narrowband services can be carried on the broadband network that cannot be adequately provided on alternative stand-alone systems, including an upgrading of the existing network? What investments would be required for such new services in addition to the investments shown on Bell Atlantic's worksheets? What reason is there to believe that such services, going beyond sheer speculation, would be economically viable? What basis is there for concluding that the broadband network would enable savings in telephony operations and maintenance over and above those enabled by upgraded or new stand-alone telephone networks? If the company cannot address these questions in satisfactory detail -- again going far beyond arm waving and cavalier responses -- the Commission must insist on a reassignment of costs, along the lines illustrated in Table 2.

An obvious problem facing the Commission is estimation of specific cost factors for stand-alone networks necessary for evaluating Bell Atlantic's tariff filing and its responses to the above questions. For illustrative purposes, I have used the $700 investment for digital loop carriers and $308 for upgrading existing networks. Clearly, however, actual costs vary as a consequence of innumerable considerations in local markets -- household density, topographical features, the mix of underground and aerial plant, the condition of existing plant, and many more.

One possible approach for the Commission involves pressing Bell Atlantic for upper-bound and lower-bound estimates of stand-alone telephone systems with essentially the same narrowband capability as the VDT network in Dover. Perhaps the Commission would then select middle-ranging estimates for its own determination of the appropriate assignment of the broadband network investment.

Undoubtedly, precise and fully satisfactory numbers will be impossible to obtain. But the Commission must not be left accepting Bell Atlantic's cost assignments simply because the relative assignments of investment outlays. If so, a large reassignment of expenses would be necessary to mirror the appropriate reassignment of investment, again resulting in a far higher burden on video than now exists.

Overhead. By no stretch of the imagination would the Commission be justified in permitting Bell Atlantic to retain a 20 percent overhead loading on video dialtone direct costs. The Commission must require Bell Atlantic to explain in detail (a) why video dialtone is expected to generate any less, or more, overhead per dollar of direct cost than other services, and (b) whether changes in overhead tend to bear a constant relationship to changes in direct cost, demonstrated by the company's past experience. In the absence of compelling answers to the contrary, the Commission should insist on a 65 percent loading of overhead for video dialtone as an approximation to the additional overhead caused by the provision of video dialtone.

The debate about overhead in this proceeding is especially disconcerting because surely this is not the first proceeding in which issues of overhead and direct expenses have been raised. If the Commission has, in the past, permitted firms under its jurisdiction to treat overhead as a fixed common cost to be allocated among services in whatever way the firms choose, the Commission has granted a stunning degree of leeway for anticompetitive cross-subsidization not only in video dialtone, but also in the wide range of telephone markets in which cable operators and other suppliers may compete. The existence of such leeway is demonstrated by the fact that Bell Atlantic exhibits a wide range of overhead loadings -- for example, from a 27 percent mark-up on its DS3 channel termination rate on a five-year basis to a 106 percent mark-up on a month-to-month basis.[46] Reinforcing this evidence is Bell Atlantic's statement that "the

[46] Direct Case, supra, Exhibit 1, Attachment E(1), at 1.

Commission granted LECs a great deal of flexibility in setting overhead levels."[47] Consequently, the Commission must review and modify its policy with respect to overhead assignments, paying careful attention to the causal relationships between direct costs and overhead.[48]

[47] Direct Case, supra, at 67.

[48] It is worth noting recent regulatory actions in Canada, highly relevant to concerns here. In that county, too, telephone companies have proposed construction of integrated broadband networks for video and telephony -- the "Beacon Initiative." There, too, concerns about cross-subsidization have been raised by cable operators and others. In response to general apprehension about cross-subsidy and other anti-competitive threats posed by firms with both monopoly and competitive markets, the Canadian Radio-television and Telecommunications Commission (CRTC) recently decided to split the rate base, with one portion assigned to a company's monopoly telephone services, the other assigned to competitive services. CRTC, Implementation of Regulatory Framework -- Splitting of the Rate Base and Related Issues, Telecom Decision CRTC 95-21, October 31, 1995. In the case of Beacon, the CRTC has decided to assign the costs of the entire broadband network to the competitive segment. Only if, and when, channels are used for telephony will their costs be transferred to the monopoly segment, with transfer prices subject to regulatory scrutiny. For any number of reasons, we cannot expect the FCC to mimic the CRTC's decision. Still, it is sobering to observe how one regulatory agency has recognized the serious threat of cross-subsidy and has taken concrete and constructive steps to protect against it.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on November 30, 1995

Leland L. Johnson

LELAND L. JOHNSON

Mailing Address: 19528 Ventura Boulevard, Tarzana, California 91356
Phone: (818) 716-5854

EDUCATION

Ph.D. Economics, 1957, Yale University
M.A. Economics, 1953, University of Oregon
B.S. Business Administration, 1952, University of Oregon

EMPLOYMENT

1993-present--Consultant specializing in telecommunications economics. Retired from The RAND Corporation.

September 1979-March 1993--Senior Economist, The RAND Corporation, Santa Monica, California.

1978-1979--Associate Administrator, Policy Analysis and Development, National Telecommunications and Information Administration, U.S. Department of Commerce, Washington, D.C.

1968-1978--Manager, Communications Policy Program, The RAND Corporation, Santa Monica, California.

1967-1968--Director of Research, President's Task Force on Communications Policy, U.S. Department of State, Washington, D.C.

1957-1967--Economist, The RAND Corporation, Santa Monica, California.

1956-1957--Instructor, Yale University, New Haven, Connecticut.

1967--Lecturer, International Trade, UCLA.

1965-1966--Visiting Professor, International Trade and Economic Growth, Claremont Graduate School.

1958-1959--Lecturer, (Statistics for Economics and Business), California State College at Northridge.

Telecommunications Policy. Dr. Johnson has evaluated the prospects for direct satellite broadcasting, the use of telephone company facilities, and other means, as competitive alternatives to cable television. He earlier dealt with issues of (a) regulating international telecommunications in response to a growing competitive market structure, (b) maintaining universal domestic telephone service in response to pressures to increase rates for local service, and (c) the role of compatibility standards in telecommunications competition and innovation. As Associate Administrator for Policy Analysis at NTIA in 1978-1979, Dr. Johnson's responsibilities included recruiting staff for a research and analysis office of about 40 staff members, His office focused on issues of (a) restricting government regulation in the domestic telephone and broadcasting fields, (b) expanding competitive pressures in the international communications industry, (c) possibilities for making more effective use of the radio spectrum, and (d) drafting legislation for the Administration and pursuing other policy options in response to problems of protecting individual privacy posed by the rapid growth of computer-based information systems. As Director of Research, President's Task Force on Communications Policy, he directed the staff activities and preparation of the Final Report (the "Rostow" report) delivered to the President in 1968. The report and accompanying staff papers addressed a wide range of issues in the telephone, cable, and broadcasting fields, with numerous specific recommendations for national policy.

PROFESSIONAL MEMBERSHIPS/HONORS

Chairman, Board of Directors, Telecommunications Policy Research Conference, Washington, D.C., 1992.

Chairman, Organizing Committee, Seventeenth Annual Telecommunications Policy Research Conference, Airlie House, VA, 1989.

Board of Directors, Annual Telecommunications Policy Research Conference, 1989-1992.

Board of Directors, International Institute for Communications 1971-1978.

Advisory Board, Committee for Economic Development, 1975.

Telecommunications Panel, American Society of International Law, 1973-1975.

Telecommunications Committee, the Twentieth Century Fund, 1969-1970.

American Economics Association Sterling Fellowship, Yale University, 1955.

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CONSULTANCIES

Cox Enterprises, Inc.
Adephia Communications Corp.
Great Lakes Cable Coalition
Atlantic Cable Coalition
California Cable Television Association
New Jersey Cable Television Association
National Cable Television Association
Canadian Cable Television Association
Time Warner, Oceanic Communication
Cablevision Industries
Comcast Corp.
Wometco Cable
AGT Limited
AT&T
Southwestern Bell Mobile Systems
Cellular Telecommunications Industry Association
Interstate Natural Gas Pipeline Association
Ford Foundation
Arizona Corporation Commission

AFFIDAVITS, DECLARATIONS AND PREFILED TESTIMONY

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November 1995

CERTIFICATE OF SERVICE

I, Christine Cox, hereby certify that a copy of the foregoing Opposition to Direct Case was mailed by First Class, postage prepaid, this 30th day of November, 1995 to the following:

* Tariff Division
Federal Communications Commission
1919 M Street, N.W.
Room 518
Washington, D.C. 20554

Edward Shakin
Betsy L. Anderson
Bell Atlantic
1320 N. Courthouse Road
8th Floor
Arlington, VA 22201

International Transcription Service
1919 M Street, N.W.
Room 246
Washington, D.C. 20054

Christine Cox
Christine Cox

* By Hand Delivery