EX PARTE OR LATE FILED

RECEIVED

AUG 14 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

UNITED STATES
TELEPHONE
ASSOCIATION

DOCKET FILE COPY ORIGINAL

EX PARTE

August 14, 1996

William F. Caton
Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

Dear Mr. Caton:

RE: Ex Parte Notice, CC Docket No. 96-112

On August 14, United States Telephone Association representatives met with Dan Gonzalez, Legal Advisor to Commissioner Chong. The USTA delegation consisted of the undersigned, Maury Talbot (BellSouth), and Sherry Herauf (Pac Tel).

The meeting focused on comments raised by USTA in this proceeding. The enclosed attachments were used in support of USTA's comments. An original and one copy are being filed in the above referenced docket. Please include a copy of this filing in the record of this proceeding.

Respectfully submitted,

Keith Townsend

Keith Townsend
Director
Regulatory Affairs & Counsel

Enclosures

cc: Dan Gonalez

No. of Copies rec'd 0+1
List A B C D E

1401 H STREET NW SUITE 600 | WASHINGTON DC 20005-2164 | TEL 202.326.7300 | FAX 202.326.7333 | INT www.usta.org

RECEIVED

AUG 14 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

USTA EX PARTE 96-112

- Telecommunications Act Encourages Development of Broadband Network and Promotes Competition

- Use of Broadband Facilities by Telcos for Nonregulated Services such as OVS Will be Impeded by:
  -- Exogenous Change for Price Cap Companies
  -- Over Allocation to Nonreg

USTA EX PARTE 96-112

- For Consumer Prices to be Considered Just and Reasonable, Sound Economics Should be Followed:

-- Maximize Welfare of Consumers of BOTH Video and Telephone Markets

-- Cable Industry Proposals Will Harm Consumer Welfare as Well as Frustrate Universal Service Goals

-- Price Caps with No Sharing is Sufficient to Prevent Cross Subsidy

-- Current AND Potential Competition Protect Consumers from Cross Subsidy. Leland Johnson Provided the Answer in 1994:
"The threat of cross-subsidization is constrained because the pool of potential LEC monopoly revenues available to absorb cost shifting is shrinking." "The threat of cross-subsidy is less today than previously, and it will continue to diminish." (Leland L. Johnson, Toward Competition in Cable Television, 80-81 MIT Press & AEI Press 1994)

-- Ratepayers Already Share in the Economies of Scope

USTA EX PARTE 96-112

- Not all Broadband Services are Nonregulated
  (video conferencing, video telephony, data services in excess of DS1, wireless transport, digital audio, etc.)

- New Regulatory Burdens are Not Necessary
  -- Existing Part 64 Rules Allow for Flexibility of Technology
  -- Rules can be Simplified Without a One-Size Fits All Allocator; Use Individual CAM Changes
  -- Special Cost Pools are Not Needed for Spare Capacity

Overview of Financial Regulation

The Relationship of Accounting, Separations, Access Charge, Rate of Return, and Tariff Rules

Role:

Part 32: Establishes accounting practices, account structure, affiliate transaction rules.

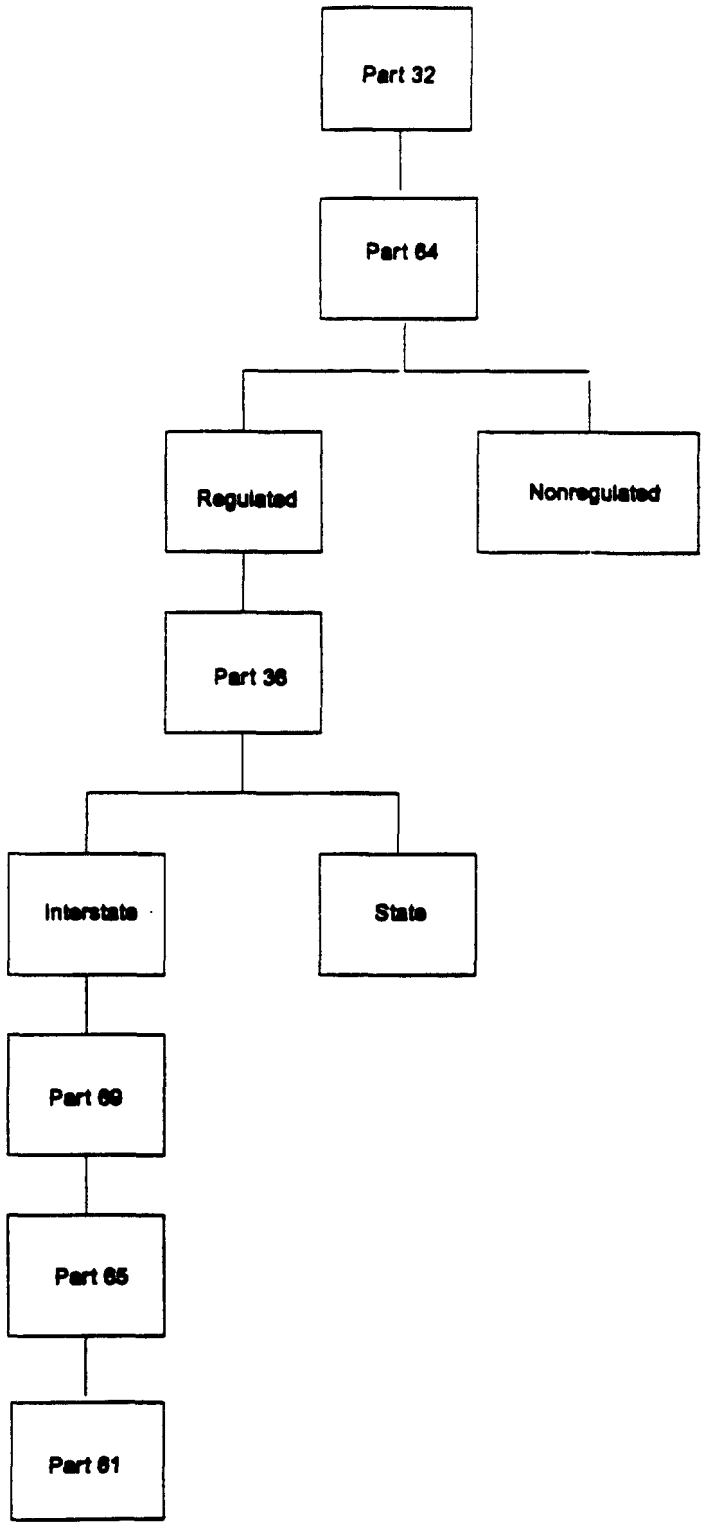
Part 64: Rules for allocation of costs between nonregulated/regulated operations

Part 36: Jurisdictional separations procedures

Part 69: Defines access elements, apportionment of interstate costs to access elements, some rate parameters

Part 65: Rate of return procedures, rate base/net income (revenue requirement) rules

Part 61: Tariff filing requirements



THE WALL STREET JOURNAL TUESDAY, AUGUST 6, 1996

Ask Not the Bells for Tolls

By ALFRED E. KAHN

The Telecommunications Reform Act of 1996, while not perfect, is a major achievement. Its central goal is clear and just right: "to provide for a pro-competitive deregulatory national policy framework designed to accelerate rapidly private-sector deployment of advanced telecommunications and information technologies . . . by opening all telecommunications markets to competition." Local and long-distance phone companies, cable TV firms and new ventures will be able to provide the full range of telecommunications services, and consumers will reap the benefits of competition.

The Federal Communications Commission is now writing regulations to carry out the new law's provisions. But the FCC seeks to do one thing that would conflict fundamentally with the law's goals. The commission proposes to formulate rules for allocating the economic costs and benefits from the new facilities—largely fiber optic networks—that telephone companies are building to provide both unregulated services like video programming and regulated phone services. In particular, the commission stated in its notice preceding the new regulations: "We believe that telephone ratepayers are entitled to at least some of the benefit of the economy of scope between telephony and competitive services."

The rationale is understandable. Regulatory commissions are responsible for protecting captive purchasers of regulated services by setting rates at cost plus a reasonable return. They have traditionally thought it necessary to decide what portion of the costs of facilities constructed to provide both regulated and unregulated services could be attributed to the former and recovered in their prices. Such cost-allocation decisions are inevitably political, once they go beyond those costs that are unambiguously attributable to the separate services—such as the cost of video programming on the one side and of completing calls on the other.

The principal example of cost allocation has been the subsidization of residential phone service, particularly in rural areas, at the expense of higher charges to long-distance callers and business customers in central cities. (Not surprisingly, therefore, as competition has come to the industry, it has concentrated on the latter two, grossly overpriced services. Every major downtown area in the country, for example, now has at least one "competitive access provider" providing local service and catering mainly to big business customers.)

The FCC is under pressure to play the same kind of game in the present case. Cable companies, eager to forestall telephone companies' entry into video, argue that all the costs of these joint facilities ought to be borne by the competitive services, but that the benefits should be used in part to reduce phone rates. "Consumer advocates"—who tend to think the only interest consumers have is in holding down the price of regulated services—echo the argument. And even the phone companies themselves (which I have represented in other cases, but not in this one) are arguing only for a "reasonable" allocation of the costs and benefits. History suggests that the FCC will feel obliged to strike a "fair balance" among these demands.

The commission might allocate a share of the revenues from the unregulated services as a "royalty" payment to telephone customers for the use of the company name, subscriber lists and contacts and the product of past, ratepayer-financed research and development. It might require companies to allocate some of the savings from using fiber optic networks—far cheaper to maintain than copper ones—to reduce the prices of the regulated services. Or it might reallocate to the unregulated activities some of the costs of past investments in the common facilities, which could in turn trigger decreases in the prices of the regulated services.

Any of these approaches would simply discourage investment in new communication facilities and thereby hinder competition. The greater the share of the benefits that go to subsidize regulated services, the higher the net revenues from the new services would have to be to justify the investment. Investors in these new services ought to bear the entire additional costs themselves—but they must also be assured that they will reap the full benefits.

Thus, the prices of the regulated telephone services should be neither raised to recover any of those costs nor reduced to share in the benefits. Consumers of regulated phone service would bear *none* of those additional costs and receive *none* of the direct benefits. But they would be better off because of the availability of the new services and the lower prices that would result from competition.

The FCC should simply get out of the way and leave the decisions to investors and consumers. The commission should call off its cost-allocation rule making, leave the prices of regulated services where they are and let the market work.

Mr. Kahn is a professor emeritus of political economy at Cornell University and a special consultant for National Economic Research Associates. He formerly served as chairman of the New York State Public Service Commission and the federal Civil Aeronautics Board.

In Telecommunications, a Tough Act to Follow

Technical, Economic Obstacles to Competition Keep Consumers From Getting Price Relief

By Paul Farhi
Washington Post Staff Writer

Has your dinner been interrupted lately with phone calls from marketers trying to get you to switch your cable TV company or local telephone service?

Don't feel left out if you haven't. Virtually no one in America has. Six months after enactment of the landmark Telecommunications Act of 1996—the law that is supposed to foster competition in cable and phone rates—the only thing that has changed for most consumers is that their cable and long-distance phone bills are higher, not lower.

Of course, no one expected the titans of telecommunications, long accustomed to limited competition, to act like merchants in a bazaar after only six months. One of the key regulatory provisions underpinning the law was adopted just a few days ago, and more are still to be written.

But a small and perhaps growing cadre of skeptics is starting to have doubts that President Clinton's grand vision of an "open marketplace where competition and innovation can move as quick as light" will come to fruition any time in the foreseeable future.

Removing the legislative and regulatory barriers that have prevented long-distance carriers and the cable industry from entering the phone business, and vice versa, may be the easy part, they say. Surmounting the technological and economic hurdles to inter-industry competition are proving far more difficult.

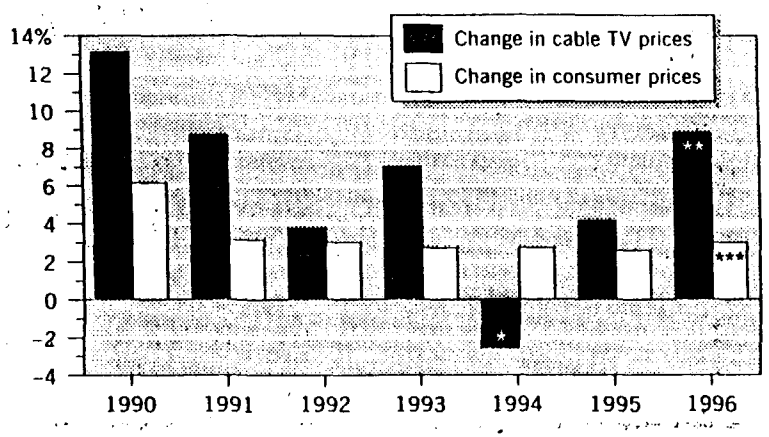
"The problem is that [benefits of] the Telecommunications Act were vastly oversold by both the Congress and the White House," declares Eli Noam, a Columbia University economist who specializes in telecommunications. "This was not the grand breakthrough that it was made out to be."

For the moment, at least, things seem to be getting worse for consumers, not better. The cost of an

See COMMUNICATIONS, H6, Col. 1

COMPETITIVE PRICING

The telecommunications bill, intended to promote more competion in cable and phone rates, was passed in February. Meanwhile, cable prices keep rising faster than inflation, with the second-highest rate change this decade predicted for 1996.



* Cable rates fell in response to the second round of deregulation.
** Projected
*** Through May

SOURCES: Bureau of Labor Statistics, Bloomberg Business News

THE WASHINGTON POST

Some Question If Consumers Will Benefit From the New Telecommunications Law

COMMUNICATIONS, From H1

interstate phone call will rise about 6 percent this year, faster than the general inflation rate of 3.5 percent, according to the Bureau of Labor Statistics. The projected increase for long-distance calls made within a state is 4.6 percent this year, following two straight years in which prices declined.

The government also projects that cable TV companies will raise their prices 8.8 percent in 1996, or 2½ times faster than the general inflation rate. And this is occurring with federal price controls still in place; the telecommunications law will eliminate most of these restraints in 1999, on the theory that the market for video service will be so robust by then that regulation will be unnecessary.

A Tale of 2 Giants

That theory still has a few bugs in it, however. Both the regional Bell telephone companies and the major cable companies are still figuring out ways to invade the others' turf in cost-effective ways. Consider the tale of two giants, Bell Atlantic Corp. and Time Warner Inc.

Bell Atlantic, biggest of the Bell phone companies, has championed and abandoned several schemes to get into the video market in recent years. It now has two plans. In some markets, Bell Atlantic plans to rebuild parts of its phone network to deliver "interactive" services; in other cities, it will offer customers small dishes capable of receiving wireless microwave transmissions, a technology known by the oxymoronic name "wireless cable." Through an affiliated company, Bell Atlantic is testing a digital wireless cable service with 120 channels in the Hampton Roads area of Virginia.

Having been burned by early promises it couldn't keep, Bell Atlantic isn't saying much about when these services will be offered to its millions of residential phone customers on the East Coast.

The company says only that it will be ready to offer wireless cable in Hampton Roads by mid-1997, and a wired service in Philadelphia by the second half of next year. Beyond that, "it's dangerous to say we'll deploy in this market or that one with a certain technology," said spokesman Larry Plumb. "We don't need to make that choice now."

Bell Atlantic's caution is echoed by Time Warner, a leading cable company that wants to cross over into the phone business. Time Warner scored a breakthrough of sorts last year when it convinced regulators in New York state to allow the company to connect its cable wires to Rochester's municipal phone system.

This "interconnection" agreement is among the first of hundreds that will have to be worked out across the nation among incumbent local phone companies and their would-be challengers.

Interconnection—which sets the prices and terms under which a challenger can use an incumbent phone company's ubiquitous network—makes a second, third or fourth local phone provider theoretically possible (a cable company needs to "hand off" its calls to the local incumbent because a cable system's wires don't extend to as many homes and businesses as the phone company's). The Bells have an incentive to cut these deals; without them, the Bells won't be allowed to offer long-distance service to their own customers.

Time Warner may be the furthest along in cracking into the local phone market, but it hasn't gotten very far. After investing in costly phone-switching equipment and fiber-optic lines, the company has "several thousand lines" up and running, mainly in a number of apartment buildings and in employees' homes around Rochester, said Time Warner spokesman Mike Luftman. Asked when the service will become widely available, Luftman demurs. "We don't want to start getting people excited when we can't offer it to them," he said.

A Matter of Money

Phone company executives say that's because cable can't deliver: Transforming a cable system into a full-blown phone system is more difficult and expensive than expected, they argue.

Raymond W. Smith, Bell Atlantic's chief executive, said in April that it may cost cable companies, such as industry leader Tele-Communications Inc., as much as $1,500 per household to become telephone-ready, a figure that would take years and years to recoup. Although cable companies hotly dispute that number, Smith said Bell Atlantic pulled out of its proposed merger with TCI in 1994 in part because of these uncertainties.

Dale Hatfield, an engineering consultant to both the cable and phone industries, said that installing all the necessary equipment and working out an economical interconnection agreement with the local phone company are only the first steps. Making cable companies into phone companies also implies creating an efficient billing operation and maintaining near-perfect reliability of the system, he said.

"It's fair to say, given the economics and technical uncertainties of all this, that full-blown competition is very much up in the air," said Hatfield.

Even if these difficulties can be worked out, he added, competitors are more likely to target the highly profitable business market than the low- or no-margin residential customer.

Change in Focus

Indeed, much of the cable industry's initial enthusiasm for providing phone service seems now to have been transferred to a new and perhaps less risky business: using the cable "plant" as the conduit to provide computer users with high-speed access to the Internet.

The Bells, too, are racing more quickly toward the Internet than providing movies over their phone lines.

Bell Atlantic and Time Warner do seem to have one feature in common: Both are involved in huge mergers. Bell Atlantic in April announced a $23 billion merger with the Bell company next door, Nynex Corp.; Time Warner said last September that it was acquiring cable TV programmer Turner Broadcasting System Inc. in a deal now valued at about $6.6 billion.

They aren't alone, however. Before and after its passage, the Telecommunications Act has helped fuel several multibillion-dollar deals—from the mating of two other Baby Bells (Pacific Telesis Group and SBC Corp., the phone company formerly known as Southwestern Bell) to Westinghouse Electric Corp.'s $3.9 billion purchase of radio powerhouse Infinity Broadcasting Corp. in June.

Although the companies themselves say they are merging to tackle the competitive challenges ushered in by the Telecommunications Act, Noam, of Columbia University, said these deals are as much about protecting the markets these companies dominate as they are about venturing into new markets.

"Because everyone expects more competition, everyone makes these defensive moves and gets bigger," he said. "As a result, less competition develops."

In other words, a law that permitted greater consolidation in the name of competition could wind up defeating that competition.

AUG 1 0 1996

Customers the winners as Chamblee gets taste of cable competition

By Patti Bond
STAFF WRITER

If you're tired of waiting on eternal hold every time you call your cable company, move to Chamblee. For now, residents there don't bother picking up the phone. they just look out the front door.

Since BellSouth launched its cable television and video services trial in April, Chamblee residents have noticed a pickup in neighborhood activity from BellSouth sales representatives and rivals from Scripps Howard.

"I find it odd that in the 20 years that I've had cable, this is the only time someone has come out to my house without me asking them to," said Bob Carr, who was visited recently by a Scripps representative announcing beefed-up service. "I've been calling the cable company for years asking for more channels."

Scripps has added 22 channels to its expanded basic service and nine premium channels, available to subscribers in Chamblee and parts of DeKalb County, which overlaps BellSouth's trial area. But the improvements didn't keep Carr from changing to BellSouth, which installed a switch allowing him to compare the services.

"It looks like Scripps is scrambling to keep up," Carr said.

No more monopoly

Competition has rocked Scripps' monopoly in Chamblee, where BellSouth has targeted an area in which Scripps now serves 450 customers. Scripps has 30,000 subscribers in DeKalb County, where BellSouth has installed wiring near 8,000 homes for future expansion of its cable trial.

BellSouth hopes to sign up 700 households in the trial, which started with about 100 subscribers, including 70 employees who received free service, said Jeff Smith, vice president of marketing. BellSouth won't say how many paying customers it has.

BellSouth's cable license was the first in Georgia granted to a telephone company. Scripps tried unsuccessfully to block the license, but it now has a different perspective. "Competition is only going to help the customer," said Dee Jones, controller. "And it's going to help us be better at what we do."

Cable and telephone companies need to get used to sharing territories, said Dave Otto, telecommunications analyst with Edward Jones & Co.

"If you're BellSouth or AT&T or any telecommunications company, you better have a cable service available," Otto said. "The walls are coming down, and within a year everybody is going to be in this game."

1/2