Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Allocation of Costs Associated with	)	CC Docket No. 96-112
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

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GTE's REPLY COMMENTS

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SUMMARY

1. Under the mandate of the 1996 Act, the Commission should be seeking to reduce, not to increase, regulatory burdens. The FCC should as a matter of policy reject increases in regulatory burdens absent a showing of absolute necessity. No such showing has been made in support of the proposals of the *Notice*. Rather than adopting these proposals, the Commission should reexamine its regulations to reduce their burdens as price caps and competition make heavy-handed regulation redundant and unnecessary.

2. In the spirit of the 1996 Act, GTE urges the FCC to build on the comparative success of the Part 64 process by avoiding detailed requirements, and by allowing for flexibility that will accommodate significant differences among companies.

3. The Commission must not let the end result of the *Notice* be an unintended barrier to the provision of new, competitive advanced telecommunications and information services to the public. Such an outcome would be diametrically opposed to Congressional intent in the framing of the 1996 Act.

4. The Commission should be addressing how to streamline and eventually eliminate the Part 64 cost allocation rules, rather than considering increases in burdens as the need for regulation diminishes.

5. It would be premature for the Commission to adopt arbitrary fixed allocators that would reduce the flexibility built into the CAM process and might violate the FCC policy of technological neutrality.

6. No changes are required in the current Part 64 rules to deal with spare capacity.

7. Changes to the cost allocation rules should not affect the price cap indexes. The price cap rules detail what causes exogenous cost changes and, in the case of cost reallocations, it is not a forward-looking cost allocation of new investments. The path the Commission should take that follows the pro-competitive, deregulatory spirit of the 1996 Act is to establish a price cap plan without sharing that is attractive to all LECs.

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GTE's REPLY COMMENTS

GTE Service Corporation and its affiliated domestic telephone, wireless and video companies ("GTE"), with regard to the Notice of Proposed Rulemaking (the "NPRM" or "*Notice*"), FCC No. 96-214 (released May 10, 1996), and the Telecommunications Act of 1996 (the "1996 Act"), hereby submit their reply to comments of other parties.

I. IN CARRYING OUT ITS NEW ROLE UNDER THE 1996 ACT, THE COMMISSION SHOULD AVOID HEAVY-HANDED OVER-REGULATION THAT WOULD BE LIKELY TO DETER AGGRESSIVE LEC INVESTMENT IN ADVANCED OFFERINGS.

The comments in this proceeding set out polarized positions of Local Exchange Carriers ("LECs" or "exchange carriers") and those that compete (or will compete) with them, such as AT&T, MCI, and cable operators While the LECs have demonstrated that existing structures (price caps and effective competition) have obviated the need for more detailed regulation, their competitors have seized the opportunity to once again attempt to increase the LECs' regulatory cost burden for their own market advantage.

The Commission now finds itself at a policy crossroads. Congress has passed, and the President has signed, legislation that has permanently changed the way

telecommunication services will be delivered to the public. The 1996 Act has not only directed replacement of historically heavy regulation with competitive market forces; it has also mandated that advanced telecommunications and information services, such as those that may be integrated into the LECs' existing loop plant, must be encouraged and promoted by the Commission.[1]

Clearly, the Commission's role is not the same as it was prior to the 1996 Act. If the Commission continues to impose detailed and onerous regulation on the parties seeking to provide advanced telecommunications services and valuable new information services, the incentives for the carriers affected to seek to provide such services will be not improved but diminished -- thus running directly counter to the intent of the 1996 Act. Moreover, Section 10 of the 1996 Act requires the Commission to remove regulation that it determines to be unnecessary. The proposals of the *Notice* would dramatically increase regulatory burdens just as incentive regulation and competition reduce the usefulness of detailed regulation -- again running directly counter to the intent of the 1996 Act.

GTE urges the Commission to put aside the proposals of the *Notice* and take a fresh approach more in harmony with the spirit of the 1996 Act and the reality of a burgeoning competitive telecommunications marketplace. The Commission should adopt and apply a policy that it will increase regulatory burdens only when this can be shown to be absolutely necessary.

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[1] *See, for example*, 47 U.S.C. Section 254(h)(2). All statutory references are to 47 U.S.C. unless otherwise noted.

Promoting competition and advanced services while protecting existing users of telecommunications are not mutually exclusive goals The FCC, along with many states, has adopted incentive (price cap) regulation. This fresh approach to regulation is designed, among other things, to eliminate any supposed motivation on the part of exchange carriers to transfer benefits to unregulated affiliates -- since the realized return of the LEC is not affected by such transfers The Commission should avoid actions that would sabotage its own forward-looking policies and it efforts to carry out the letter and spirit of the 1996 Act for the sake of "protection" that is no longer necessary.

BroadBand Technologies suggests (at 4) that, if the Commission's actions are tantamount to requiring exchange carriers to pay an "up-front" penalty for using integrated distribution facilities, this reduces the likelihood that they will do so. If that happens, if once again -- as in the case of Video Dialtone service -- heavy-handed over-regulation drives LECs from the field, the prime losers will be consumers of both telecommunications and video services, since the economic benefits of integration will not be realized. It would run counter to the mandate of the 1996 Act if the Commission allowed burdensome and detailed regulation to stunt the growth of new technologies and services. Further, the Commission should avoid decisions that would place cable firms, *i.e.*, entrenched-monopoly providers of video service, in a position of unassailable strength vis-à-vis exchange carriers seeking to provide the public with a competitive alternative in furnishing video services.

In summary: Under the mandate of the 1996 Act, the Commission should be seeking to reduce, not to increase, regulatory burdens. The FCC should as a matter of

policy reject increases in regulatory burdens absent a showing of absolute necessity. No such showing has been made in support of the proposals of the *Notice*. Rather than adopting these proposals, the Commission should reexamine its regulations to reduce their burdens as price caps and competition make heavy-handed regulation redundant and unnecessary.

II. THE ONLY CHANGE REQUIRED IN THE CAM PROCESS IS STREAMLINING IT TO REFLECT THE NEW COMPETITIVE ENVIRONMENT AND THE SPIRIT OF THE 1996 ACT.

Contrary to AT&T's attempt (at 11) to convince the Commission that the Part 64 Rules will be needed in perpetuity for the price cap LECs, these rules are unnecessary, administratively burdensome, and costly not only for the LECs, but for the Commission. GTE, like other price cap carriers, has no incentive to shift costs into regulated accounts as there is nothing to be gained under price cap regulation. As USTA's consultant Dr. J. Gregory Sidak succinctly states: "Price caps eliminate the incentive for the LEC to cross-subsidize the new lines of business through misallocations of costs, for the firm may charge up to its maximum price *whether or not its accounting costs for the regulated service change*."[2] The price cap index -- not costs -- limits the amount of any change in prices.

Instead of reducing the burdens of the Part 64 process, the *Notice* would dramatically increase its burdens. GTE's comments (at 2) maintain that the existing Part 64 Rules are more than adequate in addressing the sharing of common facilities by regulated and nonregulated services. Comments of a number of parties share this

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[2] Comments of the United States Telephone Association ("USTA"), Affidavit of J. Gregory Sidak at 14 (*emphasis in the original*).

position. Thus, SWBT (at 5) states that the existing CAM process is more than sufficient to address the concerns raised in the *Notice* and adds (at 10): "[T]he whole premise of the Joint Cost Order was that LECs would increasingly provide nonregulated services." Similarly, U S WEST (at 6) finds that no major Part 64 changes are needed to address LEC provision of video programming services and other nonregulated services.

U S WEST is entirely correct on this point The Part 64 CAM process was developed in the course of a multi-year proceeding that sought to allow an exchange carrier to put in place cost accounting systems that meet the legitimate needs of regulation while fitting the operations of the LEC involved.[3] Exchange carriers were encouraged to submit proposals on how the purposes of the Part 64 rules could be accomplished within the existing operating, reporting and financial systems of each LEC. In the course of extended open proceedings that included numerous meetings with the companies affected, the Commission reviewed LEC proposals and accepted or modified them based on its judgment of what was needed in the public interest. It is not correct to speak as if current developments were not considered in 1986-1987. What

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[3] SWBT at 16 says: "In adopting CAM uniformity in 1993, the Common Carrier Bureau (Bureau) only required uniformity in 'selected areas in which the LECs' operations are very similar' and which they did not have 'differing operational characteristics.'" *Footnote omitted.*

the Commission did was to avoid absolute uniformity in cost allocation rules given the disparities in carriers' operations and in the mix of nonregulated activities.[4]

That decision was wise policy then; it is wise policy now. Flexibility has been the key to the comparative success of the Part 64 process. Had the Commission attempted to impose detailed rules, not only would the process have been more contentious -- thereby consuming more FCC and LEC resources -- but the accuracy of the overall reporting would have been compromised. Problems arose in the Part 64 process only where the rules imposed rigidity -- as in the case of the mandatory three-year allocator -- or when the rules were misinterpreted.

In summary: In the spirit of the 1996 Act, GTE urges the FCC to build on the comparative success of the Part 64 process by avoiding detailed requirements, and by allowing for flexibility that will accommodate significant differences among companies.

III. THE COMMISSION SHOULD AVOID ESTABLISHING AN UNINTENDED BARRIER TO THE PROVISION OF NEW, COMPETITIVE ADVANCED TELECOMMUNICATIONS SERVICES, THEREBY DEFEATING ESSENTIAL PURPOSES OF THE 1996 ACT.

Congress intended to encourage efficient delivery of new telecommunications services over integrated facilities by all market participants. GTE's concern that the proposals of the *Notice* could discourage LEC provision of advanced telecommunications services over integrated facilities is shared by a number of parties. U S WEST (at 2) states:

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[4] This is pointed out by NYNEX at 7 and in their n.17, which cites 6 FCC Rcd 7571, 7585 at n.46 and n.225 of the *Joint Cost Order*. NYNEX says at 7: "Carriers will utilize different type of technologies and platforms, and offer different service features in the rapidly moving competitive environment. Accordingly, the Commission should avoid adopting specific, inflexible rules."

> If the Commission attempts to impose a rigid cost allocation regime that fails to account for the legitimate differences among LECs, the Commission likely will send uneconomic signals to market participants that ultimately could retard the development of true, facilities-based competition in both the local exchange and video programming service markets.

Similarly, BellSouth (at 2) asks the Commission to clarify the objectives of this proceeding and address the promotion of advanced telecommunications infrastructure by LECs and competitive markets for information and video programming services. BellSouth (at 4) goes on to say:

> [T]he Commission must not assume that its actions in this proceeding will not substantially affect incumbent LECs' incentives to risk capital in the deployment of advanced telecommunications infrastructure and in bringing competitive new services to market. If the Commission missteps here, the Information Age Network could be postponed indefinitely.

Exchange carriers are not required to offer video services over existing loop plant. While technology may make such an offering possible, and many LECs wish to do so, onerous regulatory requirements could make such a service impractical. The Commission's goal in this proceeding should be to encourage efficient advanced telecommunications services to the public. As BroadBand Technologies (at 4) points out that "LECs already will bear significant costs to upgrade their networks in order to enter the video programming market, in which they will compete with entrenched cable TV operators and other programming providers." It adds (*id.*):

> If, in addition, they are required to pay an "up-front" penalty in the form of rate reduction for their regulated services, most, if not all, LECs will decide to avoid these burdens by simply using physically separate wireless or wireline video distribution facilities.

"Clearly," BroadBand Technologies (*id.*) concludes: "such an outcome would disserve the public interest, by denying consumers both the benefits of an advanced integrated

broadband network infrastructure, and the prospect of lower rates for both telephone and video services made possible by the economic efficiencies of integrated delivery. "

In summary: The Commission must not let the end result of the *Notice* be an unintended barrier to the provision of new, competitive advanced telecommunications and information services to the public. Such an outcome would be diametrically opposed to Congressional intent in the framing of the 1996 Act.

IV. RATHER THAN PERPETUATING AND INCREASING THE BURDENS OF REGULATION, THE COMMISSION SHOULD STREAMLINE AND EVENTUALLY ELIMINATE THE PART 64 PROCESS.

As discussed *supra* and demonstrated by many parties,[5] exchange carriers regulated under price caps no longer have a motive to engage in arbitrary cost-shifting. Cross-subsidization requires a service able to pick up the shifted costs, *i.e.*, a service whose rates can increase without an unacceptable effect on market share. Today, the vast majority of the LECs no longer provide such a service.

Price cap regulation breaks the link between costs, allocated or otherwise, and prices. In addition, there are pricing limitations built into federal and state price caps. And the reality of competition for virtually every telecommunications service severely limits LEC pricing options. No telecommunications provider can expect to sustain prices consistently higher than the competition without heavy losses in market share.

Price caps and competition make cost allocations irrelevant to the price of telecommunications services. With this link broken, the Commission should not place on exchange carriers the burden of perpetuating rules that have lost any serious

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[5] *See, for example*, Sprint at 4; SWBT at 23-25; Ameritech at 4-6; Bell Atlantic at 2-3, BellSouth at 10-15.

justification. Even more so should the Commission reject proposals to dramatically increase the burdens of the cost allocation rules In light of the mandate of Section 10, the FCC should be considering how to streamline or eliminate outdated and ineffective rules.

At the very least, as NYNEX suggests (at 6), the Commission should waive Part 64 cost accounting requirements for LECs to the extent they are subject to price cap regulation without sharing, and should give increased consideration to streamlining the Part 64 rules.

In summary: The Commission should be addressing how to streamline and eventually eliminate the Part 64 cost allocation rules, rather than considering increases in burdens as the need for regulation diminishes.

V. THERE IS NO JUSTIFICATION FOR HASTY SELECTION OF AN ARBITRARY FIXED ALLOCATOR.

GTE opposes the fixed allocator for loop plant proposed by the *Notice* on the grounds that it is, at this stage, without empirical support, completely arbitrary. Further, it would be premature to select any one method of allocation for all instances regardless of the specific facts at hand. Administrative simplicity does not justify an arbitrary and capricious choice having immense consequences.

There are very few situations where integrated voice and video services are currently being provided over integrated facilities Thus, there is no pressing need to take hasty action adopting a factor that could have chilling effects on the provision of new services. No damage will be done if the relatively few active matters that might arise are dealt with under the existing CAM process that allows for consideration of the significant facts affecting the investment and company involved. For the time being, no

damage will be done by relying on general cost allocation principles which are, as stressed by PacTel (at 6) "consistent with economic principles of cost causation and adaptable to any network architecture and service."[6]

BroadBand Technologies points out (at 6-7) that a single allocator may result in an allocation favoring one technology over another, since the proper allocation would be dependent on the network architecture used and the service provided. This could easily foreclose the use of new and more efficient technologies if the Commission removes the flexibility from the existing Part 64 rules in the name of administrative simplicity. Technical neutrality being an important purpose stressed by the Commission,[7] this would indeed be an unfortunate outcome that could lead to unfortunate and unforeseen results.

In summary: It would be premature for the Commission to adopt arbitrary fixed allocators that would reduce the flexibility built into the CAM process and might violate the FCC policy of technological neutrality.

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[6] Footnote omitted.

[7] *See Notice* at paragraph 25; *and* Amendment of Part 36 of the Commission's Rules and Regulations, CC Docket No. 80-286, Notice of Proposed Rulemaking and Notice of Inquiry, 10 FCC Rcd 12309, 12314 (1995): [stating the principles that should guide Commission action concerning the Universal Service Fund:] "Second, assistance should promote efficient investment and operation. Efficient investment and operation requires that assistance be delivered on a basis that is technology-neutral, in order to avoid encouraging investment in specific types of facilities or technologies when other means could deliver local service at lower cost."

VI. THERE IS NO NEED FOR CHANGES IN THE PART 64 RULES TO DEAL WITH SPARE CAPACITY.

GTE (at 9) suggested it would be unwise to disproportionately allocate spare facilities to nonregulated accounts on the assumption that these facilities are likely to be used for the provision of nonregulated services. Such a rule change would penalize exchange carriers for upgrading their networks in order to provide advanced regulated services and to be sure of having the capacity to meet their obligations on a timely basis as Carriers of Last Resort.

Growth in demand for regulated services will continue whether or not the LEC chooses to offer nonregulated services. PacTel (at 20) asserts that the tremendous growth in telephone usage is linked to the use of computers, pagers, fax machines and new services such as Internet access. These uses are likely to continue to grow at substantial rates and make extensive use of spare capacity.

As SWBT states (at 20), methods that attempt to forecast long-term use of these facilities would be unreliable and arbitrary. Further, PacTel (at 20) suggests that the costs of spare facilities are an inseparable part of the plant's unit cost and cannot be discretely identified; thus any attempt to do so would be problematic and without significant benefit. PacTel correctly concludes (*id.*): "the Commission's concerns about the allocation of spare capacity contemplates a problem where none exists"

In summary: No changes are required in the current Part 64 rules to deal with spare capacity.

VII. ANY NEW COST ALLOCATION RULES SHOULD NOT RESULT IN EXOGENOUS COST CHANGES FOR PRICE CAP CARRIERS.

Concerning the reallocation of investment from regulated to nonregulated activities pursuant to the Commission's Part 64 cost allocation rules, AT&T (at 10) says that the FCC's price cap rule -- specifically 47 C.F.R. Section 61.45(d)(1)(v) -- establishes a presumption that cost reallocations due to changes in the Part 64 cost allocation process are exogenous, and thus require decreases in related price cap indices.[8] AT&T misses the point of the price cap rules. As SWBT (at 23) points out, this exogenous cost rule "was intended to re-adjust regulated prices in the event that the historical allocation of costs to existing nonregulated activities were altered significantly to shift a larger share of total costs to nonregulated activities." It adds (*id.*):

> The exogenous cost rules were never intended to make significant changes in regulated price cap indexes when new nonregulated services are introduced. When a carrier introduces a new nonregulated service, no automatic exogenous changes were ever contemplated, nor would they be appropriate.

The word *reallocation* is key to the interpretation of this rule. GTE agrees with Bell Atlantic at (7) and BellSouth (at 11-12) that the Commission is not proposing a reallocation or true-up of plant in-service at the inception of price caps, but a new allocation for future plant. GTE, like Bell Atlantic, questions how costs that are not included can be removed unless the Commission first finds a way to have them included -- a circular effort and a waste of time. Further, the cost of new plant has no place in the price cap equation since prices are not set based on regulated accounting costs, but are constrained by the price cap indexes.

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[8] *See also* MCI at 16-17.

In addition, as USTA (at 13) notes: "a moving average Total Factor Productivity ('TFP') methodology ... reflects the economies of scale achieved through the provisioning of regulated and nonregulated services over a shared system." To require an exogenous adjustment for the same economies of scale that are captured by TFP would double count the effect and could lead to "unreasonable low rates." Since the Commission has already tentatively concluded that a TFP approach should be used;[9] and, since the TFP method measures TFP for all services that have joint and common inputs with regulated services, there is no reason to require exogenous treatment. As explained by Christensen Associates, "[u]nder Part 32 accounting rules, nonregulated services that have joint and common inputs with regulated services are included in the operating revenue and expense. Hence those services were included in our TFP study."[10]

The Commission should (1) recognize that the price cap rules covering exogenous cost changes for the reallocation of past investments for true-up purposes do not encompass exogenous cost changes for future investments based on a new allocation method, and (2) adopt a price cap plan without sharing that is attractive to all LECs thus eliminating any need for regulatory concern about cost allocations.

In summary: The Commission should avoid imposing unnecessary and burdensome regulations on carriers. Cost allocations are not price drivers for price cap

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[9] Price Cap Performance Review for Local Exchange Carriers, Fourth Further Notice of Proposed Rulemaking, 10 FCC Rcd 13659 (1995) at paragraph 25.

[10] USTA's Comments, CC Docket No. 94-1, filed January 16, 1996, Attachment A at 27.

companies as the price cap indexes control the maximum price that can be charged -- not costs. Further, any new changes to the cost allocation rules should not affect the price cap indexes. The price cap rules detail what causes exogenous cost changes and, in the case of cost reallocations, it is not a forward-looking cost allocation of new investments. The path the Commission should take that follows the pro-competitive, deregulatory spirit of the 1996 Act is to establish a price cap plan without sharing that is attractive to all LECs. In doing this, the Commission will eliminate any need whatsoever for cumbersome and administratively burdensome regulatory cost allocation rules that attempt to predict the future

Respectfully submitted,

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June 12, 1996

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Certificate of Service

I, Judy R. Quinlan, hereby certify that copies of the foregoing "GTE's Reply Comments" have been mailed by first class United States mail, postage prepaid, on the 12th day of June, 1996 to all parties of record.

Judy R. Quinlan