ORIGINAL

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

In the Matter of	)	
	)	
Bell Atlantic Telephone Companies	)	Transmittal Nos. 741, 786
	)	
Revisions to Tariff F.C.C. No. 10	)	CC Docket No. 95-145
	)	
Rates, Terms, and Regulations	)	
for Video Dialtone Service in	)	DOCKET FILE COPY ORIGINAL
Dover Township, New Jersey	)	

OPPOSITION TO THE BELL ATLANTIC DIRECT CASE

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SUMMARY

By its own admission, Bell Atlantic will spend a minimum of $68 million to construct a video dialtone system that passes 38,000 households in Dover Township, New Jersey. There is no doubt that its actual expenses are much, much higher.

The Commission has long held that telephone companies are free to make such investments. Indeed, it has applauded the efforts of competitors to enter the video services marketplace. But the Commission has also been clear that telephone company forays into video dialtone should be financed by video dialtone customers or (should the business prove unprofitable) telephone company shareholders.

Bell Atlantic so far has ignored these pronouncements. Rather than viewing the Commission's video dialtone rules as an opportunity to compete in the video marketplace, Bell Atlantic seems to think that the rules guarantee it a place in the market -- even when its entry plan is completely uneconomic. Bell Atlantic is therefore insisting that the Commission "must" allow it to subsidize the construction of its Dover video dialtone system with regulated telephone revenues or else it "won't" be able to offer video dialtone service.

The public interest demands, however, that Bell Atlantic recover video dialtone costs from video dialtone customers. If those services prove unprofitable, it is Bell Atlantic's shareholders who properly should pick up the tab. Yet the record is clear that Bell Atlantic is unwilling to reduce its dividends. In fact, it has had insufficient free cash flow to pay dividends without borrowing money.

Bell Atlantic's $68 million-plus investment in Dover has to be financed somehow. The Company therefore is already extracting money from two innocent sources: its employees (through widespread lay-offs) and its telephony competitors (through inflated interconnection

charges). It now wants the Commission's blessing to tap a third innocent source: its captive telephone ratepayers.

It is not the Commission's job to protect Bell Atlantic from the wrath of its shareholders for making a poor business decision. And it is particularly not the Commission's task to shield Bell Atlantic when the request is that captive ratepayers, employees and competitors be forced to pay for Bell Atlantic's investment blunders.

Bell Atlantic tries to obscure the fact that its Dover video dialtone system will lose money by allocating a full 72 percent of the costs it labels as "common " to the regulated telephony side of the video dialtone system. Reasonable economic theory suggests, however, that Bell Atlantic has this entirely backwards: 72 percent of the common costs should be allocated to video. Bell Atlantic also tries to hide Dover's true costs by adopting a ridiculously low overhead loading factor and by treating overhead as fixed rather than variable.

Once all costs are properly identified and a more reasonable (and still very generous) 50/50 cost allocation is used, the figures show that Bell Atlantic's Dover system will lose $7 million per year if current rates are permitted to remain in effect. This loss would increase to over $600 million per year if extended to all locations for which Bell Atlantic originally filed Section 214 applications, and would reach $2 billion per year if extended to the entire Bell Atlantic service area. Bell Atlantic must be required to raise its video dialtone rates to cover these enormous losses. If the service is uneconomic at those higher rates, that is a matter of concern for Bell Atlantic's shareholders -- not the Commission.

Not surprisingly, Bell Atlantic has attempted to narrow the issues in this proceeding by claiming that the Commission can only consider the reasonableness of its proposed cost methodology. The Commission's review of Bell Atlantic's Dover tariff, however, is not limited to considering whether Bell Atlantic's methodology is reasonable. Allocation of costs between video and telephony in telephone company broadband network rebuilds is a policy question that must be decided by the Commission as a coherent, consistently applied policy. Because the Commission has chosen to make such determinations in the tariff process, the precedential value of its decision in Dover will have an enormous effect on other LECs proposing video dialtone networks. The Commission must use this proceeding to prescribe cost allocation principles for video dialtone that protect competition and prevent cross-subsidization. A mere "rubber-stamp" approval of Bell Atlantic's Dover investigation responses would be an abdication of responsibility and contrary to the Commission's prior promises. The Commission simply cannot be in a position of insuring video marketplace winners and losers by propping up bad LEC investments.

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> If a new entrant cannot serve a community on an unsubsidized basis, there is no justification for ratepayers' funds being used to finance contrived competitive entry that would be uneconomic but for the subsidy. -- Bell Atlantic, October 10, 1995.[1/]

I. INTRODUCTION.

Cox Enterprises, Inc. ("Cox"), by its attorneys, hereby submits this Opposition to Bell Atlantic's Direct Case in which Bell Atlantic attempts to justify its tariff to provide video dialtone service in Dover Township, New Jersey.[2/] The Direct Case confirms Cox's consistent assertion -- that video dialtone service using current technology is not economically viable unless parties other than video dialtone customers foot the bill. The only other parties to whom Bell Atlantic can shift its losses -- telephony competitor/customers, telephone employees and captive ratepayers -- will bear the brunt of the Dover system losses in the absence of cost

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1/ See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, Comments of Bell Atlantic, CC Docket No. 80-286 (filed October 10, 1995) at 3.

2/ In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, Regulations for Video Dialtone Service in Dover Township, New Jersey, Bell Atlantic Direct Case, Transmittal Nos. 741, 786, CC Docket No. 95-145 (filed October 26, 1995) ("Direct Case").

allocation requirements. Economic reality dictates that Bell Atlantic's shareholders will not foot the bill of the Dover video investment, and in light of the deep personnel cuts already made, it is unlikely any further burden could be shouldered by Bell Atlantic's employees. Therefore, Bell Atlantic picks the obvious place to book the cost -- telephony ratepayers and telephony competitors who must rely on essential Bell Atlantic facilities. The Commission must reject Bell Atlantic's plea that the Commission guarantee Bell Atlantic a place in the video services marketplace via video dialtone regardless of whether video dialtone is economically viable.

By suspending Bell Atlantic's video dialtone tariff the Commission recognized that substantial questions of lawfulness exist.[3/] In its Investigation Order the Commission echoed the concerns raised by Cox and others as to whether video dialtone is viable absent ratepayer cross-subsidy.[4/] Bell Atlantic's own data show unequivocally that its Dover video dialtone system cannot meet the price cap "new services test"[5/] established by the Commission. Bell Atlantic's Dover video dialtone system is an economic failure and the Commission must refuse to bow to obvious pressure from Bell Atlantic to find lawful such a patently unreasonable tariff.

Most importantly, the Commission's findings in this investigation must establish a reasonable policy for future video dialtone tariffs by establishing clear cost allocation rules to

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3/ In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, Regulations for Video Dialtone Service in Dover Township, New Jersey, Order, Transmittal Nos. 741, 786 (released June 9, 1995) ("Suspension Order").

4/ In the Matter of Bell Atlantic Telephone Companies Revisions to Tariff F.C.C. No. 10 Rates, Terms, Regulations for Video Dialtone Service in Dover Township, New Jersey, Order Designating Issues For Investigation, Transmittal Nos. 741, 786, CC Docket No. 95-145 (released September 8, 1995) ("Investigation Order").

5/ Telephone Company-Cable Television Cross-Ownership Rules, Memorandum Opinion and Order on Reconsideration and Third Further Notice of Proposed Rulemaking, 10 FCC Rcd 244, 340 (1994) ("Video Dialtone Reconsideration Order").

prevent the proliferation of local exchange carrier ("LEC") money shifting gamesmanship. The regulation of video dialtone is critically dependent on a consistent policy determination of the appropriate allocation of common costs between video and telephone services. Acceptance of Bell Atlantic's blatant mischaracterization of the overwhelming majority of "common" costs as telephony costs would be an abdication of responsibility and against public policy.

Cox has urged the Commission to adopt clear cost allocation rules for video dialtone.[6/] However, instead of developing cost allocation rules for video dialtone early in the video dialtone rulemaking cycle, as is the usual chain of events when establishing a new LEC service, the Commission allows each carrier to make its own determination of a suitable cost allocation plan and then reviews that allocation as part of the video dialtone tariff process.[7/] Bell Atlantic has submitted a cost allocation plan that loads onto telephony ratepayers 72 percent of the costs identified as common costs. The Commission must come to grips with this patently unreasonable and unfair allocation.

Because of the decision to review video dialtone cost allocations on a case-by-case basis, the precedential value of the Commission's determinations in Dover will have an enormous effect on other LECs proposing video dialtone networks. Accordingly, the Commission must use this proceeding to prescribe cost allocation principles for video dialtone that protect competition and prevent cross-subsidization.

6/ See, e.g., Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulation, Petition for Reconsideration filed by Cox Enterprises, Inc., CC Docket No. 94-1 (filed November 6, 1995) at 2.

7/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 340.

Resolution of the proper allocation of common costs between video and telephony is a policy matter that demands immediate attention. As shown by Bell Atlantic's Dover tariff, leaving cost allocation decisions to the LECs guarantees that the Commission will be in the business of propping up bad LEC investments. Moreover, permitting a misallocation of costs will impose an enormous cross-subsidy burden on virtually powerless state regulators under the existing separations scheme. Bell Atlantic's Dover tariff, if illustrative of general video dialtone costs and revenues, shows that the economics of video dialtone is not as the Commission envisioned or may have hoped. The Commission must not, however, place itself in the role of competitive score keeper by failing to act to protect telephone ratepayers from massive cross subsidization. The Commission must staunch the video dialtone money hemorrhage now by establishing cost allocation rules and policies to apply to all future LEC video dialtone tariff proposals.

II. THE MONEY FOR BELL ATLANTIC'S $68 MILLION DOVER INVESTMENT MUST BE PAID BY SOMEONE.

> In the remaining years of this decade, video dialtone and related offerings will likely stimulate tens if not hundreds of billions of dollars of local exchange carrier investment in network upgrades. Proper allocation of these costs is essential to protect consumers who do not choose to use telco-provided video services. Unfair leveraging of market power must be avoided; we seek not simply competition but competition which is fair and which has the best possible chance of being sustainable over the long run.[8]

8/ Separate Statement of Commissioner Susan Ness, Re: Video Dialtone (CC Docket No. 87-266) (released October 20, 1994) at 1.

Accepting Bell Atlantic's gross understatement of the "total projected costs" for the Dover system of $68 million,[9] a question immediately arises as to who foots the bill if this investment does not recover the identified costs. In other video dialtone proceedings Bell Atlantic and other LECs consistently have parroted the Commission's expectation that shareholders will absorb video dialtone system costs if a system fails,[10] but shareholder realization of video dialtone costs is unlikely because of Bell Atlantic's ability, and publicly stated intention, to divert costs elsewhere. Further, if losses are in line with Cox's estimates,[11] Bell Atlantic is likely to spread the costs unevenly and as transparently as possible among the limited constituencies it has available: shareholders, employees, competitor customers and ratepayers.

A. Shareholders.

Shareholder dividends are sacred in the telephone industry. Indeed, Bell Atlantic Chairman Raymond Smith publicly cited a reluctance to cut dividends as one of the reasons behind last year's collapse of Bell Atlantic's proposed merger with Tele-Communications, Inc.[12] Telephone company shareholders have come to expect utility-type dividends with clockwork regularity. This gives more than lip service to the stereotype that utility shareholders are the

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9/ Direct Case at 16. As Cox will show in Section IV, the actual cost of the Dover video dialtone system is much higher than $68 million.

10/ See, e.g., In the Matter of the Application of the Chesapeake and Potomac Telephone Company of Virginia, Order and Authorization, 10 FCC Rcd 2975, 3002 (1995).

11/ As shown in the attached Exhibit 1, when all costs are included and when common costs are allocated according to a neutral 50/50 cost allocation plan, the Dover system will lose over $7 million each year.

12/ Michael Dresser, Bells Take a Hard Look at Dividends, The Baltimore Sun, April 9, 1995 at 1D.

proverbial "widows and orphans" or pension fund investors who value the predictability and security of telephone company stocks. The LECs understandably are very reluctant to take any action that might cause current investors to lose confidence in their ability to deliver predictable dividends now, just as the LECs are poised to enter highly competitive, capital intensive businesses such as video programming, interchange services and manufacturing.

To date, none of the regional Bell Operating Companies has ever cut its dividend, even in the face of an uncertain future financial environment. Despite a negative free cash flow in 1994, Bell Atlantic actually increased its quarterly dividend from $.69 to $.70 per share earlier this spring, prompting analyst reports that Bell Atlantic is borrowing money to pay dividends.[13/] Such extreme reluctance to cut dividends, even when faced with negative free cash flow, suggests that Bell Atlantic will undoubtedly seek some other alternative than to pass the costs of major new venture failures on to shareholders.

B. Employees.

Bell Atlantic, along with the other LECs involved in video dialtone, has rapidly downsized to become more efficient as a result of its chosen price cap productivity goals. Bell Atlantic's union is objecting to the elimination of jobs in a period when customer service complaints are climbing.[14/]

13/ See, e.g., John M. Higgins, Cable vs. Telcos: Who Bleeds More, Multichannel News, June 26, 1995, at 12A.

14/ Robert Gebeloff, Reach Out and Touch; Phone Union Wooing Public; Ads Link Complaints to Job Cuts, The Bergen Record, September 27, 1995, at B1.

In late 1994 Bell Atlantic announced plans to eliminate 5,600 jobs, or almost 8 percent of its workforce, over the next three and a half years.[15/] In New Jersey, where the Dover system is located, job losses will be between 1,400 and 1,600, or more than 10 percent of the Bell Atlantic workforce in the state.[16/]

These job cuts will save Bell Atlantic money, reportedly resulting in total payroll savings of about $228 million through 1997.[17/] Bell Atlantic President James G. Cullen said he expects the company to offer more services, such as video sent over telephone networks, as a result of the cost savings, but no telephone rate reductions were expected as a result of the cutbacks.[18/] Bell Atlantic is not passing worker reduction cost savings back to telephone ratepayers, the group that has paid for worker salaries. Rather, Bell Atlantic's public admission that it is cutting workers from the basic telephony side of its business and using the savings to fund video dialtone is telling. Bell Atlantic is able to cushion the impact of a bad investment in Dover simply by firing employees as part of its corporate savings strategy. This will, however, only be a short-term fix because as employee levels have dropped, customer service complaints have risen. Bell Atlantic does not have enough employees to fire to finance video dialtone deployment on a wide-spread basis, and thus must look to other revenue sources (such as ratepayers and telephony customer/competitors) to pay for its proposed investments. Only by

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15/ Sandra Sugawara, Bell Atlantic to Eliminate 5,600 Jobs Over 3 1/2 Years, The Washington Post, August 16, 1994, at A1.

16/ Robert Gebeloff, Bell Atlantic Slashing Jobs; 1,400 Cuts Planned in N.J., The Bergen Record, August 16, 1994, at D1.

17/ Sandra Sugawara, Bell Atlantic to Eliminate 5,600 Jobs Over 3 1/2 Years, The Washington Post, August 16, 1994, at A1.

18/ Id.

adopting a cost allocation method that places most of the video dialtone system costs where they belong can Bell Atlantic's video dialtone proposals be permitted to remain in effect.

C. Customer/Competitors.

Bell Atlantic has a variety of telephony customer/competitors in the competitive access provider ("CAP") and emerging competitive telecommunications area that, from Bell Atlantic's strategic perspective, could help defray the Dover video losses because of Bell Atlantic's control over essential bottleneck facilities. For example, Bell Atlantic could well seek to recover its video venture losses by loading costs onto functions or services vital to opening the local loop to competition such as interconnection and number portability as it has done in Virginia, where it has argued that all new carriers offering competitive local telephone services should pay the incumbent's admittedly non-cost based tariffed intrastate switched access rate.[19] This strategy already has caused one potential competitor to reconsider its plans to enter the local market.[20] Bell Atlantic is perfectly poised to foist improper costs onto its customer/competitors because competitors have no choice but to pay the charges or leave the field. In a perverse twist, Bell Atlantic could use funds from cable telephony competitors seeking to interconnect with its telephone network to subsidize video dialtone systems that compete for the cable companies' core business -- thus forcing cable operators to subsidize their own competition in both telephony and video. Unless the Commission acts to prevent cross subsidies and properly

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19/ See In the Matter of Investigating Local Exchange Telephone Competition, Including Adopting Rules Pursuant to Va. Code § 56-265.4:4.C.3., Comments of Bell Atlantic, Case No. PUC950018 (filed before the State Corporation Commission of Virginia on August 4, 1995) at 5-7.

20/ See SBC Media Ventures Asks Md. PSC to Suspend Action on Its Telephony Bid; Interconnect Cited, Communications Daily, Page 1 (November 17, 1994).

allocate common costs, the pervasive LEC control over essential bottleneck facilities can be used to disrupt true competition in both the telephony and the video markets.

D. Ratepayers.

Bell Atlantic claims that its proposed Dover cost allocation should be judged reasonable because "Bell Atlantic is required by state regulators to be capable of providing both advanced voice and new broadband services."[21/] What Bell Atlantic omits, however, is that it was Bell Atlantic, not state regulators, that first proposed "requiring" Bell Atlantic to upgrade its New Jersey facilities to include broadband capabilities. In fact, at the same time it was filing its Section 214 application for the Dover system, Bell Atlantic proposed "Opportunity New Jersey," a scheme of "alternative regulation" that includes broadband network upgrade requirements.[22/] "Opportunity New Jersey" removes Bell Atlantic's New Jersey affiliate, New Jersey Bell, from rate regulation and provides for formula-based rate increases for regulated services. The plan caps basic residential rates until the year 2000, but omits any real mechanism for state regulators to decrease basic residential rates.[23/] Consequently, when Bell Atlantic cuts 10 percent of its New Jersey workforce, state regulators have no mechanism to require Bell Atlantic to pass those cost savings on to consumers. Instead, as Bell Atlantic's President freely admits, Bell Atlantic will use its cushion of cash from ratepayers and employee dismissals to

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21/ Direct Case at 22.

22/ In Re New Jersey Bell Telephone Company, 143 PUR4th 297, 304 (1993) (Docket No. T092030358) (Released May 6, 1993).

23/ The plan does require a 50/50 sharing of earnings between New Jersey Bell and state ratepayers if New Jersey Bell's rate of return on equity exceeds 13.7% and requires rate reductions when New Jersey Bell's rate of return on equity exceeds 11.7%. 143 PUR4th at 326. Such levels will never be reached, however, as long as Bell Atlantic remains free to shift its costs to regulated telephone ratepayers, thereby reducing the apparent size of any earnings.

fund its video dialtone system despite orders from New Jersey to fund its network upgrades from reduced dividend payments.[24] To the contrary, as discussed above, New Jersey Bell's parent corporation Bell Atlantic actually raised, not lowered, dividends this year despite a negative free cash flow.

New Jersey regulators are also poorly equipped to detect cross subsidization, even subsidies on the massive scale of Bell Atlantic's. Structural separation requirements for video dialtone services were proposed but not adopted by the New Jersey Board of Regulatory Commissioners because the New Jersey Commission determined that current safeguards are sufficient to protect state ratepayers. The New Jersey Board of Regulatory Commissioners promised to impose additional safeguards if necessary.[25] New Jersey deemed its carrier-controlled accounting system, the "Embedded Analysis System" ("EAS"), sufficient to identify and track video dialtone investments despite contentions by New Jersey's own Department of the Public Advocate, Division of Rate Counsel, that EAS reports are not sufficient to prevent cross-subsidization of competitive services.[26]

The FCC should not continue its unjustified confidence in the adequacy of state and federal price caps to protect Bell Atlantic's telephone ratepayers from bearing the burden of the Dover investment. Price cap rules allow LECs to "game the system" by choosing annually

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24/ "The funds to construct [Opportunity New Jersey] are to come from reduced dividend payments to Bell Atlantic, retained earnings, debt issuance and new services revenues." 143 PUR4th at 328. As discussed in Section IIA above, Bell Atlantic cannot pass on reduced dividend payments to its shareholders in the present investment environment without risking significant adverse effects on its stock's value.

25/ 143 PUR4th at 375.

26/ 143 PUR4th at 369.

among the available productivity factor options. If LECs misallocate costs to regulated telephony, thereby artificially depressing telephony earnings, virtually all of the productivity benefit from the price cap is lost.[27/] Further, price cap rules may provide incentives for LECs to cut costs further than would be prudent, absent LEC monopoly control of the local exchange market. The money "saved" is then used to fund non-telephony projects. In Ameritech's service territory, for example, a LEC heavily investing in cable system overbuilds, telephone service has deteriorated in recent months so drastically as to provoke a spate of state commission investigations.[28/] U S West, another LEC with significant video dialtone interests that operates under federal and state price cap regulation, has also been the subject of increasing service complaints, prompting state regulatory action in Arizona, Montana, Colorado and Idaho.[29/] In Idaho the Public Utility Commission has proposed sanctions against U S West that would force the company to give refunds to customers unless the level of consumer complaints decline.[30/]

27/ See, e.g., Letter to the Honorable Reed E. Hundt, Chairman, Federal Communications Commission, from James O. Robbins, President and Chief Executive Officer, Cox Communications, Inc., ex parte filing in CC Docket No. 87-266 and CC Docket 94-1 (filed June 28, 1995).

28/ See Investigation Into Adequacy of Service Provided by Ameritech Wisconsin, Wisconsin PUC, Docket No. 6720-TI-115 (August 24, 1995); Investigation into Ameritech Ohio's Compliance With Minimum LEC Service Standards, PUCO Case No. 95-711-TP-COI, 1995 PUC LEXIS 626 (October 5, 1995).

29/ John DeWitt, Phone Woes Stay on the Line; US West Gripes Flood Regulators, Arizona Business Gazette, October 26, 1995, at 1.

30/ Id.

Bell Atlantic recently has seen customer complaints soar from an average of 72,000 per quarter in 1992 to more than 286,000 per quarter since that time.[31]

New Jersey ratepayers will pay the majority of Bell Atlantic's Dover video dialtone system costs unless the Commission establishes firm cost allocation rules. New Jersey regulators expressly relied on the Commission to establish appropriate separations and accounting guidelines for services such as video dialtone, a reliance the Commission should not ignore. Bell Atlantic's claim that its "Opportunity New Jersey" program makes the majority of video dialtone/telephony common costs attributable to telephony is a farce. Bell Atlantic crafted the New Jersey incentive regulation to protect itself from any significant downside as New Jersey employee layoffs and telephone ratepayers subsidize the Dover system without discernable means of detection or remediation at the state level.

Neither Bell Atlantic nor the Commission, if it ends the investigation without action, can hide from the fact that telephony customer/competitors and telephone ratepayers will finance Bell Atlantic's ill-advised, revenue losing Dover investment. This investigation must set the Commission on the proper path to establishing rules and policies that do not invite abuse by the LECs.

III. THE BELL ATLANTIC CASE DEMONSTRATES THE PROBLEM OF LEAVING ESSENTIAL POLICY DECISIONS TO A SELF-INTERESTED LEC.

In the Video Dialtone Reconsideration Order, the Commission decided not to initiate a rulemaking to develop new video dialtone-specific tariffing and cost allocation requirements.

31/ Robert Gebeloff, Reach Out and Touch; Phone Union Wooing Public Ads Link Complaints to Job Cuts, The Bergen Record, September 27, 1995, at B1.

Instead, the Commission reasoned that the "first few tariff proceedings will provide a far more concrete and realistic factual context for future decision making."[32] The Commission further postponed promulgating any cost allocation rules in the Suspension Order, noting that it will determine at the conclusion of the investigation whether Bell Atlantic properly allocated its common costs.[33]

Cox challenged the Commission's avoidance of the development of cost allocation rules, fearing exactly the situation that has now occurred. Because there are currently no Commission-promulgated cost allocation rules or even a stated policy, Bell Atlantic has taken a free rein and allocated the majority of its video dialtone costs to its telephony ratepayers, thereby allowing it to charge unreasonably low prices for its video dialtone service, prices that remain in effect during the investigation.[34] When costs are reallocated to a supportable level, Bell Atlantic's video dialtone system cannot recover what Bell Atlantic has identified as its direct costs, let alone any reasonable portion of overhead costs.[35] Disturbingly, Bell Atlantic is attempting to reframe the issues in this investigation to usurp the Commission's authority to use this investigation to establish cost allocation rules for video dialtone providers. Bell Atlantic has ignored the fact that the Commission has yet to determine appropriate cost allocation rules or policies and is interpreting the Commission's authority to

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32/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 340.

33/ Suspension Order at 3.

34/ While Bell Atlantic's tariff imposes charges on customer programmers, not on end users, the tariff charges are purposefully low enough such that the customer programmers can themselves charge end users unreasonably low prices.

35/ See Exhibit 2.

promulgate further policies by claiming that the Commission can only consider whether Bell Atlantic's preferred methodology is reasonable.

Bell Atlantic's narrow framing of the Commission's discretion is unsupportable. Not only does the Commission have the authority to prescribe a reasonable allocation, it must use this proceeding to establish video dialtone cost allocation policies.[36/] Because the Commission has already suspended Bell Atlantic's tariff, serious questions of lawfulness already exist. Bell Atlantic bears the burden of proving that its rates and the underlying cost allocations are lawful. In determining whether Bell Atlantic's rates are lawful, the Commission is not limited to considering whether Bell Atlantic's methodology is reasonable. Indeed, the Commission is entirely free to, and must consider, whether other methods of allocation would be preferable.

A. The Commission Cannot Rubber Stamp Bell Atlantic's Proposed Allocation of Common Costs.

It is plainly not in Bell Atlantic's interest to support anything other than the 72/28 allocation it has presented throughout the tariffing process. Bell Atlantic has attempted to narrow the allocation issue by claiming that the Commission can only consider the methodologies reflected in its tariff. Bell Atlantic's aggressive approach to the Commission's Investigation Order is an obvious strategy to force the Commission to retreat from any serious investigation of the cost allocation issue.

As the Commission has already recognized, this proceeding is not run-of-the-mill. Because this investigation is the first instance in which cost allocation issues will be

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36/ Video Dialtone Reconsideration Order, 10 FCC Rcd at 340.

addressed within a functioning commercial video dialtone environment, the Commission must use the proceeding to establish cost allocation policies that can be applied to all video dialtone carriers, consistent with the Commission's prior stated intent. Allocation of common costs is a policy question that must be resolved by the Commission. By claiming that the reasonableness of its formula is the only cost issue, Bell Atlantic attempts to force the Commission to grant the LECs unlimited flexibility -- the discretion to allocate video buildout costs as they wish. The cost allocation decision has fundamental social policy implications and is too important to be left to carrier discretion. The Commission must use this investigation to finally establish and articulate a cost allocation policy that protects the public interest.

B. Bell Atlantic Bears the Burden of Proving that its Rates and the Underlying Costs Are Lawful.

Bell Atlantic attempts to shift the burden of proof. It suggests that the Commission must presume that Bell Atlantic's cost allocation method is reasonable and that the lawfulness of its tariff can only be judged within the confines of the proposal. This analysis is fundamentally flawed. By suspending the tariff, the Commission already has found that substantial questions of lawfulness exist. The Communications Act and Commission precedent place the burden on Bell Atlantic to prove the lawfulness of its rates and underlying cost allocations.

Section 204(a)(1) of the Act provides that, when the Commission suspends a new or revised charge, "the burden of proof to show that the new or revised charge . . . is just and reasonable shall be upon the carrier." Commission precedent illustrates that carriers bear the burden of demonstrating that suspended rates are lawful.[37/] For example, in 1990 Access Tariff Filings, the Common Carrier Bureau found that a carrier filed DS1 rates more than eight times its rates for voice grade special access service. The Bureau suspended the rates and initiated an investigation. In finding the rates unlawful, the Commission reasoned that the carrier failed to prove that its "rates were reasonably based upon its costs."[38/] The Commission noted that "in any tariff investigation pursuant to Section 204(a) of the Act, a carrier bears the burden" of showing that its rates are reasonable.[39/]

Similarly, in Investigation of Special Access Tariffs, the Common Carrier Bureau suspended certain of the LECs' special access rates and initiated an investigation. In concluding that the rates were unlawful, the Bureau stated:

> We conclude that the affected LECs have failed to sustain their burden of proof that the suspended rates for HiCap and DDS are just and reasonable. Section 204(a) of the Communications Act . . . places the burden of proof on the carrier to show that any increased charge or proposed charge is just and reasonable.[40/]

In evaluating Bell Atlantic's rates and underlying cost allocations, the Commission is not constrained by any presumption that the rates or the underlying cost allocations are reasonable. Bell Atlantic bears the burden of proving that its rates are lawful. Bell Atlantic has failed to sustain its burden.

37/ See, e.g., In the Matter of Annual 1990 Access Tariff Filings, Memorandum Opinion and Order, 5 FCC Rcd 7487 (1990) ("1990 Access Tariff Filings"); In the Matter of Investigation of Special Access Tariffs of Local Exchange Carriers, Memorandum Opinion and Order, 63 RR 2d 362 (1987) ("Investigation of Special Access Tariffs").

38/ 1990 Access Tariff Filings, 5 FCC Rcd at 7488.

39/ Id. at 7487.

40/ Investigation of Special Access Tariffs, 63 RR2d at 367.

C. Bell Atlantic is Wrong in Asserting that the Commission Must Approve its Common Cost Allocation Even if it Finds that Other Methods are Preferable.

In its Direct Case, Bell Atlantic argues that the cost allocation issue before the Commission is limited to whether Bell Atlantic's chosen methodology is reasonable. It claims that the Commission cannot choose a different method of cost allocation, even if it finds that another method is preferable. That is absurd. The Commission has stated in both the Video Dialtone Reconsideration Order and the Suspension Order that the Commission will use this investigation to determine appropriate cost allocation methods for video dialtone providers. The Commission cannot ascertain its preferred method for allocating common costs if it considers only a single method. To determine whether Bell Atlantic's cost allocation is reasonable, the Commission must consider the impact of applying other methods.

Tariff investigations can be vehicles for prescribing changes in the results or methods of tariff calculations.[41/] For example, Ameritech Operating Companies involved the LECs' tariffs for expanded interconnection through virtual collocation for special access and switched transport services. The Commission suspended the tariff, initiated an investigation and determined that, on the basis of the record, the LECs had unreasonably proposed to recover a greater share of overhead costs in charges for expanded interconnection services than they recovered in charges for comparable services. Because the Commission determined that the

41/ See, e.g., In the Matter of Ameritech Operating Companies Revisions to Tariff F.C.C. No. 2 et. al, Order, 10 FCC Rcd 1960 (1994) ("Ameritech Operating Companies").

LECs had unreasonably calculated their expanded interconnection rates, the Commission prescribed a formula for them to use in recalculating their rates.[42/]

Adoption of Bell Atlantic's position would require either an up or down vote on the proposed issue being investigated. That plainly is not the limit of the Commission's discretion. In a tariff investigation proceeding the Commission must prescribe rates and/or methodologies that were not proposed by the carrier if that is what is required to create a lawful, reasonable tariff.

The Commission's intention to use this tariff investigation to determine whether Bell Atlantic's cost allocations are reasonable should come as no surprise to Bell Atlantic. If Bell Atlantic cannot economically justify its video dialtone system by recovering costs from video dialtone customers, the Commission must reject its proposal as unlawful. The Commission is not an insurer of Bell Atlantic's commercial success in its chosen new business venture. If Bell Atlantic cannot operate its video dialtone system without unfairly burdening employees, competitors or telephony ratepayers, the Commission cannot conclude that an unreasonable and unlawful proposal is adequate simply because it would like to see a video dialtone system succeed. The Commission stated in the Section 214 Dover Application Order that "[o]ur action in this proceeding in no way limits our ability to ensure, in the subsequent tariff review process, that [New Jersey Bell's] tariffed rates for video dialtone service are just and reasonable. It is

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42/ Ameritech Operating Companies, 10 FCC Rcd at 1974-75.

clear that consideration of costs in a Section 214 proceeding is distinct from the examination of rates in the tariff review process."[43] The Commission must live up to those words.

IV. THE COST OF VIDEO DIALTONE SHOULD BE RECOVERED FROM VIDEO DIALTONE USERS AND NOT INNOCENT PARTIES.

Cox repeatedly has pointed out that the actual costs of the Bell Atlantic Dover video dialtone system are far higher than the $68 million of costs reported by Bell Atlantic.[44] When the true costs of the system are combined with Bell Atlantic's own elasticity figures, it becomes patently clear that Bell Atlantic will be forced to subsidize its video dialtone system with monies taken from the constituency groups discussed in Section II above. Indeed, if Bell Atlantic has its way, most of the cross-subsidization will come from telephone ratepayers, although employees and competitors who must rely on bottleneck functions are also very much at risk. At this late date Bell Atlantic's true costs will never be recovered because, among other things, costs such as planning, legal services and research and development are not reflected in the $51 million Bell Atlantic admits it had spent on the Dover system as of August, 1995.[45] As a matter of public policy, the Commission <u>must</u> require Bell Atlantic to recover the complete cost of video dialtone from video dialtone users, not from other parties.

<u>43</u>/ <u>New Jersey Bell Telephone Company</u>, Order and Authorization, 9 FCC Rcd 3677, 3685 (1994) ("<u>Section 214 Dover Application Order</u>").

<u>44</u>/ <u>See</u>, <u>e.g.</u>, Letter to Geraldine Matise, Chief, Tariff Division, Common Carrier Bureau, Federal Communications Commission, from Leonard J. Kennedy, Esq., in Bell Atlantic Tariff F.C.C. No. 10, Transmittal No. 741 (filed May 15, 1995).

<u>45</u>/ Direct Case at 3, 57-58. For example, Bell Atlantic's total Planning, Research and Development expenses for 1994 were $13,753,000.00. (FCC Statistics of Common Carriers for 1994, Table 2.9, lines 267, 275). Bell Atlantic claims that only $38.74 of this was for video dialtone, or 3/10,000 of 1 percent.