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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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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

REPLY COMMENTS OF THE
AD HOC TELECOMMUNICATIONS USERS COMMITTEE

The Ad Hoc Telecommunications Users Committee ("Ad Hoc Committee") hereby submits its reply to comments filed in response to the Federal Communications Commission's ("Commission") *Second Report and Order and Third Further Notice of Proposed Rulemaking* in the above-captioned proceeding.[1]

The Ad Hoc Committee's interest in this proceeding stems from its belief that its members' interest and the public interest generally would be best served if the local exchange and access service markets become effectively competitive. The Ad Hoc Committee believes that cable television operators could be a prime source of such competition, and is concerned that Commission efforts to promote competition in the cable television industry through telephone company

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

entry, while laudable, could undermine fair competition in both markets and, in turn, harm all users.

A. The *de minimus* Threshold Will Not Be Easy To Administer and Could Harm Emerging Telecommunications Competition.

Contrary to positions taken by local exchange carriers ("LECs") in this proceeding,[2] the Ad Hoc Committee agrees with other commentors that utilization of a *de minimus* threshold for purposes of allocating Video Dialtone ("VDT") costs and revenues to calculate the LECs' interstate rates of return is not practicable and would produce cross-subsidization that would be unfair to subscribers of the LECs' basic services and to cable television providers who could be a source of telecommunications service competition. Despite the Commission's suggestion that "an unnecessary administrative burden"[3] would be avoided by application of the *de minimis* threshold, the affected LECs have, in fact, not shown that any additional burden would be created.[4] None of the LECs has supplied any estimates of the magnitude of the administrative costs that they purportedly would incur to separate VDT services from telephone services. Moreover, the commenting LECs ignore the fact that all LECs are already required to account for and report VDT revenues and

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2 *See* Comments of NYNEX at 1-3; Comments of Southwestern Bell at 8-10; Comments of Bell Atlantic at 4-5; Comments of Pacific Bell at 2-3; Comments of BellSouth at 3; Comments of US West at 2; Comments of the Southern New England Telephone Co. at 4-5; and Comments of GTE at 5-6.

3 SR&O and TFNPRM at ¶ 35.

4 It is clear, however, that adopting the *de minimis* threshold would create a new administrative burden for the Commission, which would have to take on an extra chore to monitor when the threshold triggers.

costs (including VDT dedicated investment and the VDT portion of shared investment) in their ARMIS 43-09 quarterly reports.[5] Therefore, to comply with existing accounting standards, LECs will have to assume an "administrative burden" of segregating their VDT financial accounts in any case. Thus, it should take LECs only a minimal incremental effort to exclude VDT earnings and costs from their interstate rate of return calculations. The problems that would be raised by implementation of the *de minimus* standard far outweigh the incremental effort that the LECs would have to expend to properly allocate VDT costs and revenues from the outset.

The LECs have proposed a variety of measures for the *de minimis* threshold based, for example, on revenues, investment, or plant in service.[6] Given the LECs' strong incentives to engage in cross-subsidization of their new VDT networks, it is not surprising that the specific thresholds that they propose would perpetuate the *de minimus* exemption until a major portion of their VDT investment is in place. Appendix A attached to these Comments shows that for many of the VDT systems that have been authorized, the entire network could be constructed without the dedicated VDT investment triggering a 25 basis points threshold. For example, the entire projected investment for NYNEX's proposed VDT systems in Rhode Island

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5 *In the Matter of Reporting Requirements on Video Dialtone Costs and Jurisdictional Separations for Local Exchange Carriers Offering Video Dialtone Services*, Memorandum Opinion and Order, DA 95-2026, AAD No. 95-59, released September 29, 1995 ("ARMIS 43-09 Report").

6 *See* Comments of US West at 2 (set threshold at VDT revenues equal to 2% of overall revenues); Comments of NYNEX at 1-2 (set threshold at amount of dedicated interstate VDT investment which would reduce LEC overall rate of return by 25 basis points); and Comments of BellSouth at 3 (set threshold at VDT investment equal to 5% of unseparated gross plant).

and Massachusetts will change the company's interstate rate of return by only 5 and 16 basis points, respectively, but would undoubtedly have a profound impact on video distribution and telecommunications competition in those regions.[7]

The total amount of cross-subsidization of LECs' VDT networks that could occur under the *de minimis* thresholds suggested by the LECs would be substantial. For example, NYNEX and GTE support the Commission's approach to set a threshold at the level of investment that would result in a change in the rate of return of as much as twenty-five basis points.[8] If the Commission adopts this proposed threshold, the effect will be implicit approval of millions of dollars in cross-subsidy. As correctly estimated by MCI, for Regional Bell Operating Companies ("RBOCs") alone, a 25 basis points change in rate of return amounts to roughly $112-million dollars.[9] These cross-subsidies will affect ratepayers not only in the short run through an impact on shareable excess earnings, but also in the long run, and more importantly, by reducing the competitiveness of video distribution and telecommunications markets.

As evidenced by their Section 214 applications, the incumbent LECs are planning to focus their construction of VDT networks on certain lucrative markets. If the *de minimis* threshold were adopted, cable television operators within those markets would be forced to compete with a subsidized VDT service. For

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7 See Appendix A attached to these Comments.

8 Comments of NYNEX at 3; and Comments of GTE at 6.

9 Comments of MCI at 5.

example, Bell Atlantic's dedicated VDT investment in the Dover system would change its interstate rate of return by only 6 basis points, and therefore would not surpass the Commission's proposed *de minimis* threshold.[10] The existing cable operator in Dover would thus be subject to unfair competition from a subsidized VDT service. The Ad Hoc Committee carries no brief for the cable television industry, but is convinced that implementation of a *de minimus* threshold would work against the development of telecommunications competition in the local exchange and access service markets, and thus, would disserve consumers of telecommunications services.

The Commission proposes calculation of the *de minimis* threshold based on the amount of *dedicated* VDT investment.[11] This proposal is unreasonable. The threshold should not be based only on dedicated investment for two reasons. First, in the LECs' VDT applications, the vast majority of VDT investment is characterized as being shared with telephony. Therefore, LECs' expenditures on VDT systems would be seriously underestimated by only considering dedicated VDT investment. Second, the Commission's approach might create incentives to increase shared costs. As observed by NCTA in its comments:

> [C]ounting only dedicated costs, as the Commission suggests, would arbitrarily benefit LECs that have constructed systems with integrated rather than stand-alone facilities. It might also create the incentive to build integrated systems, regardless of whether such designs are the most efficient.[12]

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10 *See* Appendix A attached to these Comments.

11 SR&O and TFNPRM at ¶ 40.

12 Comments of NCTA at 8 (footnote omitted).

Such undesirable incentives would increase shared costs and impose additional burdens on telephone ratepayers. One LEC, Southwestern Bell, has also recognized the problems with the Commission's proposed approach:

> SWBT does not believe that this would be an equitable mechanism for determining the *de minimis* threshold. First, because it focuses on the "wholly dedicated" amount of investment, the results could vary widely depending upon a particular LECs' VDT network architecture.[13]

Therefore, the Ad Hoc Committee urges the Commission to refrain from adopting a threshold based on dedicated VDT investment.

Other parties have proposed different methods for setting the threshold. US West suggests setting the threshold based on the level of VDT revenues.[14] This approach, however, is flawed because, as a new service, VDT will not generate any significant amount of revenues until the majority of the investment is in place. For example, in its Section 214 application to provide VDT service in Florida, California and Hawaii, GTE forecasted that until the bulk of the VDT initial investment is in place, its revenues will be minuscule.[15] Thus, US West's proposed

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13 Comments of Southwestern Bell at 8-9.

14 Comments of US West at 2.

15 *See* Applications of GTE Incorporated for authority under Section 214 of the Communications Act of 1934, as amended, to construct, operate, own and maintain facilities to provide Video Dialtone Service in the Ventura County, California area (W-P-C-6956); in the Pinellas County and Pasco County, Florida areas (W-P-C-6957); in the Honolulu, Hawaii area (W-P-C-6958); Amendments, Exhibits E.

methodology would allow LECs to subsidize the whole construction of their VDT plant without crossing the *de minimis* threshold.

Southwestern Bell urges that the *de minimus* threshold be based on "the ratio of the number of households in the study area passed by the VDT system(s) compared to the total working loops in the study area."[16] This approach is invalid because it treats VDT and telephony connections as equivalent when, in fact, the per-subscriber investment requirements for VDT are substantially greater than those for telephony on a cost-causative basis. Consequently, adopting Southwestern Bell's proposal would significantly underestimate the financial impact of VDT service on the LECs' operations.

B. Causation Should Drive VDT Cost Allocations.

The Ad Hoc Committee, like NCTA and CCTA, recognizes the importance of the cost allocation process for VDT services.[17] It is crucial for the prevention of cross-subsidization of VDT services that the proper cost allocation methodology will be used for the apportionment of shared costs to the VDT basket. Even now, allocations of shared VDT/telephony costs are being made in order to establish VDT rates during the tariff review process, using data that is to be filed with the Commission in the ARMIS 43-09 reports.[18] The Ad Hoc Committee agrees with CCTA that the Commission's suggested use of a different cost allocation method for

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16 Comments of Southwestern Bell at 10.

17 Comments of NCTA at 4; and Comments of CCTA at 14-16.

18 ARMIS 43-09 Report at 4.

the VDT basket could deviate from the principles of allocating costs based on cost causation that the Ad Hoc Committee and other parties urge the Commission to adopt.[19]

The Ad Hoc Committee disagrees with MCI's support of the Commission's proposal for a fixed allocator, and notes that MCI is the only commenting party that endorses such an approach.[20] The the Ad Hoc Committee also disagrees with GTE's characterization as "senseless" of applying the same cost allocation methodology to the determination of the VDT basket costs as would be used in the VDT tariff setting process.[21] As NCTA has demonstrated, it is *essential* that a single cost allocation methodology be used for both purposes.[22] Using different allocation methods for setting VDT rates versus segregating costs between VDT and telephony baskets could lead to the double recovery of VDT-related costs. For example, if the method used to set rates had allocated 35% of shared investments to telephony, and the Commission chose a 50% fixed allocator for the purposes of determining sharing/low end adjustments, the LEC would have the opportunity to recover 15% of those costs from both ratepayers and VDT customers. The only reasonable approach, therefore, is to utilize the results of the cost

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19 Comments of CCTA at 17; Initial Comments of the Ad Hoc Committee, filed April 17, 1995, at 6, n.5-6.

20 Comments of MCI at 7.

21 Comments of GTE at 2.

22 Comments of NCTA at 6.

allocations used for setting VDT tariff rates (as reported in the ARMIS 43-09 Report) to determine the level of shared costs attributed to the VDT basket.[23]

The Ad Hoc Committee agrees with CCTA, NCTA and Comcast/Cox that the Commission must comprehensively examine VDT cost allocation issues.[24] As Comcast/Cox has observed:

> The creation of a separate VDT basket will be a wasted effort if LECs are permitted to decide unilaterally what portion of common costs, if any, are allocated to video dialtone in the first place.[25]

Therefore, the Ad Hoc Committee urges the Commission to discontinue its efforts to devise an artificial cost allocator for the determination of VDT basket costs, and to focus its attention on the primary task of ensuring that proper, cost-causative cost allocations are made for VDT-related investments.

CONCLUSION

After reviewing comments of other parties, the Ad Hoc Committee is of the view that the Commission's proposed *de minimus* standard cannot be implemented in a way that would protect emerging telecommunications competitors from unfair, cross-subsidized competition. As a consequence, consumers of telecommunications services would be harmed if the Commission attempts to

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23 US West has also concluded that there is no need to undertake another calculation of allocated VDT costs for determination of the VDT basket's costs, since all of the allocations will already have been made in the context of setting rates for VDT services. Comments of US West at 2.

24 Comments of CCTA at 17; Comments of NCTA at 3-4; and Comments of Comcast/Cox at 1-2.

25 Comments of Comcast/Cox at 2.

implement a *de minimus* threshold for purposes of allocating LECs' VDT costs and revenues to calculate sharing obligations and low end adjustments. The Commission, therefore, should not attempt to implement its *de minimus* threshold approach. Administrative convenience cannot take precedence over sound, competition-friendly public policy. Nor should administrative convenience drive the Commission to adopt poor cost allocation methodologies for VDT. The Commission should require that VDT costs be allocated on a cost-causative basis.

Respectfully submitted,

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Appendix A

Effect of Dedicated VDT Investment on Interstate Rate of Return

Company/ Region	VDT Investment	Rate Base	Operating Income	ROR w/out VDT invest.	ROR w/ VDT invest.	Change in ROR
Ameritech						
Michigan	54,840	2,919,054	380,864	13.05%	12.81%	0.24%
Ohio	83,307	2,919,054	380,864	13.05%	12.69%	0.36%
Indiana	48,559	2,919,054	380,864	13.05%	12.83%	0.21%
Illinois	158,580	2,919,054	380,864	13.05%	12.38%	0.67%
Wisconsin	52,864	2,919,054	380,864	13.05%	12.82%	0.23%
Bell Atlantic						
Dover	16,041	4,002,233	567,813	14.19%	14.13%	0.06%
NYNEX						
Rhode Island	16,138	3,705,955	438,000	11.82%	11.77%	0.05%
Massachusetts	51,823	3,705,955	438,000	11.82%	11.66%	0.16%
Pacific Bell						
Orange County	28,874	2,424,222	370,577	15.29%	15.11%	0.18%
San Francisco	65,860	2,424,222	370,577	15.29%	14.88%	0.40%
Los Angeles	46,620	2,424,222	370,577	15.29%	15.00%	0.29%
San Diego	36,729	2,424,222	370,577	15.29%	15.06%	0.23%

CERTIFICATE OF SERVICE

I, Meredith Forman, hereby certify that true and correct copies of the foregoing Reply Comments of the Ad Hoc Telecommunications Users Committee were served this 20th day of November, 1995 via hand delivery upon the following parties:

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