

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

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Policy and Rules Concerning the	)	CC Docket No. 96-61
Interstate, Interexchange Marketplace	)	
	)	
Implementation of Section 254(g) of	)	
the Communications Act of 1934,	)	
as amended	)	
	)	
1998 Biennial Regulatory Review –	)	
Review of Customer Premises Equipment	)	CC Docket No. 98-183
and Enhanced Services Unbundling Rules	)	
in the Interexchange, Exchange Access	)	
and Local Exchange Markets	)	

**BELLSOUTH COMMENTS**

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## TABLE OF CONTENTS

	<u>PAGE</u>
I. Introduction and Summary .....	1
II. The Commission Should Modify Its Current CPE Bundling Prohibition for Local Exchange Carriers. ....	3
III. The Consumer Benefits of Bundling Should be Equally Available to All Customers. ....	11
IV. The Bundling Rules For Enhanced Services Should be the Same as the Rules for CPE; The Commission's Focus Should be on Removal of <i>Computer III</i> Limitations .....	13

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**BELLSOUTH COMMENTS**

BellSouth Corporation, by counsel and on behalf of its affiliated companies (collectively “BellSouth”), submits these comments in response to the Commission’s *Further Notice of Proposed Rulemaking*<sup>1</sup> in the above referenced proceeding.

**I. Introduction and Summary**

In this proceeding, the Commission proposes to revisit its current policies that prohibit all carriers from bundling customer premises equipment (“CPE”) with telecommunications services. BellSouth supports the Commission’s contention that many consumers will benefit from the elimination of the CPE bundling prohibition. For *all* consumers to have an opportunity to share

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<sup>1</sup> *Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended; 1998 Biennial Regulatory Review – Review of Customer Premises Equipment and Enhanced Services Unbundling Rules in the Interexchange, Exchange Access and Local Exchange Markets*, CC Docket No. 96-61, CC Docket No. 98-183, *Further Notice of Proposed Rulemaking*, FCC 98-258 (rel. Oct. 9, 1998) (“Notice”).

in those benefits, however, the Commission must ensure that no subset of carriers is uniquely saddled with outdated and needless limitations on their authority to offer bundled service and equipment packages. Conditions have changed materially from when local exchange companies (and all other carriers) were originally subjected to the bundling prohibition. Moreover, the Commission has determined in analogous contexts that even where a carrier's service market is not fully competitive, bundling should not be prohibited as long as the common carrier component of the bundle remains separately available on nondiscriminatory terms. Accordingly, BellSouth urges the Commission not to draw artificial distinctions between different categories of carriers in granting relief from the CPE bundling prohibition.

The Commission also proposes in this proceeding to address current restrictions on carriers' enhanced service offerings. In contrast to the Commission's blanket prohibition on bundling CPE with common carrier services, all carriers are already permitted to offer bundled service packages that have both enhanced service and telecommunication service components, subject only to the condition that facilities-based carriers make the telecommunications service component separately available on nondiscriminatory terms. This is essentially the same result BellSouth urges above for the Commission's CPE proposal. Accordingly, BellSouth does not see a need at this time for a material change in the Commission's enhanced service unbundling requirement, *per se*. Where the Commission *should* make modification in the enhanced service context is to eliminate all vestiges of the *Computer III* requirements that attach only to the BOCs. Those requirements are no longer justified in light of the unbundling and other obligations mandated by the 1996 Telecommunications Act. BOCs' enhanced service offerings should be subject to no greater restrictions than are those of other carriers.

BellSouth's reasoning is set forth below.

## II. The Commission Should Modify Its Current CPE Bundling Prohibition for Local Exchange Carriers.

The Commission has proposed in the *Notice* to revisit its current prohibition against bundling CPE with common carrier transmission services. Conditions in the communications service and CPE marketplaces have changed dramatically from when the Commission first established this prohibition. With these changes, the bundling prohibition no longer makes sense. Accordingly, BellSouth supports the Commission's general proposal to modify its CPE bundling prohibition.

The bulk of the Commission's inquiries and tentative conclusions, however, focus on possible opportunities for such bundling by nondominant interexchange carriers. Although the *Notice* also asks about possible modification of the bundling prohibition for LECs, the Commission suggests that differences between interexchange markets and local exchange markets might provide a basis for granting relief only to IXCs.<sup>2</sup> Contrary to this suggestion, there is no need to continue to apply to local exchange carriers any form of bundling prohibition that is not also applicable to IXCs.

The Commission originally adopted its CPE bundling prohibition in the *Computer II*<sup>3</sup> proceeding to address a then-common industry practice of including CPE within carriers' tariffed service offerings. The Commission was concerned that such arrangements could cause customers to purchase CPE they may not want in order to obtain basic transmission services and could distort competition in the CPE marketplace through subsidization of tariffed CPE. To

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<sup>2</sup> *Notice* at ¶ 29.

<sup>3</sup> *Amendment of Section 64.702 of the Commission's Rules and Regulations*, 77 FCC 2d 384 (1980) ("*Computer II Final Decision*"), on reconsideration, 84 FCC 2d 50 (1980), on further reconsideration, 88 FCC 2d 572 (1981), *aff'd sub nom.*, *Computer and Communications Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

address these concerns, the Commission required carriers to provide CPE separate and apart from their basic transmission services and it detariffed the CPE.

At the time that the Commission adopted these requirements in 1980, the industry was dominated by a singular, vertically integrated AT&T. Not only was AT&T the overwhelmingly dominant long distance carrier and owner and controller of the large majority of the nation's local exchange operations, but AT&T was also the designer, manufacturer, and fabricator of both the equipment used in its network and the equipment used by customers. Because of this dominance, AT&T controlled just about every aspect of the provision of both telecommunications service and end user equipment. The bundling prohibition originally adopted by the Commission was but a component piece of an overall scheme designed by the Commission to limit AT&T's ability to misuse the power of its size and vertical integration.

Much has changed since the Commission's original requirement. The Commission's CPE detariffing requirement has been in effect for years and the consequences in the CPE marketplace have been dramatic. Little argument can be advanced that the CPE market is not one of the most competitive and innovative in existence today. Customers have an enormous range of choices of CPE, and countless manufacturers large and small, domestic and international, distribute their products through thousands – if not tens of thousands – of distribution outlets.

Nor is there any longer a concern that tariffed services will subsidize CPE. Removal of CPE from tariffs ensures that costs of CPE are not recovered through regulated rates.<sup>4</sup> This

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<sup>4</sup> *Computer II Final Decision*, 77 FCC 2d at 445 (“[I]t is important that the costs attributable to the regulated utility service be separated from the competitive provision of equipment used in conjunction with the service by the removal of such equipment from a carrier's rate base. This is accomplished through detariffing.”).

assurance is supplemented, at least in the BOCs' case, by cost allocation manuals, processes, and audits.

Moreover, the industry structure also has changed materially. No longer does a vertically integrated, dominant service provider, much less a local exchange carrier, also control the network equipment and CPE design, manufacturing, and distribution process. Indeed, the BOCs, in particular, are presently prohibited from manufacturing both CPE and equipment for their own networks.<sup>5</sup> These conditions, together with extant obligations to disclose interface specifications so that all manufacturers have the same opportunity to design and manufacture CPE conforming to those specifications, ensure that no local exchange carrier can limit competitors' opportunities in the CPE marketplace.

Notwithstanding the robust competitiveness of the CPE marketplace, however, the Commission has suggested that it might still have reservations about granting bundling relief unless the market for the communications service component is also "workably competitive." These reservations stem from an observation the Commission espoused in the *Computer II* proceeding that "[i]f the markets for components of [a] commodity bundle are workably competitive, bundling may present no major societal problems so long as the consumer is not deceived concerning the content and quality of the bundle."<sup>6</sup> Since the time of that observation, however, the Commission has concluded in multiple contexts that such a degree of competition in the services market is *not* necessary to permit bundling of common carrier offerings with other products as long as the common carrier component remains separately available on

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<sup>5</sup> Of course, even when a BOC gains manufacturing relief, it will enter a highly competitive market with zero market share, making it impossible to leverage any bundled offering in an anticompetitive fashion.

<sup>6</sup> *Computer II Final Decision*, 77 FCC 2d at 443 n. 52.

nondiscriminatory terms. Because local exchange carriers remain obligated to provide their services under tariff, that condition is met. Accordingly, the Commission should grant LECs relief to offer CPE and services on an optional bundled basis and need not make a determination of the degree of competition in the local exchange market to do so.

In the *Cellular CPE Bundling Order*,<sup>7</sup> the Commission permitted cellular carriers to bundle cellular service with cellular CPE. As here, the Commission began its analysis with the general proposition that bundling of a common carrier offering with CPE might present no societal problems as long as the markets for the components of the bundle are competitive. Applying that test to the cellular service and cellular CPE markets, the Commission concluded that the cellular service market was not fully competitive.<sup>8</sup> Nonetheless, the Commission found that cellular carriers would be unable to use any market power in the cellular service market to inhibit competition in the cellular CPE market. Accordingly, the Commission permitted cellular carriers to bundle cellular CPE with their service offerings, as long as the carrier continued to make the cellular service separately available on nondiscriminatory terms. Extending the same analysis to the local exchange market, the Commission should similarly allow LECs to offer optional bundles of services and CPE.

Specifically, the Commission found that even in the absence of a fully competitive cellular service market, cellular carriers engaged in bundling would not be able to restrict competition in the CPE market. First, the Commission found that notwithstanding a lack of competition in local cellular service markets, no service provider was likely to possess market

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<sup>7</sup> *Bundling of Cellular Customer Premises Equipment and Cellular Service*, 7 FCC Rcd 4028 (1992) (“*Cellular CPE Bundling Order*”).

<sup>8</sup> *Id.* at 4028, 4029.

power that could impact the numerous CPE manufacturers operating on a national and international basis.<sup>9</sup> The same holds true for local exchange carriers. Given the number of local exchange carriers (incumbents, resellers, and facilities-based competitors) operating throughout the country, even if a LEC were able to foreclose a CPE vendor from its local area through bundling, the vendor could easily sell its equipment to the hundreds of other carriers across the country or to those carriers' customers. More accurately, however, no local exchange carrier even has the ability to foreclose a CPE vendor from a service area in the first instance, because a local exchange carrier's services remain available at tariffed rates to all customers. CPE vendors thus cannot be foreclosed from selling CPE compatible with those services.

Similarly, the Commission found that even with market power, cellular carriers would not have the ability to utilize bundling to engage in sustained predatory pricing in the CPE market. The Commission found that because of the availability of the service component separately on nondiscriminatory terms, customers would be able to buy lower priced CPE outside of the bundle and to obtain the service component at its nondiscriminatory rate.<sup>10</sup> The continued separate availability of local exchange services under tariff similarly precludes LECs from utilizing bundling practices to achieve supracompetitive pricing for the CPE.

Even more so than in the cellular proceeding, LECs' resale obligations also make it a practical impossibility to utilize bundles to impede competition in the CPE market. Cellular carriers' resale obligations require only that there be no resale restrictions on the carrier's cellular service offering; cellular resale carriers are not entitled to any special wholesale pricing rate. In contrast, incumbent LECs are required to provide their telecommunications services to resellers

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<sup>9</sup> *Id.* at 4030.

<sup>10</sup> *Id.*

at a substantially discounted wholesale rate.<sup>11</sup> Accordingly, customers dissatisfied with an incumbent LEC's CPE and service bundle not only may buy their CPE elsewhere to create their own bundle with the incumbent's service, but also may create their own bundle by buying service from the resale carrier, or may even buy the resale carrier's bundle. Optional CPE bundles can thus *promote* competition in the CPE market rather than impede it.

Nor is there a likelihood that local exchange carriers could utilize their tariffed services to subsidize nonregulated CPE. Most local exchange carriers today are no longer governed by strict rate of return regulation, but are instead subject to various forms of price caps or rate level regulation. These forms of regulation provide no guarantee of return on investment and instead create incentives for greater earnings through efficient operations and lower costs. In specifically rejecting cross subsidy concerns in the *Cellular CPE Bundling Order*, the Commission expressly endorsed the observation of the Department of Justice that "absent a guaranteed return on their cellular service investment, carriers cannot expect to recover CPE discounts by including [the amount of the CPE discount] in their rate base."<sup>12</sup> Thus, the Commission concluded that carriers not subject to rate of return regulation were unlikely to have any motivation to subsidize CPE costs from regulated operations. That observation is just as true for providers of local exchange service.<sup>13</sup>

Finally, the Commission observed in the *Cellular CPE Bundling Order* that the possibility that one carrier could dominate the CPE market was further diminished because most

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<sup>11</sup> 47 U.S.C. § 251(c)(4).

<sup>12</sup> *Id.* 4031.

<sup>13</sup> *See also*, note 4, *supra*.

of the cellular carriers did not manufacture CPE.<sup>14</sup> As noted above, few local exchange carriers manufacture any CPE, and certainly none manufacture an exhaustive line of equipment.

Moreover, BOCs are specifically prohibited from doing so. For this reason and those above, just as for cellular service providers, no realistic possibility exists that local exchange carriers, even with market power, could adversely affect competition in the CPE marketplace through optional bundles of CPE and service.

The Commission has also reached the same result as in the *Cellular CPE Bundling Order* in a number of other contexts, but exhibiting even *less* concern with the degree of competition in local exchange service markets. For example, relatively recently and without any consternation over “market power,” the Commission expressly permitted incumbent local exchange carriers to bundle video services with local exchange service in a single package at a single price, subject to two conditions.<sup>15</sup> First, the carrier must not require a subscriber to purchase its video service in order to obtain local exchange service. Second, in selling the package, the LEC must impute to the sales the unbundled tariff rate for the regulated service. In other words, as long as the tariffed service remains separately available and all customers are charged the tariffed rate for that service, optional video service and local exchange service bundles are permissible.

Similarly, as discussed below, the Commission’s enhanced service bundling restriction has always been limited to require only that a facilities-based carrier not subject to a separate subsidiary requirement that packages an enhanced service with a basic service must continue to make the basic service separately available under tariff.<sup>16</sup> Indeed, as long as the basic service

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<sup>14</sup> *Cellular CPE Bundling Order*, 7 FCC Rcd at 4030.

<sup>15</sup> *Implementation of Section 302 of the Telecommunications Act of 1996: Open Video Systems*, 11 FCC Rcd 20227 (1996). See also, 47 C.F.R. § 76.1514.

<sup>16</sup> *Computer II Final Decision*, 77 FCC 2d at 475.

remains separately available under tariff, facilities-based carriers are even able to bundle CPE with the bundled enhanced service.<sup>17</sup> Again, it is the separate availability of the tariffed offering that is the key to the bundling opportunity, not the degree of competition in the basic service market.

Finally, the Commission specifically declined in the *CMRS Safeguards Order*<sup>18</sup> to prohibit incumbent LECs from bundling local exchange service with CMRS service obtained from a CMRS affiliate. Concluding that competing LECs would have available to them multiple sources of CMRS that would enable them to create bundled LEC-CMRS service offering to match incumbent LECs' bundles, the Commission found that regulation of such bundling was unnecessary.<sup>19</sup>

In sum, while the Commission has suggested that it should consider whether the local exchange market is sufficiently "workably competitive" to sustain bundling by local exchange carriers, the Commission's own past practice demonstrates that that consideration becomes an irrelevant factor when the service component of the bundle remains separately available on nondiscriminatory, tariffed terms. Given that local exchange carriers' tariffed services, by definition, remain separately available on nondiscriminatory terms, there is no reason to continue to deny LECs the opportunity to offer optional packages of CPE and local exchange service, including package discount pricing.

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<sup>17</sup> *Petition For Declaratory Ruling That AT&T's InterSpan Frame Relay Service Is a Basic Service*, 10 FCC Rcd 13717, 13723-724 and n. 84 (1995) ("*Frame Relay Order*").

<sup>18</sup> *Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Radio Services*, 12 FCC Rcd 15668, 15719, (1997) ("*CMRS Safeguards Order*").

<sup>19</sup> *Id.*

### **III. The Consumer Benefits of Bundling Should be Equally Available to All Customers.**

Elimination of the current CPE bundling prohibition in accordance with the foregoing discussion will enable carriers to better serve their customers. For example, carriers will be able to offer new service promotions utilizing CPE in specially priced promotional packages or to structure packaged service and equipment solutions that better meet customers' needs. For all customers to recognize the benefits of such improved pricing opportunities, however, the Commission must ensure that all carriers have the same abilities to respond to their customers and that no carrier or group of carriers is denied that opportunity. As outlined above, of course, because local exchange carriers' tariffing obligations ensure the continued separate availability of all of those carriers' common carrier services, LECs will have neither the opportunity to discriminate against customers not buying their CPE nor their ability to exercise any market power in the services market to impede competition in the CPE market. Accordingly, there would be no justification for adopting disparate bundling restrictions for different carriers or, by implication, denying the consumer benefits of bundling to a subset of customers.

That consumers will benefit from greater package pricing flexibility for carriers is undeniable. The Commission has already "found that bundling may be used as an 'efficient distribution mechanism' and an 'efficient promotional device' that may allow consumers to obtain goods and services 'more economically than if it were prohibited'."<sup>20</sup> Indeed, the price of CPE may often present the greatest deterrent to a customer's decision to purchase a new telecommunications service. Whether that CPE price represents a psychological barrier or an actual economic barrier, opportunities for carriers to specially price CPE in packages with a

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<sup>20</sup> Notice at ¶ 14, citing *Cellular CPE Bundling Order*, 7 FCC Rcd at 4030-31.

service subscription will enable many customers to obtain desirable new services they otherwise would have denied themselves.

Promotional discounts on CPE can also assist in the economic introduction of new services. For example, by providing discounts on CPE that is associated with, or required for, new service offerings, carriers will be able to generate faster and more widespread sales of the new service. The more sales the carrier is able to generate, the larger the population of users will be over which the fixed costs of the new offering may be spread. And, by so spreading the fixed costs, carriers can achieve greater economies of scale, which in turn will lower the cost of providing service to each subscriber.<sup>21</sup>

Promotional pricing of CPE in association with new tariffed offerings can also increase competition in the CPE marketplace and create new opportunities for independent CPE vendors to sell their products. With a service like Caller ID, for example, carriers may find it desirable to utilize the necessary CPE adjunct device as an inducement for customers to subscribe to the service. Because carriers are primarily motivated to sell more services rather than to be in the CPE business, however, a carrier utilizing the adjunct device merely as a sales inducement is likely to attempt to keep its promotional expenses as low as possible by providing only the most basic CPE device available. Independent CPE retailers thus have the opportunity to “upsell” these customers with more feature rich devices (*e.g.*, display units with greater storage of incoming calls, phones with built-in Caller ID display) or to sell them additional devices, since a separate device is needed for each extension in the customer’s home or office. Thus, carrier

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<sup>21</sup> *Cf.*, *Cellular CPE Bundling Order*, 7 FCC Rcd at 4031 (“[W]ith the influx of new subscribers due to the bundling of cellular CPE and service, the fixed costs of providing cellular service are spread over a larger population of users, achieving economies of scale and lowering the cost of providing service to each subscriber.”).

provided promotional bundles of CPE and service can create new sales opportunities for independent CPE providers.

Because no carrier has the ability to exert market power in the CPE market if the carrier's services remain separately available on nondiscriminatory terms, there is no need to distinguish between types of carriers for purposes of granting relief from the current strict bundling prohibition. Indeed, to the contrary, to subject carriers to disparate bundling regulations would unjustifiably tilt the competitive playing field and discriminate against customers served by carriers subject to the more restrictive requisition. Accordingly, the Commission should not grant more favorable relief to IXCs or to any subset of LECs than it grants to all LECs, including BOCs and other incumbents.

#### **IV. The Bundling Rules For Enhanced Services Should be the Same as the Rules for CPE; The Commission's Focus Should be on Removal of *Computer III* Limitations**

The Commission correctly observed in the *Notice* that in contrast to the blanket prohibition against bundling CPE with transmission services, the Commission's rules regarding enhanced services operates only as a "restriction."<sup>22</sup> Pursuant to this less stringent restriction, carriers are not prohibited from providing enhanced services bundled with their underlying transport services. Indeed, the Commission's presumptive "resale" model for carrier provision of enhanced services contemplates that a carrier will offer an enhanced service that incorporates an underlying transmission service to the customer as a singular "bundled" offering.<sup>23</sup> Rather,

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<sup>22</sup> *Notice* at ¶ 1 ("Our current rules currently *prohibit* telecommunications carriers from bundling telecommunications services with CPE, and *place restrictions* on the bundling of telecommunications services with enhanced services.") (emphasis added). *See also*, 47 C.F.R. § 64.702(e) (requiring that CPE, but not enhanced services, be "separate and distinct" from common carrier communications services).

<sup>23</sup> *See, Computer II Final Decision*, 77 FCC 2d at 475; *Frame Relay Order*, 10 FCC Rcd at 13723-724 and n. 84.

the restriction on enhanced service bundling refers to the requirement the Commission imposed on facilities-based carriers to unbundle and provide under tariff the common carrier services underlying the enhanced service bundle.<sup>24</sup>

Thus, the current restriction on bundling of enhanced services is, for facilities based carriers, equivalent to the result advocated above for CPE bundling. That is, bundling is permitted on the condition that the basic service component of the combined offering remains separately available on nondiscriminatory terms. And, as noted above, this result is appropriate for CPE bundling for the same reasons it has always been permitted in the enhanced service context.

Thus, rather than focussing on the bundling restriction *per se*, the Commission should return its attention to the *Computer III Further Remand Proceeding*<sup>25</sup> and move swiftly to grant BOCs relief from the current constraints on their abilities to bring enhanced services to the market. As has been conclusively demonstrated in that proceeding, the enhanced services market is incredibly robust and competitive. Moreover, enhanced service providers are no longer dependent on BOCs for underlying network services. Numerous competitive local exchange carriers are already providing services to enhanced service providers pursuant to the carriers' interconnection, resale, and unbundling rights under section 251 of the Communications

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<sup>24</sup> *Computer II Final Decision*, 77 FCC 2d at 475.

<sup>25</sup> *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Review -- Review of Computer III and ONA Safeguards and Requirements*, CC Docket No. 95-20, CC Docket No. 98-10, *Further Notice of Proposed Rulemaking*, 13 FCC Rcd 6040 (1998).

Act.<sup>26</sup> Burdensome regulations on BOCs' abilities to provide enhanced services are no longer necessary to protect against discrimination by BOCs against other enhanced service providers.

The Commission should eliminate those requirements to allow BOCs to offer and provide enhanced services under the same rules that apply to other carriers.

### CONCLUSION

For the reasons set forth herein, the Commission should eliminate the CPE bundling prohibition for local exchange carriers. The Commission should also move quickly to free BOCs from the unnecessary and outdated restrictions of the *Computer III* regime.

Respectfully submitted,  
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<sup>26</sup> 47 U.S.C. § 251.