareowners, it would decline to deploy video dialtone.

Cox also states that the Commission should "determine a reasonable allocation of common costs that must be applied in all VDT tariffs." Any arbitrary allocation of such costs results in economic inefficiency and reduces consumer welfare. Cox has offered no justification for the Commission to deviate from sound economics in regulating LEC provision of video dialtone services. Adopting Cox's recommendation would simply handicap the telephone companies' ability to offer efficient prices when competing with incumbent cable operators like Cox. While such a rule would afford a distinct competitive advantage to the incumbent cable operator, that advantage would come at the expense of the public interest.

In conclusion, Cox and Snavely King seem to have a profound misunderstanding of common carrier principles. Therefore, their recommendations are inappropriate and unnecessary.

Sincerely,

A handwritten signature in black ink, appearing to be the name of the sender, written in a cursive style.

cc: **The Honorable Andrew C. Barrett**
The Honorable Rachelle B. Chong
The Honorable James H. Quello
The Honorable Susan Ness