

UNITED STATES HOUSE OF REPRESENTATIVES  
COMMITTEE ON ENERGY AND COMMERCE  
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE

TESTIMONY OF

THE HONORABLE PATRICIA M. WORTHY, CHAIRMAN  
PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA

ON BEHALF OF THE

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS  
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ON

COMPETITION IN THE INFORMATION SERVICES INDUSTRY

APRIL 20, 1988

## SUMMARY

THE CONSENT DECREE COURT'S MARCH 7, 1988, INFORMATION SERVICES ORDER EXACERBATES EXISTING PROBLEMS CREATED BY THE FCC'S PREEMPTION OF STATE REGULATION OF BELL OPERATING COMPANY PROVISION OF ENHANCED SERVICES. IN THE ABSENCE OF PROHIBITIONS AGAINST PROVIDING MANY INFORMATION SERVICES, AND IN LIGHT OF LIMITED STATE AUTHORITY, THE NARUC FEARS THAT THE COURT HAS CREATED OPPORTUNITIES FOR THE REGIONAL HOLDING COMPANIES (RHCS) TO USE REVENUES FROM REGULATED TELEPHONE SERVICES TO SUSTAIN UNREGULATED ENHANCED SERVICES. AS A RESULT, CAPTIVE RATEPAYERS MAY FACE ARTIFICIAL RATE INCREASES, AND DEVELOPMENT OF A STRONG INFORMATION SERVICES INDUSTRY COMPETING ON A LEVEL PLAYING FIELD MAY BE CRITICALLY UNDERMINED.

THE CHARACTERISTICS OF INTRASTATE MARKETS FOR TELEPHONE SERVICE, ENHANCED OR OTHERWISE, CAN DIFFER SUBSTANTIALLY. TO BE EFFECTIVE, REGULATION OF INFORMATION SERVICES MARKETS OPENED TO THE RHCS BY THE INFORMATION SERVICES ORDER MUST BE TAILORED SPECIFICALLY TO LOCAL MARKET CONDITIONS. THE STATES ARE DENIED THIS ESSENTIAL AUTHORITY, HOWEVER, BY THE FCC'S PREEMPTION DECISIONS. ALTHOUGH THESE DECISIONS ARE CURRENTLY UNDER REVIEW BY THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT, FOR THE PRESENT THE STATES ARE IN MANY RESPECTS POWERLESS TO REGULATE EFFECTIVELY RHC ENHANCED SERVICES.

IN LIGHT OF JUDGE GREENE'S ORDER AND THE INADEQUACIES OF THE FCC'S COMPUTER III REGIME, IT WILL BE INCUMBENT ON THE STATES TO STUDY CLOSELY AND CAREFULLY THEIR RESPECTIVE COURSES OF ACTION.

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

MY NAME IS PATRICIA WORTHY AND I AM CHAIRMAN OF THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA. I AM TESTIFYING TODAY ON BEHALF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC) IN MY CAPACITY AS VICE CHAIR OF ITS COMMITTEE ON COMMUNICATIONS.

THE NARUC IS A QUASI-GOVERNMENTAL, NONPROFIT ORGANIZATION FOUNDED IN 1889. WITHIN OUR MEMBERSHIP ARE THE GOVERNMENTAL AGENCIES OF THE FIFTY STATES, THE DISTRICT OF COLUMBIA, PUERTO RICO AND THE VIRGIN ISLANDS WHICH ARE ENGAGED IN THE REGULATION OF TELEPHONE UTILITIES. OUR CHIEF OBJECTIVE IS TO SERVE THE CONSUMER INTEREST BY SEEKING TO IMPROVE THE QUALITY AND EFFECTIVENESS OF GOVERNMENT REGULATION IN AMERICA.

THE ASSOCIATION APPRECIATES THIS OPPORTUNITY TO TESTIFY ON THE STATE OF COMPETITION IN THE INFORMATION SERVICES INDUSTRY, AND ON THE CONSENT DECREE COURT'S MARCH 7, 1988 DECISION ON THE PROVISION OF INFORMATION SERVICES BY THE SEVEN REGIONAL BELL HOLDING COMPANIES, OR RHCS. THESE DEVELOPMENTS, IN COMBINATION WITH RELATED ORDERS ISSUED IN RECENT MONTHS BY THE FEDERAL COMMUNICATIONS COMMISSION, WILL HAVE A TREMENDOUS IMPACT ON STATE REGULATION OF TELECOMMUNICATIONS. THE COMBINED EFFECT OF THESE NEW POLICIES HAVE STATE REGULATORS EXTREMELY CONCERNED.

LOOSENING THE INFORMATION SERVICES  
RESTRICTIONS ON THE RHCS

IN ORDER TO UNDERSTAND STATE REGULATORS' CONCERNS WITH JUDGE GREENE'S MARCH 7, 1988 DECISION ON INFORMATION SERVICES, ONE MUST UNDERSTAND THAT THE ROLE OF A FEDERAL JUDGE ENFORCING THE ANTITRUST LAWS IS DISTINCT FROM, AND ON SOME ISSUES, IN CONFLICT WITH, THE ROLE OF STATE UTILITY COMMISSIONERS OVERSEEING THE LOCAL OPERATIONS OF TELEPHONE COMPANIES.

THE INFORMATION SERVICES ORDER IS EXPLICIT IN THIS REGARD. JUDGE GREENE EXPLAINS THAT THE "FUNDAMENTAL PRINCIPLE OF JURISPRUDENCE IS THAT THE ANTITRUST LAWS PROTECT COMPETITION, NOT COMPETITORS".<sup>1/</sup> AT THE SAME TIME, HE NOTES THAT ANY BENEFITS REAPED BY RATEPAYERS AND CONSUMERS ARE ONLY TANGENTIAL IN NATURE. WHILE CONSUMERS BENEFIT FROM FAIR COMPETITION, THEIR INTERESTS ARE OF ONLY INDIRECT CONCERN. THE COURT EXPLAINED THAT "[THE ANTITRUST] LAWS SEEK TO FOSTER COMPETITION BY INCREASING THE NUMBER OF PROVIDERS IN THE MARKETPLACE AND THEREBY ALLOWING THE CONSUMERS, THROUGH DEMAND FOR SERVICES, TO SELECT THE WINNING FIRM".<sup>2/</sup> THAT IS NOT TO SAY THAT JUDGE GREENE'S DECISIONS FAIL TO CONSIDER THE PLIGHT OF OUR CITIZENS, FOR IN HIS SEPTEMBER 10, 1987 <sup>3/</sup> ORDER HE STATED, MOST EMPHATICALLY, THAT "THE PROTECTION OF CONSUMERS IS A FOREMOST OBJECTIVE OF THE ANTITRUST LAWS."<sup>4/</sup>

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<sup>1/</sup> United States v. AT&T, No. 82-0192, slip op. at 60, n.88 (D.C. March 7, 1988)

<sup>2/</sup> Id.

<sup>3/</sup> United States v. AT&T, No. 82-192, 673 F. Supp. 525

<sup>4/</sup> Id. at 585.

NEVERTHELESS, HE TEMPERED THAT POSITION BY STATING THAT THE "COURT'S DECISIONS ON THE CORE RESTRICTIONS DO NOT TURN ON THE FACTORS OF PROTECTION OF RATEPAYERS FROM PRICE GOUGING OR THAT OF UNIVERSAL SERVICE".<sup>5/</sup> JUDGE GREENE FURTHER NOTED THAT "UNIVERSAL SERVICE HAS BEEN EXPLICITLY DECLARED BY THE CONGRESS TO BE A PARAMOUNT NATIONAL OBJECTIVE, AND THE COURTS MAY BE EXPECTED TO AVOID TAKING ACTIONS, IF THAT CAN LEGITIMATELY BE DONE, THAT ARE INCONSISTENT WITH THIS OBJECTIVE".<sup>6/</sup>

UNLIKE THE ROLE DESCRIBED BY JUDGE GREENE FOR HIS COURT, THE PRIMARY ROLE OF STATE REGULATORS IS TO ENSURE UNIVERSAL SERVICE, THROUGH AFFORDABLE, REASONABLE AND NONDISCRIMINATORY RATES. TO ACHIEVE THESE GOALS, STATE REGULATORS MUST HAVE THE TOOLS NECESSARY TO PROTECT AGAINST DISCRIMINATION AND CROSS-SUBSIDIZATION BY THE RHC'S AND THEIR OPERATING COMPANIES. THE NARUC POLICY REGARDING THE JUSTICE DEPARTMENT'S FIRST TRIENNIAL REVIEW OF THE MFJ AND MOTIONS TO REVISE IT, DATING BACK TO FEBRUARY OF 1987, REFLECTS THOSE CONCERNS.

THE ASSOCIATION'S EXECUTIVE COMMITTEE ADOPTED A RESOLUTION [ATTACHMENT A] WHICH LISTS FOUR CONDITIONS FOR NARUC SUPPORT OF LIFTING ANY OF THE ORIGINAL LINE-OF-BUSINESS RESTRICTIONS ON THE RHCS. THEREFORE, IN EVALUATING JUDGE GREENE'S MARCH 7, 1988 DECISION ON INFORMATION SERVICES, WE MUST LOOK TO SEE IF THOSE CONDITIONS--THOUGH NOT NECESSARILY WITHIN JUDGE GREENE'S POWER TO SATISFY--HAVE, IN SOME WAY, BEEN MET. WHILE INDUSTRY CAN CLAIM

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<sup>5/</sup> Id. at n. 267.

<sup>6/</sup> 673 F. Supp. at 585.

THAT JUDGE GREENE HAS SHARED OUR CONCERN IN THE FIRST OF THESE CONDITIONS THAT "EACH SERVICE OR FUNCTION SHOULD BE VIEWED AND EVALUATED IN TERMS OF HOW IT CONTRIBUTES TO THE ENHANCEMENT OF A 'FULL SERVICE' NETWORK," WE FIND REGULATORY PROTECTIONS ADDRESSING OUR OTHER CONCERNS SORELY LACKING.

FOR INSTANCE, IT IS THE NARUC'S POSITION THAT THE ACCOUNTING OR CORPORATE FORM FOR THE OFFERING OF ANY NEW INTRASTATE SERVICE IS, FIRST AND FOREMOST, A STATE REGULATORY DECISION. STATES MUST BE FREE, AS STATED IN THE SECOND CONDITION, TO TREAT THESE SERVICES AS 'ABOVE THE LINE' OR 'BELOW THE LINE' ITEMS, AND TO REQUIRE ACCOUNTING SEPARATION PROCEDURES OR SEPARATE SUBSIDIARY REQUIREMENTS TO PROTECT FULLY THE INTERESTS OF CAPTIVE RATEPAYERS OF THE REGULATED COMPANY OR REGIONAL HOLDING COMPANY. HOWEVER, WHEN THE FCC BACKED AWAY FROM THE STRUCTURAL SEPARATIONS REQUIREMENT IN ITS COMPUTER III DECISION, IT ALSO PREEMPTED STATE REGULATORS FROM USING THAT METHOD TO PROTECT RATEPAYERS. THE NARUC AND THE STATES HAVE APPEALED THIS DECISION.<sup>7/</sup>

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<sup>7/</sup> IN LIGHT OF LOUISIANA PUBLIC SERVICE COMMISSION V. FCC, 476 U.S. 355 (1986), A NUMBER OF STATES AND THE DISTRICT OF COLUMBIA HAVE APPEALED THE COMPUTER III ORDERS TO THE EXTENT THAT THEY PREEMPT THE STATE REGULATION OF BOC PROVISION OF ENHANCED SERVICES. IN PART, THE APPEAL RESTS ON THE CONCLUSION THAT THE CASE UPHOLDING THE FCC'S COMPUTER II DECISION, HEAVILY RELIED UPON BY THE FCC IN ITS COMPUTER III PREEMPTIONS, MAY HAVE BEEN FLAWED, AND THAT LOUISIANA COMPELS A DIFFERENT RESULT. IN THAT PIVOTAL CASE, THE U.S. SUPREME COURT CLARIFIED AND REITERATED THAT CONGRESS CREATED A DUAL SCHEME OF FEDERAL-STATE REGULATION IN THIS COUNTRY, AND THAT THE FCC MAY NOT IGNORE THIS MANDATE IN ORDER TO EXPAND ITS POWER. THE STATES' APPEAL OF COMPUTER III IS NOW IN THE BRIEFING PHASE.

NOR HAVE NARUC'S THIRD AND FOURTH CONDITIONS BEEN MET. THE THIRD CONDITION STATES THAT "IN THE EVENT THAT AN AFFILIATE OF THE REGIONAL HOLDING COMPANY IS UTILIZED, THE STATE COMMISSION MUST HAVE THE AUTHORITY TO ENFORCE CONDITIONS DEEMED BY IT TO BE ESSENTIAL TO ASSURE THAT THE SWITCHED NETWORK WOULD BE ENHANCED OR PROTECTED FROM POSSIBLE EROSION OF ITS COST-EFFECTIVE INVESTMENT BASE." THE FOURTH CONDITION HOLDS THAT "THE STATE REGULATORY COMMISSIONS SHALL HAVE FULL ACCESS TO ALL BOOKS, RECORDS, FACILITIES AND PREMISE OF THE BOCS AND ALL AFFILIATED COMPANIES". THE DISTRICT COURT'S ORDER FAILS TO IMPOSE EITHER OF THESE REQUIREMENTS ON THE RHC'S OR CONDITION RHC INFORMATION SERVICES ON ADOPTION BY STATES OF RULES PROVIDING FOR THESE PROTECTIONS. BY ALLOWING THE RHCS' GREATER MARKET PRESENCE WHILE REJECTING THE OPPORTUNITY TO IMPOSE ADDITIONAL REGULATORY PROTECTIONS,<sup>8/</sup> JUDGE GREENE'S INFORMATION SERVICES DECISION ONLY EXACERBATES AN ALREADY DIFFICULT PROBLEM CAUSED BY THE FCC'S COMPUTER III DECISION. THE GREATEST THREAT TO CAPTIVE RATEPAYERS FROM RHC PROVISION OF COMPETITIVE SERVICE IS THE INCENTIVE FOR THE COMPANIES TO USE RATEPAYERS' DOLLARS TO SUBSIDIZE THEIR COMPETITIVE ACTIVITIES. EFFORTS UNDERTAKEN BY THE STATES IN 1984, 1985 AND 1986 TO AUDIT THE RHCS WERE COMPLICATED AND AT TIMES HINDERED BY PROBLEMS IN GAINING FULL ACCESS TO ALL CORPORATE BOOKS AND RECORDS, OF THE RHCS AND THEIR UNREGULATED AFFILIATES. THE STATES HAVE NO ASSURANCES FROM THE COURT OR THE FCC THAT FUTURE AUDITS WILL FACE THE SAME BARRIERS.

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<sup>8/</sup> Information Services Order at 48.

AS I MENTIONED, THESE WERE THE CONCERNS OF OUR COMMITTEE OVER A YEAR AGO. TODAY, I FEEL QUITE COMFORTABLE IN SAYING THAT THE CURRENT COMPOSITION OF OUR COMMITTEE INDICATES AN EVEN MORE CAUTIOUS AND SKEPTICAL APPROACH TO RHC FREEDOM.

THE INTERRELATIONSHIP BETWEEN THE  
INFORMATION SERVICES ORDER AND  
THE FCC'S COMPUTER III ORDERS

IN HIS INFORMATION SERVICES ORDER, JUDGE GREENE HAS ADOPTED A BROAD DEFINITION OF THE PERMISSIBLE INFORMATION TRANSMISSION ACTIVITIES THAT THE RHC'S MAY ENGAGE IN. THESE ACTIVITIES INCLUDE DATA AND VOICE STORAGE AND RETRIEVAL SERVICES, ELECTRONIC GATEWAYS TO INFORMATION SERVICE PROVIDERS, ELECTRONIC WHITE PAGES DIRECTORIES, KIOSK BILLING AND REVENUE SHARING, AND PROTOCOL CONVERSION. GIVEN THIS NEW LENIENCY ON THE PART OF THE CONSENT DECREE COURT, I THINK IT IS TIME FOR CONGRESS AND THE STATES TO ASSESS THE EFFECTIVENESS OF FEDERAL AND STATE REGULATORY POLICIES THAT ADDRESS THE POTENTIAL FOR THE RHCS TO ABUSE THEIR NEW MARKET POSITION. SPECIFICALLY, AS I MENTIONED EARLIER, THE NARUC TAKES ISSUE WITH THE FCC'S PREEMPTION OF STATE AUTHORITY IN ITS COMPUTER III RULING.

TO UNDERSTAND FULLY THE FCC'S PREEMPTION OF STATE AUTHORITY OVER RHC PROVISION OF INTRASTATE ENHANCED SERVICES, IT IS NECESSARY TO PROVIDE SOME BACKGROUND. THE FCC IN ITS COMPUTER II DECISIONS PROHIBITED STATES FROM REGULATING THE PROVISION OF ENHANCED SERVICES. AS JUSTIFICATION FOR ITS DECISION, THE FCC CONCLUDED THAT CONGRESS HAS INTENDED FOR AUTHORITY OVER SUCH



REGULATION TO RESIDE EXCLUSIVELY WITH THE FEDERAL GOVERNMENT, AND THAT AUTHORITY SHOULD NOT BE DIVIDED BETWEEN THE FCC AND STATES, AS COMMON CARRIER COMMUNICATIONS HAD BEEN. SECOND, IT RULED THAT THE STATES COULD NOT INTERFERE WITH THE FCC'S DECISION TO ALLOW AT&T TO PROVIDE ENHANCED SERVICES ON A STRUCTURALLY SEPARATED BASIS.

IN THE 1986 COMPUTER III ORDER, THE FCC CONCLUDED THAT BOCS WOULD BE PERMITTED TO OFFER ENHANCED SERVICES DIRECTLY, AND NOT THROUGH ARMS LENGTH SUBSIDIARIES, PROVIDED THAT THEY COMPLIED WITH CERTAIN NON-STRUCTURAL SAFEGUARDS. THESE SAFEGUARDS, INTENDED TO CREATE AN ENVIRONMENT CONDUCIVE TO FAIR COMPETITION BETWEEN BOCS AND ESPS, ARE AS FOLLOWS. ONE, THE BOCS MUST PROVIDE THE SAME ELEMENTS AND QUALITY OF NETWORK ACCESS TO ENHANCED SERVICE COMPETITORS THAT THE BOC USES FOR ITS OWN ENHANCED SERVICE ACTIVITIES. MOREOVER, THE BOCS MUST BEGIN TO CONFIGURE THEIR NETWORKS TO FACILITATE NETWORK ACCESS MORE BENEFICIAL TO COMPETITORS THAN CURRENTLY EXIST. THESE ARE THE COMPARABLY EFFICIENT INTERCONNECTION (CEI) AND OPEN NETWORK ARCHITECTURE (ONA) REQUIREMENTS. SECOND, THE COMPANIES MUST ADOPT SPECIAL ACCOUNTING METHODS TO ENSURE THAT THEIR REGULATED ACTIVITIES ARE NOT BEING USED TO SUBSIDIZE UNREGULATED ENHANCED SERVICE OFFERINGS. (IT IS INTERESTING TO NOTE THAT WHILE THE CURRENT FCC BELIEVES ACCOUNTING SAFEGUARDS PROVIDE ADEQUATE PROTECTION AGAINST THE DANGERS OF CROSS-SUBSIDIZATION AND OTHER ANTICOMPETITIVE ABUSES, A FEW YEARS BEFORE, IN COMPUTER II, THE FCC EXPLICITLY STATED THAT "WHILE ACCOUNTING HAS ALWAYS BEEN A

FUNDAMENTAL REGULATORY TOOL UTILIZED BY THIS COMMISSION IN THE EXERCISE OF OUR STATUTORY RESPONSIBILITIES, ITS USE HAS BY NO MEANS BEEN RECOGNIZED AS A SUBSTITUTE FOR STRUCTURAL SEPARATION."9/) THIRD, THE COMPANIES MUST REVEAL TO THE PUBLIC, IN A TIMELY FASHION, NETWORK TECHNICAL INFORMATION CONCERNING NEW ENHANCED SERVICE OFFERINGS. AND FOURTH, THE BELL OPERATING COMPANIES MUST PROVIDE INFORMATION CONCERNING CUSTOMERS' NETWORK USAGE AND CONFIGURATIONS TO ENHANCED SERVICE COMPETITORS IF THE CUSTOMER SO REQUESTS.

IN LIGHT OF JUDGE GREENE'S DECISION, WE MUST ALSO CONSIDER THE EFFECTIVENESS OF OPEN NETWORK ARCHITECTURE PLANS AS REPLACEMENTS FOR THE FCC'S STRUCTURAL SEPARATIONS REQUIREMENTS IN COMPUTER II. THE FCC DEADLINE FOR COMMENTS ON THIS QUESTION WAS JUST TWO DAYS AGO. THE NARUC FILED THE ATTACHED RESOLUTION [ATTACHMENT B] WHICH REFLECTS OUR CONCERNS THAT DEVELOPMENT OF THE ENHANCED SERVICES MARKET SHOULD NOT COME AT THE EXPENSE OF THE EXISTING FRAMEWORK FOR PROVIDING LOW-COST, HIGH-QUALITY BASIC LOCAL SERVICES, THAT ANY NEW COSTS ARISING FROM IMPLEMENTATION OF ONA BE BORNE BY THE 'COST-CAUSERS', THAT IS, THE ENHANCED SERVICE PROVIDERS, AND THAT STATE JURISDICTION OVER BASIC SERVICE RATES MUST NOT BE RESTRICTED BY FCC IMPLEMENTATION OF THE PLANS.

THE NARUC DID NOT FILE COMMENTS ON ANY SPECIFIC RHC PLAN, LEAVING THAT UP TO STATES WITHIN EACH REGION. THE D.C. PSC FILED COMMENTS INDEPENDENTLY HOWEVER, AS DID OTHER STATES. IN THE D.C.

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9/ Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), 77 FCC 2d 384, 464 (1980).

PSC'S VIEW, NONE OF THE ONA PLANS COMPLIES SUFFICIENTLY WITH THE FCC'S COMPUTER III REQUIREMENTS TO WARRANT APPROVAL BY THE FCC. AS SUCH, THE FCC SHOULD CONTINUE TO EXAMINE ON A SERVICE-BY-SERVICE BASIS, EACH NEW ENHANCED SERVICE EACH RHC INTENDS TO OFFER. ONLY IN THIS MANNER WILL THE BEST INTERESTS OF THE PUBLIC BE SERVED AND THE CREATION OF A TRULY COMPETITIVE ENHANCED SERVICE INDUSTRY GUARANTEED.

IN ITS COMMENTS, THE D.C. PSC ARGUES THAT THE MODEL ADOPTED BY THE RHCS FAILS TO PROVIDE THE LEVEL OF TECHNOLOGICAL CHANGE ENVISIONED BY THE FCC. THE FCC SPECIFICALLY STATED THAT ONA MUST INCORPORATE "A TECHNICAL DESIGN THAT SATISFIES THE [COMPARABLY EFFICIENT INTERCONNECTION] PARAMETERS," WHICH THE FCC CONSIDERS TO BE THE "HEART OF THE ABILITY OF AN OPEN NETWORK ARCHITECTURE DESIGN TO PROMOTE BOTH EFFICIENCY AND COMPETITION, AND WE WILL APPROVE SUCH A DESIGN ONLY IF WE ARE SATISFIED THAT IT ADEQUATELY MEETS THESE REQUIREMENTS."<sup>10/</sup> AS FILED, HOWEVER, THE ONA PLANS ARE NOTHING MORE THAN WARMED-OVER STATE TARIFF FILINGS--THEY PROPOSE LITTLE IN THE WAY OF TECHNOLOGICAL CHANGE, AND RELY INSTEAD ON REPACKAGING AND RENAMING EXISTING SERVICES. IT IS A REGULATORY QUICK-FIX. THIS RESHUFFLING OF EXISTING TARIFFS CANNOT BE THE TECHNICAL UPHEAVAL REQUIRED BY THE FCC'S COMPUTER III ORDERS TO CURE THE EVILS OF A CENTURY OF VERTICAL-INTEGRATION IN THE TELEPHONE INDUSTRY.

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<sup>10/</sup> Amendment of Section 64.702 of the Commission's Rules and Regulations, Report and Order, 104 FCC 2d 958 (1986), at para. 218 (emphasis added).

THE CHARACTERISTICS OF INTRASTATE MARKETS FOR TELEPHONE SERVICE CAN DIFFER SUBSTANTIALLY. TO BE EFFECTIVE, REGULATION MUST BE TAILORED SPECIFICALLY TO LOCAL MARKET CONDITIONS. IN THE CONTEXT OF THIS CASE, THE ENHANCED SERVICES MARKET IN A DENSELY POPULATED JURISDICTION, SUCH AS THE DISTRICT OF COLUMBIA, WILL BE MUCH DIFFERENT FROM THE MARKET THAT DEVELOPS IN IDAHO OR MAINE. WHILE COMPETITION AMONG ENHANCED SERVICES PROVIDERS MAY BE HEALTHY IN DENSE MARKETS, THERE MAY BE LITTLE OR NO COMPETITION IN SPARSELY POPULATED REGIONS. THE TYPES OF INDUSTRIES LOCATED IN VARIOUS AREAS OF THE COUNTRY WILL ALSO DICTATE THE CHARACTERISTICS OF THE LOCAL ENHANCED SERVICES MARKETS. DEMAND FOR ENHANCED SERVICES IN BOSTON WHERE BANKS AND INSURANCE COMPANIES PREDOMINATE WILL BE DIFFERENT THAN DEMAND FOR ENHANCED SERVICES IN THE AGRICULTURAL REGIONS OF IOWA OR WYOMING. THIS DIFFERENCE WILL BE BOTH QUALITATIVE AND QUANTITATIVE. DISPARATE INTRASTATE MARKETS CANNOT BE SUCCESSFULLY REGULATED BY A SINGLE, UNIVERSAL STANDARD DEVELOPED BY THE FCC.

RESERVING TO THE STATES THEIR PROPER ROLE OF MANAGING THE DEVELOPMENT OF LOCAL EXCHANGE COMPANIES THAT EVEN A LARGE COMMISSION STAFF WOULD FIND IT IMPOSSIBLE TO AUDIT FOR CROSS-SUBSIDIZATION IN EACH OF THOSE COMPANIES. STRUCTURAL SEPARATION, WHICH REQUIRES RELATIVELY LITTLE REGULATORY OVERSIGHT, MAY BE THE ONLY EFFECTIVE METHOD TO PREVENT CROSS-SUBSIDIZATION IN JURISDICTIONS WITH MANY LOCAL EXCHANGE

COMPANIES.<sup>11/</sup> THESE ARE EXACTLY THE KINDS OF LOCALIZED CONCERNS WHICH LED CONGRESS TO LIMIT THE FCC'S JURISDICTION PURSUANT TO SECTION 152(B) OF THE COMMUNICATIONS ACT OF 1934.

THE STATES HAVE A UNIQUE INTEREST IN INSURING THAT THE LOCAL EXCHANGE MARKET REMAINS VIABLE AND THAT LOCAL EXCHANGE COMPANIES DO NOT TAKE ADVANTAGE OF THEIR STATUS AS MONOPOLY PROVIDERS TO EXTRACT EXORBITANT RATES FOR BASIC TELEPHONE SERVICE. THE FCC'S ASSERTIONS THAT SAFEGUARDS MUST EXIST TO PREVENT CROSS-SUBSIDIES HAS LITTLE OR NO APPLICATION TO THE SUBSIDIZATION OF COMPETITIVE SERVICES THROUGH LOCAL EXCHANGE RATES.

THE FCC'S COMPUTER III ORDER FOCUSED ON OPENING THE NETWORK TO ENCOURAGE THE DEVELOPMENT OF THE ENHANCED SERVICES MARKET. IT IS OF NO CONCERN TO THE FCC IF BASIC TELEPHONE SERVICE SUBSIDIZES ENHANCED SERVICES SO LONG AS THE SUBSIDY DOES NOT RESULT IN DISTORTION OF THE MARKET.

IN DETERMINING THE APPROPRIATE REGULATION, RATES AND TREATMENT OF BASIC AND ENHANCED SERVICES OFFERED ON AN INTRASTATE BASIS ARE WITHIN THE EXCLUSIVE RIGHT OF THE STATES PURSUANT TO THE COMMUNICATIONS ACT OF 1934. THUS, THE FCC MAY NOT

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<sup>11/</sup> THE FCC HAS PROMULGATED IN CC DOCKET NO. 86-111 COST ALLOCATION REGULATIONS THAT IT ASSERTS WILL PREVENT CROSS-SUBSIDIZATION BETWEEN REGULATED AND UNREGULATED SERVICES. STATE REGULATORS HAVE NOT, THUS FAR, EMBRACED THIS APPROACH AS A MEANS TO PROTECT RATEPAYERS AGAINST MONOPOLY ABUSES. THE FINAL RESOLUTION OF THE COMPUTER III APPEAL WILL, MOST PROBABLY, AFFECT THE WAY STATE COMMISSIONS APPROACH THE PROBLEM. HENCE, THE INFORMATION SERVICES ORDER ALLOWS THE RHCS TO ENTER COMPETITIVE FIELDS WITH INADEQUATE PROTECTIONS AGAINST CROSS-SUBSIDIZATION OF INFORMATION SERVICE WITH REVENUES FROM BASIC LOCAL SERVICES.

REQUIRE STATE REGULATORS TO EMPLOY SPECIFIED REGULATORY TREATMENT OF ONA RELATED SERVICES OR APPLY A SPECIFIC REGULATORY PROCESS.

#### CONCLUSION

IN LIGHT OF JUDGE GREENE'S ORDER AND THE INADEQUACIES OF THE FCC'S COMPUTER III REGIME, IT WILL BE INCUMBENT ON THE STATES TO STUDY CLOSELY AND CAREFULLY THEIR RESPECTIVE COURSES OF ACTION. IT IS CLEAR THAT THE FCC'S PREEMPTION OF STATE REGULATION OF RHC PROVISION OF ENHANCED SERVICES MAY HAVE A CRIPPLING EFFECT ON STATES' ABILITY TO PROTECT THE INTERESTS OF THEIR RESIDENTS. AS SUCH, THE STATES WILL BE MONITORING CLOSELY THE PROGRESS OF THE NINTH CIRCUIT'S REVIEW OF THE COMPUTER III APPEAL. LIKEWISE, THERE WILL NO DOUBT BE CONSIDERABLE INTEREST IN THE PROGRESS OF THE PRESENT AND FORTHCOMING APPEALS OF JUDGE GREENE'S ORDERS.

**ATTACHMENT A**

**Resolution Supporting Conditions for  
Removal of Competitive Restrictions  
on Bell Operating Companies**

**WHEREAS, The United States Department of Justice (DOJ) has recommended to United States District Court Judge Harold Greene that the Modified Final Judgment (MFJ) in the AT&T Divestiture Case be further modified to permit the seven Regional Holding Companies (RHCs) to manufacture telephone equipment, to provide electronic information services, to offer long distance service in areas where the offering Bell Operating Company (BOC) does not have a State-protected monopoly local franchise, and to enter any other non-telecommunications business without the need to obtain special permission from the Court; and**

**WHEREAS, While the great uncertainty caused by the AT&T divestiture may have made it necessary for restrictions to be placed upon the competitive activities of the BOCs at the time the MFJ was approved, conditions in the industry have stabilized, making it appropriate to reconsider the MFJ; and**

**WHEREAS, Many regulated telephone companies have actively attempted by legislation, litigation, transfer of assets, corporate manipulation and other means to avoid regulatory accountability; and**

**WHEREAS, The authority of State regulatory agencies varies, which affects the ability of each State to monitor regulated activities; and**

**WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) is currently completing an audit of the relationship between the RHCs and the BOCs; and**

**WHEREAS, In the "Dartmouth Resolution" ratified by the NARUC Executive Committee in July, 1986, which resolution set forth conditions for removal of limitations on the BOCs, NARUC resolved as follows:**

**RESOLVED, By the Committee on Communications of the National Association of Regulatory Utility Commissioners that growing and maintaining a "feature rich" switched network that (a) spreads its richness to the broadest possible body of ratepayers through the application of low-cost (micro-electronic) technologies, and (b) seeks to expand the revenue base for maintaining the ubiquitous character of the switched network is fundamentally a function of State regulation; and be it further**

**RESOLVED, That the Committee on Communications of the National Association of Regulatory Utility Commissioners,**

subject to the conditions listed below, support the removal of constraints on information, enhanced and electronic publishing services, interLATA intrastate services, and manufacturing that is functionally related to the switched network, such as software; and be it further

RESOLVED, That activities which are not functionally related to responsibilities for maintaining a "features richness" and ubiquitous, switched network are not the primary concern of State commissions, except to the extent that the spawning of affiliates in non-essential or non-regulated areas may adversely affect the cost of capital to the regulated utility or divert its resources; and be it further

RESOLVED, That it should be recognized that the regional holding company probably provides the best insulation of the regulated utility subsidiary against ventures of other affiliates in high risk, non-essential or non-related activities; and be it further

RESOLVED, That any function or service to be authorized that is now proscribed by the MFJ should be integrated into the switched network of the BOC or otherwise structured to relate to the regulated operations in accordance with the following concepts:

(a) Each service or function should be viewed and evaluated in terms of how it contributes to the enhancement of a "full service" network for the purpose of determining how the function of service should be integrated in, or structured to, relate to the network;

(b) The accounting or corporate form for the offering of any new service is a State regulatory decision and may include treatment "above the line," or "below the line" through accounting separation or separate subsidiaries of the regulated company or regional holding company;

(c) In the event that an affiliate of the regional holding company is utilized, the State commission must have the authority to enforce conditions deemed by it to be essential to assure that the switched network would be enhanced or protected from possible erosion of its cost-effective investment base; and

(d) The State regulatory commissions shall have full access to all books, records, facilities and premises of the BOCs and all affiliated companies; now, therefore be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC),



assembled in its Winter Committee Meeting in Washington, D.C., strongly reaffirms the conditions of the Dartmouth Resolution, notes that the DOJ report does not address these conditions, and urges Judge Greene to give these conditions primary consideration in his response to the DOJ report; and be it further

RESOLVED, That the DOJ proposal be reviewed not only on antitrust grounds, but also on broader public interest grounds, as the Tunney Act directs; and be it further

RESOLVED, That the NARUC General Counsel be directed to file this resolution, the results of the NARUC audit of the RHCs, and other material deemed appropriate, with the MFJ Court of jurisdiction.

Sponsored by the Committee on Communications  
Adopted February 26, 1987

ATTACHMENT B

Resolution Regarding Open Network Architecture

WHEREAS, The Federal Communications Commission (FCC) in its Computer III Inquiry Order (CI III Order) has adopted a program of non-structural safeguards to replace the Computer Inquiry II requirement of structural separation between basic and enhanced services provided by the Bell Operating Companies (BOCs) and AT&T; and

WHEREAS, Important among these non-structural safeguards are Open Network Architecture (ONA) and Comparably Efficient Interconnection (CEI); and

WHEREAS, Detailed plans for ONA/CEI implementation have been filed by the FCC in CC Docket No. 88-2 on or before February 1, 1988; and

WHEREAS, These plans set forth terms and conditions for offering network services called "Basic Service Elements" (BSEs) and "Basic Service Arrangements" (BSAs); and

WHEREAS, This new regulatory scheme was developed out of the following FCC policy contained in the FCC's CI III Order; "ONA is the overall design of the carrier's basic network facilities and services to permit all users of the basic network, including the enhanced service operations of the carrier and its competitors to interconnect to specific basic network functions and interfaces on an unbundled and equal access basis"; and

WHEREAS, The States' responsibility for regulating local exchanges services can not be restricted by the FCC approval of ONA/CEI plans; and

WHEREAS, The FCC preemption of State authority in the CI III Order is on appeal in the U.S. Court of Appeals, 9th Circuit; now, therefore, be it

RESOLVED, By the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), assembled in its Winter Committee Meeting in Washington, D.C., that basic communications services are still the backbone of the public telecommunications network and that development of the enhanced services market should not come at the expense of the existing framework for providing low-cost, high-quality basic local services; and be it further

RESOLVED, That rates for all BSAs and BSEs that are local service offerings be set by the appropriate State regulatory authority; and be it further

RESOLVED, That pending the resolution of the CI III Order

appeal before the U.S. Court of Appeals, 9th Circuit, the FCC's adherence to the following basic principles will help to ensure that the potential efficiencies achievable in an ONA environment are obtainable without unduly burdening basic local service ratepayers:

(1) The existing division of State and Federal responsibilities for basic service regulation should be preserved in the ONA/CEI implementation process; and

(2) The FCC review of ONA/CEI plans should ensure that the plans provide for fair competition between AT&T and the BOCs and enhanced service providers; and

(3) ONA/CEI plans should ensure full public access to enhanced services, while not affecting the level of basic local service rates. Unbundling the network through the use of BSAs and BSEs should not be so excessive as to have the effect of increasing the aggregate cost of providing all network services and functions; and

(4) ONA/CEI plans should make existing and evolving network capabilities available without requiring major modifications to current network design, but, to the extent ONA and CEI impose new costs on the BOCs and AT&T, these costs should be borne by the "cost-causers", i.e., the enhanced service providers, including the enhanced service operations of the BOCs and AT&T; and

(5) BSA and BSE offerings should not adversely affect the price or availability of existing services nor should it justify withdrawal of existing services; and

(6) Users should not be forced to replace any existing services with one or more unbundled BSAs or BSEs; and be it further

RESOLVED, That the NARUC General Counsel be directed to file this resolution with the Federal Communications Commission in CC Docket No. 88-2.

Sponsored by the Committee on Communications  
Adopted March 3, 1988