

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

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COMMISSION

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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domestic telephone operating companies

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## SUMMARY

GTE urges the FCC to put aside the indefensible regulatory approach that fiercely protects the well-established monopoly (cable television) from the new challenger (exchange carriers). The whole idea of the VDT program was to subject the furnishing of cable television to intense competition, thereby benefitting the public. The public will be harmed by over-regulatory action directed against VDT, action that will preclude attainment of a competitive environment, that indeed may lead to a stillborn VDT.

GTE urges the Commission to adopt the threshold and cost allocation proposals advanced by GTE.

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| Treatment of Video Dialtone         | ) |                    |
| Services Under Price Cap Regulation | ) |                    |

**GTE's REPLY COMMENTS**

GTE Service Corporation and its affiliated domestic telephone operating companies ("GTE") hereby submit this reply to comments submitted in response to the Second Report and Order and Third Further Notice of Proposed Rulemaking, FCC 95-394 (released September 21, 1995) ("*Third Further Notice*") in the above-reference proceeding.

**I. THE COMMISSION SHOULD DEFER ACTING ON ANY ADDITIONAL VDT PRICE CAP RULES PENDING THE OUTCOME OF THE *SECOND* AND *FOURTH FURTHER NOTICES*.**

The *Third Further Notice* assumes (i) that Local Exchange Carriers ("LECs" or "exchange carriers") subject to price cap regulation will be subject to sharing and low-end adjustment options in future annual price cap filings; and (ii) that a *de minimis* threshold and specific allocation procedure to remove VDT costs and revenues from other interstate services is likely to apply to those LECs that choose productivity factors with sharing and low-end adjustment options.

In the *Second* and *Fourth Further Notices* in this docket, the Commission has questioned the need for continuing the sharing and low-end adjustment mechanisms if

a productivity factor is selected which is more appropriate to a LEC's economic circumstances or in instances where LECs encounter increased competition for local and access services.<sup>1</sup> In addition, pending federal legislation may eliminate reliance on rate of return regulation altogether. In light of this uncertainty as to the essential preconditions of such a provision, and inasmuch as the removal of sharing and low-end adjustment options from the overall price cap plan would render this proceeding moot, GTE urges the Commission to defer action on any additional VDT price cap rules pending the outcome of the *Second* and *Fourth Further Notices*.

**II. TO THE EXTENT THE COMMISSION ISSUES A RULING IN THIS PROCEEDING PRIOR TO REACHING A CONCLUSION IN THE *SECOND* AND *FOURTH FURTHER NOTICES*, OVERLY-COMPLEX RULES BASED ON STANDARD COST OF SERVICE STANDARDS SHOULD NOT BE ADOPTED FOR VDT.**

- A. So that the *de minimis* threshold will be easy to administer and based on data that is readily available and verifiable, it should be based on the amount of direct investment, revenues, or households passed.**

In comments submitted in response to the *Third Further Notice*, a number of reasonable approaches to establishing a *de minimis* standard are proposed. These include (1) basing the threshold level on a specified percentage of direct VDT

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<sup>1</sup> Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, FCC 95-393 (released September 20, 1995) ("*Second Further Notice*") at para. 164.; and Fourth Further Notice of Proposed Rulemaking, FCC 95-406 (released September 27, 1995) ("*Fourth Further Notice*") at para. 124.

investment, as suggested by GTE and others;<sup>2</sup> (2) basing it on a certain percentage of overall interstate revenues that are attributable to VDT, as suggested by US West (at 2); and (3) using a set percentage of total study area households passed by VDT facilities, as suggested by Southwestern Bell (at 10).

These are all workable solutions. For any of these proposals, threshold levels could be easily verified by data submitted in a LEC's ARMIS Reports. By establishing threshold levels based on readily available data, the Commission would avoid increasing the complexity of the annual filing process – which would result from creating the need to submit additional rate of return calculations and cost study showings each time an exchange carrier's PCI is adjusted.

Linking a threshold level to a simple rate-of-return-analysis using direct costs, as proposed in the *Third Further Notice*, would not be overly burdensome. However, it could result in inconsistent outcomes from one year to the next, depending on how VDT costs and revenues change relative to those for switched and special access services.<sup>3</sup>

Basing a threshold level on a rate-of-return calculation would also interject an element of cost-of-service regulation in the price cap plan at a time when the Commission is reducing its reliance on sharing and the low-end adjustment mechanisms. The Commission should avoid creating any new linkages between standard cost-of-service and price cap regulation.

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<sup>2</sup> See PacBell at 2, SNET at 5, Bell South at 3 n.4.

<sup>3</sup> See US West at 2.

**Accordingly:** GTE urges the FCC to adopt a simple threshold level based on the amount of direct investment, revenues, or households passed.

**B. The record demonstrates that flexibility in proposing allocation plans is warranted and reasonable.**

Based on the record submitted in response to the *Third Further Notice*, there is little support or justification for creating detailed VDT-specific cost allocation rules in Part 69. As most commenters observe, cost and revenue data will be readily available in order to determine appropriate allocation of VDT costs to the VDT price cap basket, if necessary.<sup>4</sup>

Exchange carriers should be allowed to follow existing Part 36 and 69 rules to allocate VDT costs when the *de minimis* threshold is achieved. There is no need to modify Part 69 rules to specify special cost allocation rules. LECs can simply follow existing Part 69 conventions as they do today for other services. Expenses and costs that are allocated among the switched access, special access, and interexchange categories could also be apportioned to VDT using the same procedures and methods.

Where deviations are necessary, LECs should be allowed to justify their allocation methods based on their unique financial and/or operational circumstances in their annual price cap tariff filing. Given that VDT network architectures and cost structures will not be uniform among all LECs, and each VDT provider will face different markets and competitive structures, this flexibility is crucial. LECs should be afforded

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<sup>4</sup> See, for example, US West at 3, Pacific Bell at 3.

the flexibility to submit special studies, like those submitted in support of their tariffs, if they deem necessary.

However, GTE is opposed to mandating any allocation method that is directly tied to a LEC's pricing calculations in its VDT tariff filing. VDT services offerings, their related costs, and price levels will evolve and change over time as a direct result of the nature of competition in local video markets. VDT prices should be, and will be, governed by market forces, and should not be tied to a rate-of-return showing.

GTE agrees with the comments of BellSouth (at 4) that Part 69 rules should not be amended to dictate cost allocation procedures for services that are fully subject to price cap regulation. Part 69 rules do not purport to determine rates for price cap companies and should not be expected to make such determinations in the future.

In contrast, existing rules governing sharing and low-end adjustments to the price cap index are codified in Part 61. Indeed, existing language set forth in Section 61.45(d)(4) -- which requires that cost changes attributable to price cap services be apportioned on a cost-causative basis -- would adequately accommodate the approach GTE is advocating.

Finally, the Commission should, once again, reject the notion that price levels for VDT should be based on fully allocated cost techniques.<sup>5</sup>

The cable industry asserts that cross-subsidization of VDT can only be prevented if a the method used to allocate VDT costs to the VDT basket for purposes of determining sharing and low-end adjustments is consistent with the manner in which

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<sup>5</sup> AT&T at 8, MCI at 7.

VDT prices are set.<sup>6</sup> Such an argument is unsupportable. As long as incremental costs are recovered, VDT price levels will not be predatory, nor will ratepayers for other services bear any costs as a result of VDT.

The price cap plan itself was designed to simulate some of the efficiency incentives found in competitive markets and to act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary.<sup>7</sup> In the case of VDT, the actual competitive nature of a LEC's entry into a market dominated by existing cable operators negates the need to apply any price cap regulation at all. It is even more inescapable that the competitive nature of LEC video offerings does not warrant the imposition of fully allocated costing techniques and other rate-of-return constraints.

The comments of the cable industry suggest that their strategy here is to ensure that VDT rates are set at excessive levels. This is exactly what would occur if traditional cost-of-service regulations are applied, in any form, to VDT. This action would furnish a pricing umbrella for the benefit of cable firms, an umbrella under which they could continue to overcharge the public. This outcome would defeat the whole purpose of VDT.

**Summary:** The record demonstrates that the Commission should provide for flexibility in allocation plans.

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<sup>6</sup> NCTA at 4-6, CCTA at 17.

<sup>7</sup> See *Second Further Notice* at para. 9.

**C. The Commission must adopt flexible competitive-oriented policies if it expects its VDT model to survive.**

To the direct detriment of subscribers who stand to gain from the promise of the expanded alternative video programming that VDT can provide, the Commission has burdened its VDT model with excessive regulation. Alternative forms of video programming delivery are made more attractive to LECs each time the Commission imposes new rules and constraints on VDT operators. Indeed, at the very time the Commission is considering, in three separate rulemaking proceedings, a plethora of new regulations designed to constrain the programming, operational, financial, and pricing abilities of LECs, it is proposing to relax regulatory controls on the very entities that exert total control over existing video distribution markets - the monopoly cable providers.<sup>8</sup>

Further, it appears that the Commission has foreclosed any opportunity to treat VDT services as what they truly are -- competitive delivery mechanisms -- by categorically excluding them from any consideration for pricing flexibility in the *Second Further Notice*, despite the fact that VDT offerings will most likely meet each and every competitive test for streamlined regulation that the Commission is currently considering for LEC services.<sup>9</sup> Thus, the Commission is now faced with a crucial decision. It can (i) move forward and adopt more sensible rules for VDT implementation; or it can (ii)

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<sup>8</sup> See In the Matter of Waiver of the Commission's Rules Regulating Rates for Cable Services, as applied to cable systems operating in Dover Township, Ocean County, New Jersey, Order Requesting Comments, FCC 95-455 (released November 6, 1995).

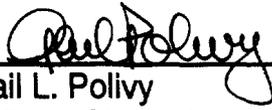
<sup>9</sup> See *Second Further Notice* at para. 38, note 51 and paras. 134-143.

smother VDT with complex and antiquated cost-of-service and restrictive pricing constraints, the combination of which will guarantee the continuation of the cable television monopoly. GTE urges the Commission to select the first option.

Respectfully submitted,

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November 20, 1995

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## 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 20th day of November, 1995 to all parties of record.

  
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Ann D. Berkowitz