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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

October 27, 1995

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
Room 222
1919 M Street NW
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Re: Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1

Dear Mr. Caton:

Enclosed for filing is an original and four (4) copies of MCI Telecommunications Corporation's Comments in the above-captioned rulemaking proceeding.

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

Sincerely,

Mary L. Brown

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No. of Copies rec'd 0+4
List ABCDE

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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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Comments

MCI Telecommunications Corp. ("MCI") hereby responds to the Third Further Notice of Proposed Rulemaking in this phase of the price cap performance review proceeding, which is limited to the regulatory treatment of local exchange carriers' ("LECs'") video dialtone services.[1] MCI opposes the Commission's proposal to create a "de minimis" standard that would exempt LECs from cost allocation requirements. The proposal is inconsistent with existing Commission cost allocation systems, requires costly and cumbersome auditing procedures to enforce, and is likely to permit video dialtone carriers to cross subsidize their video dialtone offerings with revenue from other common carrier services. Based on MCI's review of the Video Dialtone Section 214 applications, there is no video dialtone system authorized today that MCI would consider de minimis. MCI also renews its call for a video dialtone Part 69 element to

[1] Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, CC Docket No. 94-1, Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394, released September 21, 1995 (Third Video Dialtone Notice).

which costs can be allocated. Absent creation of a Part 69 element for video dialtone, and associated ARMIS reporting, it is unlikely that the Commission will be able to monitor video dialtone costs to protect telephone ratepayers from unlawful cross subsidy.

Background

In deciding to segregate video dialtone rates in a separate video dialtone price caps basket, the Commission also decided that costs and revenues should be separated. This is necessary, the Commission found, in order to ensure that the sharing and low end adjustment mechanism under price caps is not affected by video dialtone costs and revenues. The Commission decided that, at any level above a de minimis amount, video dialtone costs and revenues should be separated from existing Part 69 access elements for the purposes of reporting costs and revenues of telephony. As suggested in the Third Video Dialtone Notice, the threshold for cost allocations would be set based on subsidiary accounting records that the LECs have been required to maintain. As an example, the Commission said that if the costs become large enough to have the effect of reducing the overall rate of return by 10 or 25 basis points, cost allocation and separate reporting would be required.[2]

The Commission also proposed to institute a method or factor for Part 69

[2] Third Video Dialtone Notice at paras. 39-40.

allocation purposes once the de minimis threshold has been passed. In the Notice, the Commission suggests that LECs be required to separate costs pursuant to the Commission's new services test, and states that the cost methodologies might vary according to the kind of video dialtone system the LEC is building. The Commission alternatively suggests the use of a fixed allocator, as well as any other proposals that parties might wish to suggest.

A De Minimis Threshold Is Inconsistent With Commission Cost Allocation Policy

MCI opposes the de minimis threshold that would trigger cost allocation reporting. Nowhere in the Commission's cost reporting and allocation rules is there any rule which allows carriers to forgo cost allocation practices because an amount is deemed "too small." The Uniform System of Accounts (Part 32) requires all costs to be recorded. The Part 64 separation of nonregulated costs and affiliate transaction rules contain no such de minimis exemption. Jurisdictional separations (Part 36) similarly requires all regulated costs to be separated. Most importantly, the Part 69 access rules serve to allocate all of the interstate revenue requirements to Part 69 rate elements. The notion that there may be video dialtone costs that are "too small" to be worthy of a cost allocation process is antithetical to the entire history of common carrier cost allocation theory at the Commission.

Specifically, the Commission's cost allocation system has relied exclusively on fully distributed costing. This is to be distinguished from incremental costing methods which are permitted under tariff regulations and which are used for pricing purposes. Under price caps, the cost allocation rules up through and including Part 69 are used exclusively for reporting and monitoring of carrier investments, expenses, and revenues.

The reason for the use of fully distributed costing methodologies is stated most concisely in the Commission's decision inaugurating a Part 64 process to separate the cost of regulated and nonregulated activities. There, the Commission noted that it had two reasons for the decision to employ fully distributed costing methods -- (1) the prevention of cross-subsidy; and (2) allowing ratepayers to reap some of the benefits of the economies of scale and scope that come from a carrier's participation in nonregulated activities. The Commission found that "it would not be just and reasonable to allow all of those economies to belong to the nonregulated activities."[3] The public policy guiding LEC participation in nonregulated activities is no different in the context of LEC participation in video dialtone.

Inconsistency with the entire body of Commission cost allocations is only one reason to avoid the use of a de minimis standard. By requiring carriers participating in video dialtone to separate all video dialtone costs from telephony -- and not just some of those costs -- the Commission avoids the heavy burden of having to monitor and

[3] Separation of costs of regulated telephone service from costs of nonregulated activities, CC Docket No. 86-111, Report and Order, 2 FCC Rcd 1298, 1312 (1987).

audit LEC accounting practices to ensure that its rules are being followed. The recent release of the Lobbying Expenses audit should give policymakers pause in allowing the LECs flexibility in deciding when cost allocations should be performed.[4]

The proposal contained in the Third Video Dialtone Notice to consider as de minimis costs that would trigger less than a 10 or 25 basis point change in LEC rate of return fails to protect telephone ratepayers. For the Regional Bell Operating Companies (RBOCs) alone, 10 basis points amounts to $45 million, and 25 basis points amounts to $112 million. Should the proposed de minimis standard be adopted, the Commission would be powerless to take action against a cross subsidy of RBOC video dialtone systems of up to $45 million or $112 million. MCI strongly opposes any action by the Commission that would permit cross subsidy of this magnitude.

Lax regulation that allows cross subsidy in any amount is bad public policy.

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[4] On October 26, 1995, the Common Carrier Bureau released a summary of its audit of BOC lobbying costs. The Commission's rules require the BOCs to exclude lobbying costs from their interstate telephone costs. The summary explains that, prior to the audit, the BOCs recorded only minimal lobbying costs in the correct manner. For example, the auditors found that two BOCs had limited the definition of lobbying to encompass only face-to-face contacts with legislators that lasted an hour and attempted to influence them on legislation. The auditors also found that most BOCs had misclassified the costs of lobbying-related clerical and staff support, travel, and overheads as operating expenses. Auditors also concluded that all of the BOCs had failed to record any portion of their dues to the United States Telephone Association, which had lobbied on behalf of the BOCs. They further found that certain BOCs have financed the publication of articles as part of their lobbying efforts without recording the associated costs in Account 7370. Summary of Audit Findings, Report No. CC 95-65, Common Carrier Action, released October 26, 1995 at 2.

LEC telephone costs and revenues should be reported separately from video dialtone costs and revenues in order to ensure that the Commission always has an accurate picture of LEC performance. Whether sharing is ultimately discarded by the Commission as a ratepayer-protection device, the Commission will nonetheless have an ongoing need to understand LEC financial performance in telephony in isolation from nonregulated activities and video dialtone. MCI believes that any de minimis standard that the FCC decides to adopt must be small enough to ensure that all of the video dialtone systems now authorized or that are pending would trigger cost allocation requirements. In Attachment A to these comments, MCI presents the total dollars involved in constructing video dialtone systems in RBOC areas only. For those systems reviewed, the costs amount to $3.3 billion. It is worth noting that these are but a fraction of all video dialtone systems that the LECs have asked to build. The dollars are significant, and should not be commingled with telephone costs for reporting purposes.

A Part 69 Allocator Should Reflect Fully Distributed Costing Principles

In addition to the issue of the threshold requirement for triggering cost allocations, the Commission has requested comment on adoption of a Part 69 allocator that would serve to separate video dialtone costs that exceed the threshold. MCI continues to advocate that the Commission adopt a separate Part 69 element for this purpose. A video dialtone Part 69 element would serve the same purpose as the existing special access element or Interexchange element -- it would create a Part 69 "bucket" for costs to be allocated to, without prescribing a specific rate structure for the video dialtone services that a LEC will tariff. Absent the creation of a video dialtone element in Part 69, video dialtone will be treated differently from any other service offering the LECs provide. The Commission has to date given no cogent reason for declining to adopt a Part 69 element.

MCI suggests that in developing an allocator, the Commission attempt to follow as closely as possible the fully distributed costing principles used in Part 69 today. Most importantly, fully distributed costing requires the direct assignment of costs that are dedicated to a service. The Commission must identify those Part 32 accounts in which the LECs will record dedicated video dialtone investment, and amend those portions of Subparts D and E of its Part 69 rules to create video dialtone specific cost buckets.

The allocation of joint and common costs is much more difficult. A decision in this docket that is consistent with prior policy decisions would allow telephone ratepayers to reap some of the benefit of LEC participation in a new activity. This is an equitable result, since the dollars LECs use to finance video dialtone systems are generated from telephone ratepayers. One way to accomplish this goal is to adopt a 50 percent allocation factor to joint and common costs used by video dialtone systems and telephone services. In the context of loop investment, which is likely to be the largest joint and common cost, a 50 percent allocator can be justified under the theory that the loop facility is now supporting two loops -- a telephone loop and a broadband loop. Each splits the cost.[5] MCI further suggests that the Commission consider treating the adoption of this rule as an exogenous cost change for the purpose of calculating price cap baskets for those carriers with video dialtone systems currently in operation. That will ensure that the joint costs are effectively removed from the LECs' common line basket.

At minimum, MCI argues that the allocator should result in telephone ratepayers being "held harmless" from video dialtone investment and other costs. The allocator should ensure that telephone costs do not increase, and should decline by the approximate amount of the minimum productivity factor. This will ensure that telephone ratepayers do not underwrite LEC ventures in video dialtone.

[5] Even this allocator may assign too much cost to telephony if, as seems likely, the loop is used more for video services than for voice. In addition, the video services will use a much greater portion of the bandwidth of the loop.

Conclusion

For the foregoing reasons, MCI urges the Commission to establish a de minimis threshold requirement that ensures that all video dialtone systems authorized or pending would trigger cost allocation reporting. This is the best, most efficient method of protecting telephone ratepayers from cross-subsidy. MCI further urges the Commission to establish a Part 69 element for video dialtone and to employ a fully distributed cost allocation methodology in assigning costs and revenues above a de minimis level.

Respectfully submitted,

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Date: October 27, 1995

ATTACHMENT A
Video Dialtone Costs By RBOCs

RBOC	TOTAL COST
Ameritech	$398 million
WPC 6926	
WPC 6927	
WPC 6928	
WPC 6929	
WPC 6930	
Bell Atlantic	$1,641 million
WPC 6912	
WPC 6834	
WPC 6840	
WPC 6966	
WPC 6838	
BellSouth	$8.8 million
WPC 6977	
NYNEX	$90 million
WPC 6983	
WPC 6982	
PacTel	$112.2 million
WPC 6916	
WPC 6913	
WPC 6915	
US West	$1,138 million
WPC 6919	
WPC 6921	
WPC 6922	
WPC 6945	
WPC 6944	
WPC 7026	
WPC 7024	
WPC 7025	
WPC 7027	
WPC 6868	
TOTAL	**$3,388 million**

CERTIFICATE OF SERVICE

I, Stan Miller, do hereby certify that copies of the foregoing Comments were sent via first class mail, postage paid, to the following on this 27th day of October 1995.

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