

Before the
Federal Communications Commission
Washington, D.C. 20554

EarthLink, Inc.,)	
)	
Complainant,)	
)	
v.)	EB Docket No. 14-207
)	File No. EB-04-MD-006
SBC Communications Inc., and SBC Advanced Solutions, Inc.,)	
)	
Defendants.)	

MEMORANDUM OPINION AND ORDER

Adopted: May 4, 2016

Released: May 4, 2016

By the Chief, Enforcement Bureau:

I. INTRODUCTION

1. This Memorandum Opinion and Order denies the claims alleged in the formal complaint¹ that EarthLink, Inc. (EarthLink) filed against SBC Communications, Inc. (SBC) and SBC Advanced Solutions, Inc. (SBC-ASI) (collectively, Defendants) under Section 208 of the Communications Act of 1934, as amended (Act).² In short, the Complaint alleges that SBC and SBC-ASI illegally subsidized their retail Internet access service with profits earned from the sale of their wholesale asynchronous digital subscriber line (ADSL) transport service³ in violation of Sections 201(b) and 202(a) of the Act,⁴

¹ Complaint, File No. EB-04-MD-006 (filed May 13, 2004) (Complaint). At the request of Commission staff, EarthLink supplemented its Complaint on May 28, 2004. See Letter dated May 21, 2004, from Lisa B. Griffin, Deputy Chief, FCC, MDRD, to Donna A. Lampert, Counsel for EarthLink, and Mike Alarcon, Resident Agent for Defendants. See also Letter dated May 28, 2004, from Kenneth R. Boley, Counsel for EarthLink, to Marlene Dortch, Secretary, FCC, File No. EB-04-MD-006 (EarthLink Supplement).

² 47 U.S.C. § 208.

³ ADSL service is a type of digital subscriber line service used for residential and small business applications. *Deployment of Wireline Services Offering Advanced Telecommunications Capability; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order in CC Docket No. 98-147 and Fourth Report and Order in CC Docket No. 96-98, 14 FCC Rcd 20912, 20943, n.135 (1999), *vacated in part sub nom. United States Telecom Ass'n v. FCC*, 290 F.3d 415 (D.C. Cir. 2002). For purposes of this case, the parties define the relevant DSL transport as "Basic I" wholesale DSL Transport provided by SBC-ASI at downstream speeds of 384 Kbps to 1.5 Mbps and upstream speeds of 128 Kbps to 256 Kbps. Joint Statement of Stipulated Facts, Disputed Facts, and Key Legal Issues, File No. EB-04-MD-006 (filed July 27, 2004) (Joint Statement) at 2, para. 7.

⁴ 47 U.S.C. §§ 201(b), 202(a).

Section 64.901 of the Commission's rules (Rules),⁵ and the Commission's *Computer III* requirements.⁶ For the reasons explained below, we find EarthLink's claims to be without merit.⁷

II. BACKGROUND

A. The Parties

2. EarthLink is an Internet service provider (ISP) providing ADSL-based Internet access services.⁸ SBC is a holding company that owns and controls many telecommunications-related enterprises, including SBC-ASI.⁹ In accordance with conditions established by the Commission,¹⁰ SBC formed SBC-ASI as a structurally-separate affiliate.¹¹ The parties stipulated that, during the relevant period, SBC-ASI was a local exchange carrier (LEC) that provided high-speed and advanced telecommunications services, including ADSL transport, to affiliated and non-affiliated ISPs for their use in providing retail Internet access service within SBC's local service territory.¹² SBC-ASI does not own its network; rather, it obtains access to local loops from its affiliate LECs.¹³

3. SBC also owns and controls several structurally-separate ISP affiliates, known collectively as SBC Internet Services (SBCIS), which obtain wholesale ADSL transport services from SBC-ASI and compete with EarthLink in the provision of retail Internet access services.¹⁴ SBCIS is not a party to this proceeding, although EarthLink puts the retail service SBCIS offers at issue.

B. The SBC-ASI Service

4. EarthLink has purchased from SBC-ASI wholesale DSL transport service (SBC-ASI

⁵ 47 CFR § 64.901.

⁶ See *Amendment of Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry)*, Report and Order, 104 F.C.C.2d 958 (1986) (subsequent history omitted) (*Computer III Phase I Order*).

⁷ We decide this case based on the law as it existed at the time of the conduct in question, notwithstanding the Commission's subsequent forbearance from rules that EarthLink seeks to reply upon here. In the *2015 Open Internet Order*, the Commission's forbearance "result[ed] in a 'light-touch' approach for the use of Title II . . . [including] no unbundling of last-mile facilities, no tariffing, no rate regulation, and no cost accounting rules." See *Protecting and Promoting the Open Internet*, GN Docket No. 14-28, Report and Order on Remand, Declaratory Ruling, and Order, 30 FCC Rcd 5601, 5611, para. 37(2015) (*2015 Open Internet Order*), *pets. for review pending sub nom USTA v. FCC No. 15-1063* (D.C. Cir. filed May 22, 2015).

⁸ Joint Statement at 1, para. 1; Complaint at 6, para. 12.

⁹ Joint Statement at 1, para. 2.

¹⁰ See *Application of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, Memorandum Opinion and Order, 14 FCC Rcd 14712 (1999) (*SBC/Ameritech Merger Order*), *vacated in part sub nom. Association of Communications Enters. v. FCC*, 235 F.3d 662 (D.C. Cir. 2001).

¹¹ Supplemented Answer of SBC Communications, Inc. and SBC Advanced Solutions, Inc., File No. EB-04-MD-006 (filed June 28, 2004) (Answer) at 6, para. 5. See also Answer, Exhibit A, Declaration of Keith J. Epstein (Epstein Declaration) at 5, para. 6.

¹² Joint Statement at 1-2, paras. 3, 5.

¹³ *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, Memorandum Opinion and Order, 17 FCC Rcd 27000, 27003, para. 7 & n.25 (2002) (*SBC Advanced Services Forbearance Order*).

¹⁴ Joint Statement at 1-3, paras. 2, 6, 13, 17.

Service) as a transmission input to EarthLink's retail Internet access service.¹⁵ Specifically, [REDACTED]

5. On December 31, 2002, the Commission released an order holding that, to the extent SBC operates in accordance with the separate affiliate structure established in the *SBC/Ameritech Merger Order*, and with certain other safeguards in place, the Commission would forbear from applying tariffing regulation to SBC-ASI's advanced services operations.¹⁷ Subsequently, on February 8, 2003, SBC-ASI withdrew its federal tariff and began offering DSL transport under the terms and conditions posted on its website.¹⁸

6. [REDACTED]
[REDACTED]
[REDACTED] Since August 1, 2003, SBC-ASI has offered promotional and regular web-posted rates for DSL transport service as low as \$23.00 per month per DSL arrangement.²⁰ [REDACTED]
[REDACTED]

C. The SBCIS Service

7. During the complaint period, SBCIS provided retail Internet access service (SBCIS Service) using only the SBC-ASI Service for DSL transport.²¹ The parties stipulated for the purposes of this dispute that the SBCIS Service is an information service.²² The parties also stipulated that SBCIS offered retail Internet access service at prices as low as \$26.95 to \$29.95 per month with a 12-month term commitment.²³ Defendants state that SBCIS charged various rates for the service during the period

¹⁵ Joint Statement at 3, para. 14.

¹⁶ Joint Statement at 3, para. 18.

¹⁷ *SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27008-09, paras. 13-16. The Common Carrier Bureau waived cost support and notice requirements for the tariff filing, as well as for subsequent amendments to the tariff. *Id.*, 17 FCC Rcd at 27003, n.18 (citing Letter from Jane E. Jackson, Chief, Competitive Pricing Division, Common Carrier Bureau, FCC, to Debbie Clemons, Associate Director-Federal Regulatory, SBC, Special Permission No. 01-095 (Sept. 7, 2001)).

¹⁸ Joint Statement at 3, para. 19.

¹⁹ Joint Statement at 3, para. 20.

²⁰ Joint Statement at 2, paras. 10-11.

²¹ Joint Statement at 2, paras. 8, 13.

²² Joint Statement at 3-4, paras. 17, 23-24. Even though the Commission has now reclassified broadband Internet access service as a telecommunications service, the Commission's reclassification of broadband Internet access service was prospective in effect and does not affect this Complaint. *See Protecting and Promoting the Open Internet*, Report and Order on Remand, Declaratory Ruling, and Order, 30 FCC Rcd 5601, 5733, para. 308 n.792 (2015) ("[T]he classification decisions in this Order appropriately apply only on a prospective basis."). Because this Complaint pre-dates the Commission's reclassification of broadband Internet access service as a telecommunications service, the *2015 Open Internet Order* is not relevant to the present Complaint and nothing that we say in this Order involves or relates to the *2015 Open Internet Order*.

²³ Joint Statement at 2, para. 12. After the close of briefing in this case, SBCIS reduced its introductory price for new customers to \$14.95 per month with a 12-month term commitment. *See* Letter dated June 13, 2005, from Mark J. O'Connor, Counsel for EarthLink, to Marlene H. Dortch, Secretary, FCC, File No. EB-04-MD-006. *See also*

covered by the Complaint, and that SBCIS sets its retail rates to reflect the competitive marketplace for retail Internet access service.²⁴ According to EarthLink, the rates ranged from \$26.95 to \$34.95, and the margin between the SBC-ASI rate and the SBCIS rates varied from a low of \$0.05 per month to a high of \$8.79 per month, which EarthLink claims is insufficient for SBCIS to operate profitably.²⁵

D. EarthLink's Complaint and Defendants' Answer

8. The Complaint contains three counts.²⁶ In Count I, EarthLink contends that the Defendants' practice of using the regulated SBC-ASI Service to subsidize the nonregulated SBCIS Service violates Section 201(b) of the Act and Sections 64.901(a) and (b) of the Commission's rules.²⁷ To make its case, EarthLink relies on what it claims are three Commission "tests" to show that the costs of the SBCIS Service are not covered by its revenues, and, instead, are defrayed by revenues from the SBC-ASI Service.²⁸ In Count II, EarthLink contends that the purported unlawful cross-subsidy provides an unreasonably discriminatory benefit to SBCIS in violation of Section 202(a) of the Act, because it effectively reduces the SBC-ASI transport price that SBCIS pays.²⁹ In Count III, EarthLink alleges that the purported unlawful cross-subsidy violates the *Computer III* requirement that SBCIS pay a charge for the SBC-ASI Service that is equal to what unaffiliated ISPs pay to SBC-ASI, and that SBC-ASI failed to post a comparably efficient interconnection (CEI) plan for its transport service.³⁰

9. EarthLink denies that it is challenging SBC-ASI's rates as being unreasonably high.³¹ EarthLink also states that it is not alleging a price squeeze regarding its ability, as a competitor and

Letter dated June 15, 2005, from Aaron M. Panner, Counsel for Defendants, to Marlene H. Dortch, Secretary, FCC, File No. EB-04-MD-006.

²⁴ Answer at 18, para. 35. See Defendants' Responses to Interrogatories, File No. EB-04-MD-006 (filed Sept. 24, 2004) (Defendants' Sept. 24 Discovery Responses) at 3 & Exhibit C (rates charged for SBCIS Service).

²⁵ Complaint at 10-11, para. 18 & Exhibit 9 (Rate History for SBC-ASI and SBCIS Service).

²⁶ Pursuant to Section 1.722(d) of the Commission's rules, 47 CFR § 1.722(d), EarthLink bifurcated its liability and prospective relief claims from its claims for damages. Complaint at 41, para. 58. EarthLink subsequently withdrew its request for prospective relief. Letter dated May 18, 2018, from Jennifer P. Bagg, Counsel for EarthLink, to Christopher Killion, Chief, FCC, MDRD, File No. EB-04-MD-006, at 3.

²⁷ Complaint at 8-25, paras. 17-22, 26-40; Complaint Attachment, Affidavit of August H. Ankum, Ph.D. (filed May 6, 2004) (Ankum Affidavit) at 11-14, paras. 24-26; Reply, File No. EB-04-MD-006 (filed July 12, 2004) (Reply) at 5-48, paras. 9-52; Brief of EarthLink, Inc., File No. EB-04-MD-006 (filed Dec. 10, 2004) (EarthLink's Opening Brief) at 2-42; Responsive Brief of EarthLink, Inc., File No. EB-04-MD-006 (filed Jan. 7, 2005) (EarthLink's Responsive Brief) at 1-30. We use the term "regulated" to mean subject to economic regulation under Title II of the Communications Act and "nonregulated" to mean not subject to economic regulation under Title II of the Communications Act.

²⁸ Complaint at 15-25, paras. 26-40; Reply at 39-48, paras. 40-52; EarthLink's Opening Brief at 14-25; EarthLink's Responsive Brief at 27-30.

²⁹ Complaint at 25-28, paras. 41-48; Reply at 48-50, paras. 53-54; EarthLink's Opening Brief at 42-44; EarthLink's Responsive Brief at 4-15.

³⁰ Complaint at 14, 29-34, paras. 23, 49-54; (citing *Computer III Phase I Order*, 104 F.C.C.2d at 1040, 1047, paras. 159, 172; *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review - Review of Computer III and ONA Safeguards and Requirements*, Report and Order, 14 FCC Rcd 4289, 4305, para. 23 (*CEI Further Remand Order*), *recon.*, 14 FCC Rcd 21628 (1999)); Reply at 50-55, paras. 55-61; EarthLink's Opening Brief at 45-53.

³¹ Complaint at 4, 24, paras. 6, 40.

customer of Defendants, to purchase DSL transport service as an input to its retail Internet service.³² Moreover, EarthLink does not allege a violation of Section 254(k) of the Act, which prohibits carriers from using non-competitive services to subsidize competitive services,³³ or of Section 64.901(c) of the Commission's rules, which tracks Section 254(k)'s requirements.³⁴ Thus, EarthLink's claims are fairly narrowly drawn.

10. SBC and SBC-ASI maintain that the Commission lacks jurisdiction over EarthLink's complaint against SBC, arguing that SBC does not provide telecommunications services and is not a common carrier as defined in the Act.³⁵ SBC and SBC-ASI also assert several defenses pertaining to the merits. First, they argue that EarthLink's claims have no basis because SBC and SBC-ASI are in compliance with the *SBC/Ameritech Merger Order* and all applicable cost allocation and affiliate transaction rules with respect to SBC-ASI's provision of advanced services.³⁶ Second, the Defendants argue that, in the absence of any challenge to the reasonableness of SBC-ASI's rates (which purportedly include only costs properly attributable to the regulated activity), there cannot be any illegal cross-subsidy.³⁷ Third, the Defendants maintain that, because SBC-ASI makes its service available to unaffiliated ISPs on the same rates, terms, and conditions that it makes service available to SBCIS, SBC-ASI complies with the requirements of the *SBC Advanced Services Forbearance Order*.³⁸ Fourth, the Defendants contend that although SBC-ASI has not posted a formal CEI plan for SBCIS, SBC-ASI has posted on its website the terms and conditions under which SBCIS receives service, thereby substantially complying with any applicable CEI obligation.³⁹ Finally, the Defendants claim that expanding existing law to encompass EarthLink's claims would (1) undermine the Commission's declared broadband policies; (2) constrain SBCIS's ability to reduce the price of retail service to consumers' detriment; and (3) place an unreasonable and legally unsupported limitation on SBC-ASI's

³² Reply at 56-58, paras. 64-65; EarthLink's Opening Brief at 60.

³³ 47 U.S.C. § 254(k).

³⁴ 47 CFR § 64.901(c). The Commission's affiliate transactions rules apply to all transactions between carriers and their nonregulated affiliates that affect the carrier's regulated books of account. They are intended to protect against the flow of cross-subsidies from regulated to nonregulated affiliates. *See Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities, Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates*, Report and Order, 2 FCC Rcd 1298, 1335-40, paras. 284-330 (1987) (*Joint Cost Order*), Order on Reconsideration, 2 FCC Rcd 6283 (1987) (*Joint Cost Reconsideration Order*), Order on Further Reconsideration, 3 FCC Rcd 6701 (1988), *affirmed sub nom. Southwestern Bell Corp. v. FCC*, 896 F.2d 1378 (D.C.Cir.1990); 47 CFR Part 32. On January 31, 2005, the Wireline Competition Bureau granted, on an interim basis, a waiver of the Part 32 rules for SBC-ASI, finding that it would serve the public interest to allow SBC-ASI to avoid the cost associated with creating a new accounting and reporting system that would comply with the Commission's rules, pending a decision as to whether SBC-ASI is nondominant. *SBC Advanced Solutions, Inc. Petition for Waiver of the Commission's Accounting, Separations, Cost Allocation, and Reporting Rules*, Order, 20 FCC Rcd 1915, 1917, para. 8 (WCB Jan. 31, 2005).

³⁵ Answer at 13, para. 19; Epstein Declaration at 1, para. 2; Defendants' Opening Brief on the Merits, File No. EB-04-MD-006 (filed Dec. 10, 2004) (Defendants' Opening Brief) at 6, n.3.

³⁶ Answer at 4-6, paras. 2-4, 31-34 (citing *SBC/Ameritech Merger Order*, 14 FCC Rcd at 14893-909, paras. 444-76). *See also* Defendants' Opening Brief at 11-14; Defendants' Response Brief on the Merits, File No. EB-04-MD-006 (filed Jan. 7, 2005) (Defendants' Responsive Brief) at 13, 15.

³⁷ Defendants' Opening Brief at 6-9, 11-15; Defendants' Responsive Brief at 2 n.1, 4-6. *See also* Complaint at 24-25, para. 40; Answer at 35-36.

³⁸ Answer at 33, 35; Defendants' Opening Brief at 24-26; Defendants' Responsive Brief at 14.

³⁹ Answer at 43; Defendants' Opening Brief at 26-27; Defendants' Responsive Brief at 13-15.

ability to recoup its investment in broadband services.⁴⁰

III. DISCUSSION

A. The Commission Has Jurisdiction Over EarthLink's Complaint Against SBC.

11. Section 411(a) of the Act provides that, in “any proceeding for the enforcement of the provisions of this Act,” whether the proceeding is brought at the Commission or in district court, “it shall be lawful to include as parties, in addition to the carrier, all persons interested in or affected by the charge, regulation, or practice under consideration”⁴¹ “Decrees may be made” against parties joined under Section 411 “in the same manner, to the same extent, and subject to the same provisions as are or shall be authorized by law with respect to carriers.”⁴²

12. SBC owns and controls SBC-ASI, a common carrier providing wholesale ADSL transport, and SBCIS, a provider of retail Internet access service.⁴³ In that role, SBC establishes the price of the SBC-ASI and SBCIS services.⁴⁴ The complaint alleges that, because of the manner in which SBC has priced the services of SBC-ASI and SBCIS and has “linked” the two services, SBC “as a whole makes a profit,” resulting in an illegal cross-subsidization.⁴⁵ Given the ownership and control SBC exercises over the other defendant in this proceeding,⁴⁶ we find that SBC is “interested in or affected by” the practice under consideration in EarthLink’s complaint.⁴⁷ Accordingly, SBC is properly joined as a party to this proceeding under Section 411(a) of the Act.⁴⁸

⁴⁰ Answer at 46-48 & n.15; Defendants’ Opening Brief at 27-32; Defendants’ Responsive Brief at 7-9, 17-18.

⁴¹ 47 U.S.C. § 411(a).

⁴² *Id.*

⁴³ Joint Statement at 1-2, paras. 2-3, 7.

⁴⁴ Joint Statement at 3, para. 21 (since February 8, 2003, “SBC has set the SBC ASI DSL Transport Service rate and the SBCIS Service rate at various levels”).

⁴⁵ See Complaint at 19-21, paras. 32-35. See also Complaint at 26, para. 44 (“SBC engages in an intracorporate transfer of supranormal profits from the SBC-ASI Service to the SBCIS Service.”).

⁴⁶ The Defendants argue that the Commission lacks jurisdiction over EarthLink’s complaint against SBC because SBC does not provide telecommunications services and is not a common carrier as defined in the Act. See note 38 *supra*. They admit, however, that during the Complaint period, SBC exercised ownership and control over SBC-ASI and SBCIS, including the price setting conduct at issue. See Joint Statement at 3, para. 21.

⁴⁷ See *Ambassador, Inc. v. United States*, 325 U.S. 317, 325 (1945) (holding that hotels exacting charges for furnishing telephone service to guests properly were joined under Section 411 as parties to FCC enforcement proceeding, because “[o]ne can hardly gainsay the Government’s assertion that the [hotels] are persons interested in and affected by the regulation in question”). See also *Better T.V., Inc. of Dutchess County, N.Y. v. New York Telephone Co.*, Memorandum Opinion and Order and Certificate, 18 F.C.C.2d 783, 788-89, para. 13 (rejecting AT&T’s objection to being made a party under Section 411(a) because AT&T potentially dictated New York Telephone’s “policies and practices” by virtue of AT&T’s control of voting stock and, in any event, “will be interested in or affected by the decision and orders issued” in the proceeding); *Petition by Telecable Corp. to Stay Construction or Operation of a CATV System in Bloomington and Normal, Ill.*, by G.T.&E. Communications, Inc., Memorandum Opinion and Order, 18 F.C.C.2d 348, 349-50, paras. 4-5 (1969) (holding that G.T. & E. (the parent company) appropriately was a party to a proceeding against its common carrier subsidiary because “it is the parent company which may be in a position to establish, maintain, and coordinate” the CATV acquisition policies at issue).

⁴⁸ Cf. *General Communications, Inc. v. Alaska Communications Systems Holdings, Inc.*, Memorandum Opinion and Order, 16 FCC Rcd 2834, 2861-62, paras. 70-71 (2001) (dismissing a holding company defendant that was not alleged to have committed any “conduct that, by itself, injured [the complainant]”), *review granted in part and denied in part, and case remanded ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403 (D.C. Cir. 2002).

B. EarthLink's Cross-Subsidy Allegations Fail to State a Claim Under Section 201(b) of the Act and Section 64.901(a) and (b) of the Commission's Rules.

13. EarthLink alleges that the SBCIS Service is priced substantially below cost and is sold at a loss.⁴⁹ It asserts that SBCIS can only offer such a low retail rate because SBCIS receives an unlawful cross-subsidy from the allegedly inflated rates SBC-ASI charges for the regulated wholesale DSL transport service that SBCIS uses as an input to the retail service.⁵⁰ EarthLink argues that the low retail rate distorts the competitive market for the service and gives SBCIS an unfair advantage.⁵¹

14. As described below, the cross-subsidy allegations pled by EarthLink fail to state a claim. Moreover, the "tests" EarthLink proffers in connection with its cross-subsidy claim do not provide an independent basis for liability.

1. The Relationship Between the Costs and Price of a Nonregulated Service Cannot Form the Basis of a Violation of Section 201(b) of the Act or Section 64.901(a) and (b) of the Commission's Rules.

15. The Commission's cost allocation rules are designed to ensure the reasonableness of regulated rates.⁵² The rules therefore encompass a system of accounting separation that inhibits carriers from imposing on ratepayers for regulated interstate services the costs and risks of nonregulated ventures. EarthLink's case, however, focuses on ensuring what it believes to be competitively fair rates for a nonregulated service. Although the Commission requires a carrier appropriately to allocate costs between its regulated and nonregulated sectors, the Commission does not regulate the prices for services not subject to economic regulation under Title II of the Act.⁵³ At bottom, and despite EarthLink's claims to the contrary, the Complaint asks the Commission to hold that the price of the nonregulated SBCIS Service is too low, relative to its costs. We decline to make such a ruling.

16. For many years, the Commission required the complete structural separation of the BOCs' enhanced services operations from their regulated common carrier operations in order to

⁴⁹ Complaint at 4-5, 12-15, 19-20, paras. 6-7, 21-24, 32; Reply at 41-42, para. 43; EarthLink's Opening Brief at 14-17, 21-25.

⁵⁰ *Id.*

⁵¹ Complaint at 16-17, 24, paras. 27, 40 ("As a retail competitor of the SBCIS Service and as a wholesale purchaser of the SBC-ASI Service, EarthLink is directly harmed by this unlawful cross-subsidy, which puts EarthLink at a competitive disadvantage."); EarthLink's Opening Brief at 2, 7-8; EarthLink's Responsive Brief at 8-13.

⁵² Although not affecting the cost allocation rules applicable to SBC at all times relevant to this Complaint, we note that the Commission granted AT&T conditional forbearance from certain cost allocation rules. *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, Memorandum Opinion and Order, 23 FCC Rcd 7302 (2008). This Complaint was filed before SBC merged with AT&T Corp. in 2005, which created the new entity of AT&T, Inc. *See SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd 18290 (2005).

⁵³ *See IP-Enabled Services*, Notice of Proposed Rulemaking, 19 FCC Rcd 4863, 4879-81, paras. 24-27 (2004) (citing *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Final Decision, 77 F.C.C.2d 384, 432-35, paras. 126-32 (1980)). *Cf. In the Matters of IP-Enabled Services and E911 Requirements for IP-Enabled Service Providers*, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245 (2005), para. 26 (using Title I and Section 251(e) to require providers of interconnected VoIP to provide E911 to their subscribers whether those providers are ultimately classified as information service providers or telecommunications carriers).

discourage cross-subsidy.⁵⁴ The Commission then moved away from structural separation requirements in favor of nonstructural safeguards, which it found would allow the BOCs to provide enhanced services more efficiently.⁵⁵ The nonstructural safeguards, which the *Computer III Phase I Order* established, included network access requirements to ensure SBC and other BOCs provided nondiscriminatory access to the basic transmission services competitors use as inputs for their nonregulated offerings.⁵⁶ They also included specific cost allocation and affiliate transaction standards, which the *Joint Cost Order* instituted.⁵⁷

17. The *Joint Cost Order* adopted rules that require local exchange carriers to allocate and assign costs either to regulated or nonregulated activities. The order also established affiliate transaction rules that require carriers to record on their books of account, at the appropriate price, all assets or services transferred between a regulated entity and a nonregulated affiliate.⁵⁸ The Commission stated that its “ultimate statutory goal was to promote just and reasonable rates for services in the interstate jurisdiction” through the accounting separation of regulated from nonregulated activities, using a fully allocated costing methodology,⁵⁹ and to “prevent cost shifting to ratepayers by means of improper transfer pricing.”⁶⁰ Thus, the Commission intended the cost allocation rules, contained in Section 64.901 of the Commission’s rules,⁶¹ and the affiliate transaction rules, contained in Section 32.27 of the Commission’s rules,⁶² to operate together to ensure just and reasonable rates for regulated services.⁶³

18. EarthLink claims that, in addition to ensuring just and reasonable rates for regulated services, the Commission’s cost allocation rules guard against cross-subsidies that could cause an anti-

⁵⁴ *Joint Cost Order*, 2 FCC Rcd at 1301-02, paras. 16-28 (citing *Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry)*, Final Decision, 77 FCC 2d 384 (1980) (subsequent history omitted)).

⁵⁵ *Computer III Phase I Order*, 104 F.C.C.2d at 1063-70, paras. 210-25.

⁵⁶ *See id.*

⁵⁷ *See Computer III Phase I Order*, 104 F.C.C.2d at 1059-68, paras. 201-22; *Joint Cost Order*, 2 FCC Rcd at 1303, para. 29.

⁵⁸ *Joint Cost Order*, 2 FCC Rcd at 1310-26, 1334-37, paras. 94-221, 284-301.

⁵⁹ *Joint Cost Order*, 2 FCC Rcd at 1299, 1303, paras. 1, 37. A fully allocated costing system divides the entire cost of a group of products through the direct assignment of costs to either regulated or nonregulated activities or through the use of an allocation factor. *Id.* at 1299, 1311, paras. 2, 94.

⁶⁰ *Joint Cost Order*, 2 FCC Rcd at 1335, para. 290.

⁶¹ 47 CFR § 64.901. Section 64.901(a) and (b) of the Commission’s rules state:

(a) Carriers required to separate their regulated costs from nonregulated costs shall use the attributable cost method of cost allocation for such purpose.

(b) In assigning or allocating costs to regulated and nonregulated activities, carriers shall follow the principles prescribed herein.

47 CFR § 64.901(a) and (b).

⁶² 47 CFR § 32.27.

⁶³ *Joint Cost Order* at 1335, paras. 291-92 (“Some parties argue that we need not adopt any transfer standards herein. This position is not consistent with our need to have an effective system for separating the costs of regulated and nonregulated activities. In fact, the absence of such standards would create a loophole that would call into question our ability to regulate.”); 47 CFR § 64.902 (“. . . all carriers subject to § 64.901 are also subject to the provisions of § 32.27 of this chapter concerning transactions with affiliates.”).

competitive impact in nonregulated markets.⁶⁴ In this way, EarthLink attempts to use the relationship between the costs and price of a nonregulated service, standing alone, to demonstrate a violation of the Act. EarthLink does not dispute that SBCIS is a nonregulated information service provider, and that SBCIS is free to set its prices in response to competition.⁶⁵ As Commission precedent makes clear, EarthLink's approach fails to state any claim under the Act and is inconsistent with the parameters of the Commission's regulation.

19. The Commission has identified one of the possible effects of improper cost shifting to be carriers charging artificially low prices for nonregulated services.⁶⁶ The Commission has not found, however, that this outcome violates the Act. In fact, the Commission's cost allocation standards state explicitly that competitors in nonregulated markets must rely on antitrust laws for protection in such circumstances. The Commission said in the *Joint Cost Order*:

While we agree that the rules we adopt here should be suitable for an increasingly competitive telecommunications environment, we disagree with those parties who intimate that we should design these rules so as to cause the accounting system to produce information that would allow us to determine whether prices for nonregulated products and services are anti-competitively low. The pricing of individual nonregulated products and services does not fall within our statutory mandate. Complaints about predatory pricing in nonregulated markets are the province of antitrust laws. The proper purpose of our cost allocation rules is to make sure that all of the costs of nonregulated activities are removed from the rate base and allowable expenses for interstate regulated services. It is not our purpose, nor should it be our purpose, to seek to attribute costs to particular nonregulated activities for purposes of establishing the relationship between cost and price.⁶⁷

20. Applying this precedent, the Commission has rejected arguments that a nonregulated service failed to recover its costs, thereby distorting the market for the service. In 1990, as part of an inquiry into whether Pacific Bell had complied with certain requirements associated with providing basic and nonregulated protocol conversion services, the Commission denied arguments by a competitor that

⁶⁴ EarthLink's Responsive Brief at 8-13.

⁶⁵ Joint Statement at 3, para. 17.

⁶⁶ *Computer III Phase I Order*, 104 F.C.C.2d at 1074, para. 234.

⁶⁷ *Joint Cost Order*, 2 FCC Rcd at 1304, para. 40. *See id.*, 2 FCC Rcd at 1312, para. 110 ("We believe that competitors in nonregulated markets must rely for protection on the antitrust laws and the standards which apply in the antitrust arena."), at 1313, para. 115 ("The scheme we adopt below allocates common cost to the nonregulated sector but leaves it wholly to the business judgment of the company and to the market place to determine how the company recovers (or fails to recover) those costs."), at 1313, para. 116 (a carrier is free to offer each nonregulated service at "whatever lawful price will maximize the company's profit from that service"), at 1313, para. 117 ("Furthermore, in the regulated sphere we have a responsibility to enforce a statutory prohibition against unjust and unreasonable charges that encompasses rates that are unreasonably low or 'predatory' as well as rates that are unreasonably high, whereas we usually have no proper interest in the prices charged for nonregulated services."). *See also Joint Cost Reconsideration Order*, 2 FCC Rcd at 6297, para. 132 ("We are not, through the operation of these [cost allocation] rules or other rules, attempting to regulate the price at which a nonregulated affiliate must sell its services."). The Commission also has mandated that any nonregulated revenue data that it requires carriers to report as part of its cost allocation rules must be reported at an aggregated level so that it cannot be used to establish a relationship between the cost and price of the nonregulated product. *See Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules)*, Order on Reconsideration, 3 FCC Rcd 6375, 6376, para. 13 (1988).

Pacific Bell's regulated rates failed to account for costs caused by the nonregulated service.⁶⁸ The Commission found that the competitive market for nonregulated protocol conversion services was well-established, and that it therefore was appropriate to refrain from any inquiry into the relationship of the prices and costs of the nonregulated service.⁶⁹ Thus, the Commission affirmed the Bureau's finding that there was no reason to reject or suspend the regulated rates.⁷⁰

21. Citing a 1990 Commission order finding apparent violations of the affiliate transaction rules arising out of the relationship between New York Telephone Company's regulated subsidiary and a nonregulated affiliate providing support services, EarthLink argues that the Commission previously has examined the relationship between the costs and price of a nonregulated service in order to find a violation of the Act.⁷¹ We disagree that the *New York Telephone Order* is relevant. First, EarthLink has not alleged a violation of the affiliate transaction rules. Second, the *New York Telephone Order* involved the carrier's regulated entity receiving goods and services from the nonregulated entity at allegedly inflated prices, which can be an unreasonable practice under Section 201(b) of the Act because it increases the costs that the regulated entity can seek to recover from its ratepayers.⁷² Here, EarthLink alleges the opposite impact—that SBC-ASI (a regulated entity) is providing an input at an inflated price to SBCIS (a nonregulated entity).⁷³ It is therefore a regulated entity's pricing that we would examine to determine a violation of the Act. EarthLink, however, has not asserted a claim associated with the reasonableness of the SBC-ASI Service rate, and, in fact, argued in its briefs that SBC-ASI's costs and rates are irrelevant to EarthLink's claim.⁷⁴ Finally, the Commission made clear in the *New York Telephone Order* that its actions with regard to the affiliate transaction rules prescribe only the manner in which carriers record charges for services on their books of account; they do not address the actual charges imposed by the nonregulated enterprise,⁷⁵ which is what EarthLink claims here when it argues that the SBCIS Service is priced too low to cover its costs.

22. EarthLink attempts to overcome the deficiencies of its Complaint by arguing that the Commission simply can order Defendants to reduce the rate for the SBC-ASI Service.⁷⁶ This argument also fails, because, again, EarthLink is not challenging the justness and reasonableness of the SBC-ASI

⁶⁸ *Pacific Bell Petition for Waiver of Section 64.702 of the Commission's Rules and Regulations to Authorize Protocol Conversion Offerings*, Memorandum Opinion and Order, 5 FCC Rcd 2838, 2841, paras. 21-22 (1990) (*Protocol Conversion Order*).

⁶⁹ *Protocol Conversion Order*, 5 FCC Rcd at 2841, para. 22 (citing *Joint Cost Order*, 2 FCC Rcd at 1298).

⁷⁰ *Id.*

⁷¹ EarthLink's Responsive Brief at 16-17 (citing *New York Telephone Co. New England Tel. and Telegraph Co.*, Order to Show Cause and Notice of Apparent Liability for Forfeitures, 5 FCC Rcd 866, 869-70, paras. 24-27 (1990) (*New York Telephone Order*)).

⁷² *New York Telephone Order*, 5 FCC Rcd at 869-70, paras. 24-27.

⁷³ EarthLink believes that the "supranormal" profits from the sales of the SBC-ASI Service are not sufficient to cover all of the losses incurred by the SBCIS Service. EarthLink's Responsive Brief at 14. EarthLink has not explained how Defendants benefit by requiring SBCIS to recover any remaining costs associated with having to pay an inflated rate for the SBC-ASI Service.

⁷⁴ EarthLink's Opening Brief at 3 ("Notably, none of these [cross-subsidy] tests require a showing that the subsidizing service (here, the SBC-ASI Transport Service) is offered at a price above its costs."), EarthLink's Responsive Brief at 19 ("Defendants agree that an inquiry as to whether any service recovers more than its stand-alone costs is not relevant to determining the existence of the alleged cross-subsidy.").

⁷⁵ *New York Telephone Order*, 5 FCC Rcd at 867-68, para. 10.

⁷⁶ Reply at 59-60, para. 67; EarthLink's Opening Brief at 61, 71-72, 76.

Service rate.⁷⁷ Thus, EarthLink offers no substantive evidence regarding an appropriate standard the Commission could utilize in assessing the reasonableness of the SBC-ASI Service rate.⁷⁸

23. We also are not persuaded by EarthLink's related assertion that it merely seeks "enforcement of regulation that applies to both Defendants," rather than regulation of SBCIS.⁷⁹ The laws the Commission consistently has used to prevent improper transfers between regulated and nonregulated activities are the affiliate transaction requirements,⁸⁰ which EarthLink does not contend the Defendants violated. Although EarthLink claims the "central charge" in its case is that, through SBC (the holding company), SBC-ASI provides a rebate to SBCIS, resulting in a lower "internal transfer price" for the SBC-ASI Service than that paid by unaffiliated ISPs, such as EarthLink,⁸¹ EarthLink has failed to allege any violation of the affiliate transaction rules. Even if EarthLink had, the affiliate transaction requirements do not dictate directly the pricing of the nonregulated service.⁸² In other words, we agree with Defendants that EarthLink's fundamental contention is that SBCIS can cause SBC-ASI to violate the Act by charging a price for retail Internet access service that is too low in comparison to the costs of providing the service.⁸³ As explained above, however, this does not state a valid claim for violation of the Act because the Commission does not review the costs of particular nonregulated activities for purposes of establishing a relationship between cost and price.

24. EarthLink's allegation that Defendants violated Sections 64.901(a) and (b) of the Commission's cost allocation rules does not add merit to its claim.⁸⁴ EarthLink argues that the alleged

⁷⁷ Complaint at 4, 24, paras. 6, 40; Reply at 13, n.33.

⁷⁸ Moreover, if the Commission were to require a reduction of the SBC-ASI Service rate, EarthLink does not explain why SBCIS nonetheless could not charge an even lower rate for its retail service, because SBCIS must acquire the wholesale service on the same terms and conditions as unaffiliated ISPs.

⁷⁹ Reply at 4, 58-59, paras. 8, 66.

⁸⁰ 47 C.F.R. § 32.27.

⁸¹ EarthLink's Responsive Brief at 6. *See* EarthLink's Opening Brief at 76 (Commission should "require SBC and SBC-ASI immediately to eliminate the intracorporate transfer or cross-subsidy described in this Complaint . . ."); EarthLink's Responsive Brief at 6-7 (the "internal transfer price" purportedly "does not change the per-subscriber return the integrated corporate parent . . . realizes on the integrated SBCIS Internet Service.").

⁸² *See* note 67 *supra*. We are not persuaded by EarthLink's argument that the *Joint Cost Order* endorses the incremental cost test, thereby requiring the Commission to consider the relationship between the costs and price of the SBCIS Service to determine if a cross-subsidy exists. EarthLink's Responsive Brief at 17 (citing *Joint Cost Order*, 2 FCC Rcd at 1312, 1351, para. 109 & n.214). The Commission stated in the *Joint Cost Order* that, "in theory," a cross-subsidy could be avoided when the long run incremental costs of an activity are born by that activity. *Joint Cost Order*, 2 FCC Rcd at 1312, para. 109. Nevertheless, the Commission described its goals as "transcend[ing] prevention of cross-subsidy," and it therefore adopted a fully allocated cost approach that it *distinguished* from an incremental cost test. *Joint Cost Order*, 2 FCC Rcd at 1310-12, paras. 94-95, 109-10. At the same time, the Commission emphasized that such an approach would not intrude on the pricing of nonregulated services, which would be left to the antitrust arena. *Joint Cost Order*, 2 FCC Rcd at 1312, para. 110. It further stated that it would avoid becoming involved at all in nonregulated pricing matters by treating the regulated and nonregulated sectors of a company's business in the aggregate for purposes of allocating costs. *Joint Cost Order*, 2 FCC Rcd at 1313, para. 115. As described in paragraph 30 *infra*, EarthLink's reliance on the incremental cost test in the context of the *Payphone Order* also is misplaced.

⁸³ Defendants' Opening Brief at 9-10 (citing *Joint Cost Order*, 2 FCC Rcd at 1304, para. 40).

⁸⁴ Complaint at 17, 24, paras. 28, 39; EarthLink's Opening Brief at 39-42, 61; EarthLink's Responsive Brief at 16-17. *See* 47 CFR §§ 64.901(a) (providing that carriers required to separate regulated costs from nonregulated costs must use the attributable cost method of cost allocation), (b) (establishing principles carriers must follow in assigning or allocating costs).

cross-subsidy effectively and improperly attributes the costs of the SBCIS Service to the SBC-ASI Service.⁸⁵ The Commission established a detailed enforcement mechanism for Section 64.901 in the *Joint Cost Order* that included filing, reporting, and recordkeeping requirements, in addition to compliance with annual independent auditing rules.⁸⁶ The Complaint does not allege a violation of any of these requirements. Again, as the Commission stated in the *Joint Cost Order*, the proper purpose of our cost allocation rules is to make sure all the costs of nonregulated services are removed from the regulated rate base.⁸⁷ EarthLink has not alleged a violation of this requirement. Moreover, EarthLink fails to address the extent to which Section 64.901 even applies to Defendants' separate affiliate structure. Although EarthLink asserts that Section 64.901 applies to all local exchange carriers and to a carrier's joint use of its network for regulated and nonregulated activities,⁸⁸ it does not respond to Defendants' argument that, in this specific case, SBC-ASI has no joint and common costs to allocate because it provides only regulated services.⁸⁹ Indeed, EarthLink states that it does not seek to prove any allegation associated with the allocation of common costs between Defendants' regulated and nonregulated operations.⁹⁰

25. We disagree with EarthLink that *Federal Power Commission v. Conway* supports a finding in its favor.⁹¹ In *FPC v. Conway*, a group of competitors of an electric utility sought to challenge a wholesale rate increase the utility filed at the Federal Power Commission (FPC), arguing that the rate increase was unjust and unreasonable and would cause a price squeeze that would make it impossible for them to sell retail power at a competitive price.⁹² The FPC stated that, because its authority was limited to oversight of the wholesale rates and not the retail rates, the anti-competitive issue was beyond the scope of its jurisdiction.⁹³ The Court rejected the FPC's argument. It based its reasoning on the fact that the competitors had argued that the wholesale rate was unjust and unreasonable, and that it was necessary, as part of an inquiry into the reasonableness of the rate, to examine whether an undue preference or discrimination was in any way traceable to the level of the wholesale rate.⁹⁴ The Court emphasized, however, that the FPC had no power to prescribe the rates for the retail sales of nonregulated electric service, nor to "remedy an alleged discriminatory or anticompetitive relationship between wholesale and retail rates by ordering the company to increase its retail rates."⁹⁵

⁸⁵ Complaint at 24, para. 39; Reply at 19-21, paras. 21-22.

⁸⁶ *Joint Cost Order*, 2 FCC Rcd at 1326-34, paras. 222-83.

⁸⁷ *Joint Cost Order*, 2 FCC Rcd at 1304, para. 40.

⁸⁸ Complaint at 17, para. 28 (citing *Implementation of Section 254(k) of the Communications Act of 1934, As Amended*, Order, 12 FCC Rcd 6415, 6416, para. 3 (1997)).

⁸⁹ Answer at 34, n.8; Defendants' Opening Brief at 8, n.7, 12; Defendants' Responsive Brief at 13.

⁹⁰ Letter from Kenneth R. Boley, Counsel for EarthLink, to Marlene Dortch, Secretary, FCC, File No. EB-04-MD-006 (filed Oct. 25, 2004) ("The issue of joint and common costs referenced by EarthLink in the Motion [to compel discovery], and regarding which EarthLink requests an evidentiary hearing, involves two separate inquiries. The first relates to the joint and common costs applicable to the SBC-ASI Service, and the second relates to the joint and common costs applicable to the SBCIS Service. It is not EarthLink's intent to request an inquiry into any costs that may be common to both the SBC-ASI Service and the SBCIS Service.").

⁹¹ Reply at 58-59 (citing *Federal Power Comm'n v. Conway*, 426 U.S. 271 (1976) (*FPC v. Conway*)); EarthLink's Opening Brief at 72-73.

⁹² *FPC v. Conway*, 426 U.S. at 274.

⁹³ *FPC v. Conway*, 426 U.S. at 275.

⁹⁴ *FPC v. Conway*, 426 U.S. at 277-78.

⁹⁵ *FPC v. Conway*, 426 U.S. at 277.

26. *FPC v. Conway* addressed both a price squeeze argument and an argument that the wholesale utility rate was unjust and unreasonable. Because EarthLink does not make such claims here, *FPC v. Conway* is inapposite. EarthLink claims, instead, that the SBCIS Service is priced below cost, and that SBC-ASI consequently is engaging in an unlawful cross-subsidy.⁹⁶ EarthLink therefore bases its case on the retail rate being anti-competitively low, which as *FPC v. Conway* indicates, is not within our purview to remedy.

27. Finally, we decline to address EarthLink's last-minute claim that SBC-ASI contravened other cost allocation requirements.⁹⁷ Specifically, in its responsive brief, EarthLink argued for the first time that SBC-ASI failed to comply with the Commission's Uniform System of Accounts, rules regarding cost allocation manual filing and review, and rules regarding ARMIS reporting and audits every two years.⁹⁸ EarthLink did not raise these specific issues or arguments in its Complaint, however, and Defendants did not have an opportunity to respond to them. Accordingly, we decline to consider them.⁹⁹

2. EarthLink's Cross-Subsidy Allegations Are Not Consistent With Standard Economic Definitions of Cross-Subsidy

28. EarthLink claims that the non-regulated retail services sold by SBCIS are unlawfully and anticompetitively cross-subsidized by the regulated wholesale transport services provided by SBC-ASI.¹⁰⁰ More specifically, it claims that the SBCIS retail DSL services are priced below incremental cost.¹⁰¹ We find that EarthLink's claim of an *unlawful* cross-subsidy is not supported by the relevant economic theory. EarthLink's claim seems to be that if SBCIS's retail DSL prices do not cover the incremental cost of supply of the DSL service, it can conclude that to be viable SBCIS must be in receipt of a cross-subsidy from SBC-ASI. This conclusion, however, does not follow. For example, SBCIS might be using profits it makes on other services, which it would ordinarily pass onto shareholders, to subsidize its DSL retail services. Such behavior would not imply SBCIS was being cross-subsidized by any regulated SBC affiliate.¹⁰² Consequently, we do not analyze whether EarthLink demonstrated that the SBCIS retail DSL services are priced below incremental cost.¹⁰³

⁹⁶ See paragraph 8 and note 28 *supra*.

⁹⁷ EarthLink's Responsive Brief at 12.

⁹⁸ *Id.*

⁹⁹ See, e.g., *AT&T Corp. v. Jefferson Telephone Co.*, Memorandum Opinion and Order, 16 FCC Rcd 16130, 16133, n.18 (2001); *Consumer.Net v. AT&T Corp.*, 15 FCC Rcd 281, 300, para. 40, n.93 (1999) (declining to consider an argument raised for the first time in the briefs). Cf. *Building Owners and Managers Ass'n Int'l v. FCC*, 254 F.3d 89, 100, n.14 (D.C. Cir. 2001) (declining to address an issue raised cursorily in the brief).

¹⁰⁰ Complaint 10-14, note in particular paragraph 22; see also Exhibit 9 (Rate History for SBC-ASI and SBCIS Service).

¹⁰¹ Complaint at 19, para. 32.

¹⁰² On the presence of a cost subsidy, see, for example, Faulhaber, G.R., Cross-Subsidization: Pricing in Public Enterprises, *American Economic Review*, 65(5), December 1975, 966-977, and also, Faulhaber, G.R., Cross-Subsidy Analysis with More Than Two Services, *Journal of Competition Law and Economics* 2005 1(3): 441-448. In particular, note that if a firm earns positive economic profits, then there may be no cross-subsidy even when a service's prices do not recover the service's incremental costs.

¹⁰³ We also note that SBCIS retail DSL services could be priced below incremental cost without raising Commission concerns. For example, such prices could still recover the incremental cost of supplying any profitably distinguishable customer group, and hence such prices would not suggest any anticompetitive behavior. This situation would arise if SBCIS were bundling a range of products to certain retail customers such that the incremental costs of the product range, as sold to the specific retail customers, were covered, even if any particular

29. We also note that EarthLink's arguments regarding cross subsidy are closely related to arguments relating to other potentially anti-competitive practices. For example, evidence that a company's retail price for a service is less than the wholesale price charged by the same company for an input to that service is commonly used to support a claim of a predatory price squeeze. EarthLink explicitly denies that it is alleging such a price squeeze. We therefore do not address whether the alleged facts would support a claim of predatory price squeeze.

3. The Cross-Subsidy "Tests" EarthLink Proffers Do Not Provide an Independent Basis for Liability.

30. EarthLink relies on three cases that it claims contain cross-subsidy tests that, if satisfied, demonstrate a violation of Section 201(b) of the Act.¹⁰⁴ Specifically, culling quotations from a Commission order, a Court of Appeals opinion, and a bureau order, EarthLink contends there are three "measures" that a decision-maker can use to "assist in the detection" of cross-subsidies.¹⁰⁵ EarthLink identifies these measures as the "incremental cost" test,¹⁰⁶ the "price transfer" test,¹⁰⁷ and the "intent" test.¹⁰⁸ We disagree with EarthLink's characterization of the three cases in question and the assertion that they establish the cross-subsidy tests EarthLink alleges.

31. To begin, the *Third Payphone Order* is distinct from the facts of this case. The *Third Payphone Order* involved the Commission's effort to define what "fairly compensated" means, as that term is used in Section 276(b)(1)(A) of the Act.¹⁰⁹ In particular, noting that a "wide range of compensation amounts may be considered 'fair,'" the Commission observed what "economic theory ... suggest[ed]"— *i.e.*, that the "costs of one service should not be cross-subsidized by another service."¹¹⁰ The Commission then noted that:

product's incremental cost was not. On cross-subsidizing customer groups rather than products, *see* Gerald R. Faulhaber & Stephen B. Levinson, *Subsidy-Free Prices and Anonymous Equity*, 71 *AM. ECON. REV.* 1083 (1981).

¹⁰⁴ Section 201(b) provides that "[a]ll charges, practices, classifications, and regulations for and in connection with such communication service, shall be just and reasonable, and any such charge, practice, classification, or regulation that is unjust or unreasonable is hereby declared to be unlawful . . ." 47 U.S.C. § 201(b).

¹⁰⁵ EarthLink's Opening Brief at 2, 9.

¹⁰⁶ EarthLink cites the origin of the "incremental cost" test as *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report and Order, and Order on Reconsideration of the Second Report and Order, 14 FCC Rcd 2545 (1999) (*Third Payphone Order*), *aff'd American Pub. Communications Council v. FCC*, 215 F.3d 51 (D.C. Cir. 2000). Complaint at 18, 22-23; Reply at 15-16, 47; EarthLink's Opening Brief at 3, 19-25, 72-75; EarthLink's Responsive Brief at 1, 17-22, 26-27, 29. EarthLink initially referred to this test as the "zone" test (Complaint at 18, 22-23), but subsequently modified its nomenclature. *See* EarthLink's Opening Brief at 3, 19-20.

¹⁰⁷ *Illinois Cities of Bethany v. FERC*, 670 F.2d 187 (D.C. Cir. 1981) (*Illinois Cities*), provides the basis for EarthLink's formulation of the "price transfer" test. Complaint at 19, 23-24; Reply at 41, n.127; EarthLink's Opening Brief at 25-27, 75; EarthLink's Responsive Brief at 21, n.66, 29-30.

¹⁰⁸ The "intent" test purportedly stems from *ITT World Communications, Inc. v. TRT Telecommunications Corp.*, Memorandum Opinion and Order, 51 Rad. Reg.2d (P & F) 1386 (1982) (*ITT World*). *See* Complaint at 3, 17-18, 21-22; Reply at 40, n.123, 41, n.127; EarthLink's Opening Brief at 3, 13-19, 73, 74; EarthLink's Responsive Brief at 27-28.

¹⁰⁹ 47 U.S.C. § 276(b)(1)(A) (requiring the Commission to "establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed intrastate and interstate call using their payphone . . .").

¹¹⁰ *Third Payphone Order*, 14 FCC Rcd at 2570, para. 56.

[C]onsumers making one type of call, such as a local coin call, should not pay a higher amount to subsidize consumers that make other types of calls, such as dial-around or toll-free calls. In order to avoid a cross-subsidy between two such services that are provided over a common facility, each service must recover at least its incremental cost, and neither service should recover more than its stand-alone cost.¹¹¹

After making that observation, the Commission discussed how its prior orders had defined “fair compensation” when establishing per-call compensation rates, and how, in the face of court remands of those prior orders, it would formulate a per-call amount that was fair to payphone owners and the beneficiaries of dial-around calls, as well as conducive to the widespread deployment of payphones.¹¹² The Commission was construing a specific statutory provision—Section 276(b)(1)—and did not purport to define the parameters of unlawful cross-subsidy for all purposes.

32. EarthLink is alleging here that a cross-subsidy exists between two separate services where one service sold at wholesale to SBCIS and non-affiliated entities, the SBC-ASI transmission service, is an input to the second service, the SBCIS Internet access service. The two services at issue are a subset of many services offered by Defendant SBC-ASI and SBCIS. By contrast, in the *Third Payphone Order*, the Commission was setting prices for two services provided over common equipment and taking steps to ensure that it was not creating a cross-subsidy between those two services. As noted in that order, “many different compensation amounts may be considered fair” so long as each service recovers its incremental cost, and neither service recovers more than its stand-alone cost.¹¹³ The Commission’s conclusions in the *Third Payphone Order* in the context of setting a price do not support a finding of cross-subsidy here. As explained above, neither the “incremental cost” nor the “stand-alone” cross-subsidy tests can establish that a cross-subsidy exists in the present context, where the profitability of the firm is not also analyzed.¹¹⁴ Thus, EarthLink’s reliance on the *Third Payphone Order*’s incremental cost test is unpersuasive on the facts before us.¹¹⁵

33. In support of its “price transfer” test arguments, EarthLink relies on *Illinois Cities*. We find that reliance misplaced. *Illinois Cities* involved an allegation that a wholesale electric power tariff, filed by a utility and approved by the Federal Energy Regulatory Commission, was too high in comparison with the utility’s retail rates. The petitioners, a group of the utility’s wholesale customers, claimed that they were being price squeezed.¹¹⁶ Prior to holding that the petitioners failed to establish a *prima facie* case of a price squeeze, the Court explained that the test the petitioners proffered was an “acceptable method[] of establishing a price squeeze case”:

Under the price transfer test the vertically integrated company’s costs of retail operations must be added to the product purchased at its wholesale rates to determine profitability . . . If the company fails to realize a profit under this test, indications are that retail costs have been improperly transferred to the wholesale

¹¹¹ *Id.*

¹¹² *Third Payphone Order*, 14 FCC Rcd at 2570-71, paras. 57-59.

¹¹³ *Third Payphone Order*, 14 FCC Rcd at 2570, para. 56.

¹¹⁴ *See supra* paragraph 28.

¹¹⁵ Additionally, the Commission generally has adopted a fully allocated costing methodology for the apportionment of costs between regulated and non-regulated activities. *See Joint Cost Order*, 2 FCC Rcd at 1312-1313, paras. 109-117.

¹¹⁶ *Illinois Cities*, 670 F.2d at 188.

operations (or, less likely, retail operations are inefficient).¹¹⁷

Again, in the matter before us, EarthLink expressly disavows that it has brought a price squeeze claim.¹¹⁸ Consequently, the “price transfer” test established in *Illinois Cities* is not applicable to this case.

34. Finally, we disagree with EarthLink’s contention that *ITT World* sets a generally-applicable “intent” standard that we should use to evaluate whether a cross-subsidy exists in this case. In *ITT World*, the former Common Carrier Bureau (now Wireline Competition Bureau) interpreted the since-repealed Record Carrier Compensation Act (RCCA) (formerly Section 222(b)(2) of the Act), which stated that “record carriers shall not impose upon users of any regulated record communications services the costs of any other services or facilities (including terminal equipment), whether regulated or nonregulated.”¹¹⁹ This statutory provision constituted an express prohibition against cross-subsidies between regulated record communications services and nonregulated terminal equipment.¹²⁰ In this context, the Common Carrier Bureau stated:

Whether unlawful cross-subsidization has taken place is a question of fact which, at least in most instances, would depend upon the carrier’s intent. Where a carrier directly ties an offer of free or reduced cost terminal equipment to exclusive use of its transmission service, or where it directly ties the equipment rates to transmission usage, the unlawful intent to cross-subsidize is patent.¹²¹

ITT World addressed a specific statutory prohibition contained in former Section 222 of the Act. EarthLink, however, invokes the general reasonableness standards contained in Sections 201(b) and 202(a) of the Act rather than a specific statutory provision prohibiting cross-subsidy. Nothing in *ITT World* suggests that the Bureau’s language was intended to apply beyond the scope of former Section 222 of the Act. Accordingly, we reject EarthLink’s argument that the “intent” test established in *ITT World* is applicable here.

C. Defendants’ Pricing Practices Regarding the SBCIS Service Are Not Unreasonably Discriminatory in Violation of Section 202(a) of the Act.

35. EarthLink makes the additional allegation that regardless of whether the claimed “intracorporate transfer” between SBC-ASI and SBCIS is considered to be cost shifting, a misallocation of costs, or a cross-subsidy, it effectively provides to SBCIS a discount on the SBC-ASI Service.¹²²

¹¹⁷ *Illinois Cities*, 670 F.2d at 190, n.14; but see *Pacific Telephone Co. v. Linkline Communications, Inc.*, 129 S. Ct. 1109, 1113 (2009) (Finding that a price squeeze claim is barred in the absence of an antitrust duty to deal with a complainant at wholesale. The court did, however, remand the case to allow consideration of a possible predatory retail price claim.).

¹¹⁸ Reply at 56-58; EarthLink’s Opening Brief at 60.

¹¹⁹ 47 U.S.C. § 222(b)(2). The RCCA was repealed in 1994. See Pub. L. No. 103-414, 108 Stat. 4296-97 (Oct. 25, 1994). “Record carriers” are providers of telex service. The RCCA was enacted to promote competition among record carriers. See, e.g., 47 U.S.C. § 222(b)(1) (requiring the Commission to “promote the development of fully competitive domestic and international markets in the provision of record communications service” and to “forbear from exercising its authority . . . as the development of competition among record carriers reduces the degree of regulation necessary to protect the public”).

¹²⁰ See *ITT World*, 51 Rad. Reg.2d at 1390, para. 15 (section 222(b)(2) “makes clear that [International Record Carrier] customers may not, either directly or indirectly, bear costs associated with terminal equipment through charges for record communications services”).

¹²¹ *ITT World*, 51 Rad. Reg.2d at 1390, para. 18.

¹²² Complaint at 25-28, paras. 41-47; Reply at 48-50, paras 53-54;

Because Defendants purportedly do not offer the same discount to EarthLink, the Complaint argues that the Defendants engage in “indirect discrimination” in violation of Section 202(a) of the Act.¹²³

36. We reject this claim. EarthLink does not contend that Defendants have violated the fundamental non-discrimination obligation under the *SBC Advanced Services Forbearance Order* to make the SBC-ASI Service available to unaffiliated ISPs on the same terms and conditions as it makes it available to SBCIS.¹²⁴ EarthLink’s discrimination claim instead hinges on a purported indirect link between the alleged cross-subsidy and the price SBCIS pays for SBC-ASI Service. As discussed above, however, there is no cause of action under the Communications Act relating to pricing nonregulated products at rates that are too low. Thus, as long as Defendants have complied with the requirement to make ADSL transport available on nondiscriminatory terms, EarthLink has failed to prove its claim of unreasonable discrimination.

D. SBC-ASI Has Not Violated the Commission’s *Computer III* Requirements.

37. EarthLink contends that Defendants breached the Commission’s Computer Inquiry requirements in two respects. First, EarthLink maintains that the purported unlawful cross-subsidy violates the *Computer III* requirement that SBCIS pay a charge for the SBC-ASI Service that is equal to what unaffiliated ISPs pay to SBC-ASI.¹²⁵ As fully discussed above,¹²⁶ we find that EarthLink has not made out an actionable claim of discrimination based on the price of the SBCIS Service.

38. Second, EarthLink contends that SBC-ASI contravened the since-eliminated requirement in the *Computer III* rules that BOCs post service-specific CEI plans on their websites in order to offer a new enhanced service, such as Internet access service.¹²⁷ According to EarthLink, by failing to post a CEI plan, SBC-ASI “further aggravate[d] the injury caused by the other violations set forth in this Complaint,” because the CEI plan may have “revealed” or “deterred” Defendants’ “illegal activities.”¹²⁸ Because we find above that the Defendants have not engaged in any illegal conduct, we need not, and do not, decide here whether SBC-ASI was subject to *Computer III* requirements during the relevant period and, if so, whether it violated those requirements by failing to post a CEI plan.

¹²³ Complaint at 26-27, para. 44.

¹²⁴ *SBC Advanced Services Forbearance Order*, 17 FCC Rcd at 27010, 27013-15, paras. 18, 23, 27. See Reply at 8, n.14 (“EarthLink does not possess sufficient information to admit or deny whether, absent the cross-subsidy or intracorporate transfer alleged in the Complaint, the rates, terms and conditions SBC-ASI posts to its website are an accurate reflection of those under which SBCIS takes service, or whether any of Defendants’ wholesale customers purchase DSL transport from SBC-ASI pursuant to individually negotiated agreements.”) EarthLink had argued initially that the Defendants also violated a legal test for determining the existence of price discrimination set out in *Illinois Cities*: “If, after wholesale and retail costs are fully allocated, the [integrated] company’s wholesale profit margin is significantly greater than its retail profit margin, indications are that a price discrimination is occurring.” Complaint at 27-27, paras. 46-47 (citing *Illinois Cities*, 670 F.2d at 199, n.53). Again, the Court was discussing price discrimination as a result of a price squeeze, something EarthLink has not alleged in this case. In addition, the test applies to an integrated company, which SBC-ASI and SBCIS are not. In any event, EarthLink appears to have abandoned this specific argument in its briefs.

¹²⁵ Complaint at 29-31, paras. 49-51; Reply at 50-55, paras. 455-61; EarthLink’s Opening Brief at 50.

¹²⁶ See paragraphs 30-36 *supra*.

¹²⁷ Complaint at 30-34, paras. 51-54; Reply at 50-55, paras. 55-61; EarthLink’s Opening Brief at 45-53. See *CEI Further Remand Order*, 14 FCC Rcd at 4292, 4294, 4297, paras. 4, 7-8, 12. In 2005, the Commission eliminated the Computer Inquiry rules for DSL service. See *Wireline Broadband Internet Access Services Order*, 20 FCC Rcd at 14875-76, para. 41. At all times relevant to this Complaint, however, the *Computer III* CEI posting rules remained in effect.

¹²⁸ Complaint at 33, para. 53.

IV. ORDERING CLAUSES

39. Accordingly, IT IS ORDERED, pursuant to Sections 4(i), 4(j), 201(b), 202(a), and 208 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), 201(b), 202(a), and 208, and the authority delegated by Sections 0.111 and 0.311 of the Commission's rules, 47 CFR §§ 0.111, 0.311, that the Complaint filed by EarthLink, Inc. against SBC Communications, Inc. and SBC Advanced Solutions, Inc. is DENIED.

FEDERAL COMMUNICATIONS COMMISSION

Travis LeBlanc
Chief
Enforcement Bureau