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

CC Docket No. 87-568

In the Matter of

AT&T Communications — Transmittal No. 1409

Revisions to Tariff F.C.C. No. 12

MEMORANDUM OPINION AND ORDER

Adopted: January 26, 1989; Released: January 27, 1989

By the Chief, Common Carrier Bureau:

I. BACKGROUND

1. On November 16, 1988, American Telephone and Telegraph Company (AT&T) filed Transmittal No. 1409 to introduce Option IV of the Virtual Telecommunications Network Service (VTNS). VTNS IV is an integrated voice and data network designed for the use of a specific customer. This is the fifth in a series of non-governmental customer individualized offerings by AT&T which consist of a customized bundled service priced at a fixed rate over a specified time period.[1] VTNS IV is scheduled to become effective on January 30, 1989.

2. On December 1, 1988, the Independent Data Communications Manufacturers Association, Inc. (IDCMA) and US Sprint Communications Company (US Sprint) filed petitions for rejection or in the alternative suspension and investigation. Also on that date, MCI Communications Corporation (MCI) filed a petition for investigation, and Puerto Rico Telephone Company (PRTC) filed a petition for rejection of the filing. AT&T filed its reply on December 8, 1988.

II. SERVICE DESCRIPTION

3. AT&T states that VTNS is generally available at the request of customers, and that VTNS IV is offered pursuant to a specific customer's request for a service that provided the functions and efficiencies required by the customer. AT&T alleges that the customer was considering alternative offerings of other service providers, and requested and received assurance that there would be no restrictions on resale. AT&T Description and Justification (D&J) at 1-2. The general regulations for the first three options under VTNS apply to Option IV, and minor changes are proposed to be made to the general regulations to reflect the method of billing calls made to port access telephone numbers. *Id.*

4. VTNS IV is generally the same as the previous VTNS offerings, but is priced differently. Pursuant to VTNS IV, AT&T provides service to the United States, Puerto Rico, and the U.S. Virgin Islands through the use of both shared and dedicated facilities. The service is provided through the use of ports, port access telephone numbers, and data transmission capabilities, and is measured, for billing purposes, at an initial increment of 18 seconds and six-second increments thereafter. *Id.* at 4-12. AT&T provides a usage volume pricing plan on Rate Schedules A and B under which the customer receives a 10 percent discount during any month in which the usage from pre-selected ports exceeds30,000. *Id.* at 12-13. In addition, VTNS IV provides for installation, change, and termination charges. *Id.* at 13-16. Regulations specific to VTNS IV differ primarily in the details specific to the requirements of this customer, and include penalties for untimely completion of the network, network availability, adjustment for chronic outages, damages for failure to meet availability guidelines, and outage credit units. *Id.* at 17-22.

5. AT&T provides demand and revenue tables, and calculates the impact of VTNS IV on the other services of AT&T for the first full year that the service is installed, 1990. The tables are based upon estimates developed by the customer and AT&T, and represent demand by the number of ports at various transmission speeds, but provide no data regarding the demand level minutes of use. *Id.* at 22-23. AT&T states that there are no cross-elastic effects included in the calculations, because all of the customer's business would be lost were AT&T not providing this service. *Id.* at 24. Furthermore, since Option IV is a new offering, asserts AT&T, the cost of service study in Section 61.38 of the Commission's Rules[2] is not required. *Id.* at 25.

6. According to AT&T, the fully distributed prospective cost studies indicate that VTNS IV will have a positive impact on net earnings in 1990 in both the private line and switched services categories, and on total interstate earnings. *Id.* at 22-28 & Appendices B-D. AT&T also provides a revenue less costs analysis for VTNS IV calculated for both the initial three-year term, and the optional five-year term, on discounted and non-discounted bases. AT&T asserts that revenues exceed costs in each year, on a company-wide basis, when the revenues are based upon the customer's estimated usage or the minimum annual charge. *Id.* at 28-32.

III. PLEADINGS

7. Petitioners request the Commission to resolve the pending Tariff 12 investigations quickly, charging that not only does the delay in deciding the issues raised by the tariff 12 filings result in de facto deregulation of Tariff 12 offerings, but also invites the filing of new Tariff 12 options by AT&T. MCI Petition at 1; PRTC Petition at 3; IDCMA Petition at 2. IDCMA proposes that all of the issues necessary to the resolution of the Tariff 12 filings have been designated and addressed in the VTNS I investigation, and that an expedited resolution of the *VTNS I Designation Order* should be applied to all of the other Tariff 12 filings. IDCMA Petition at 3. Pending resolution of the Tariff 12 issues, however, MCI suggests that the Commission should undertake to explain to VTNS customers the result of VTNS being found unlawful by the Commission, asserting that AT&T has been informing potential customers that there is little or no risk that Tariff 12 will be found to be unlawful. MCI Petition at 2-3.

8. MCI argues that Tariff 12 should be offered via a general tariff, with unbundled elements, especially in light of the demand demonstrated by the number of VTNS

options filed by AT&T and the aggressive marketing of additional options by AT&T. *Id.* at 4-5. Petitioners contend that the offering of bundled standard services at discount rates, in addition to non-regulated equipment and services and network management, "locks in" major customers which AT&T is afraid of losing. *Id.* at 7-8; US Sprint Petition at 2-4; IDCMA Petition at 3-4. IDCMA argues further that non-carrier systems integrators cannot market their services or equipment on the VTNS network because only AT&T knows what constitutes VTNS. The failure of AT&T to offer basic transmission services on a non-discriminatory basis to all customers violates the Commission's pro-competitive customer premises equipment (CPE) policy. [3] MCI characterizes AT&T's individual offerings of service under Tariff 12 as self-deregulation, and asserts that the Commission must inspect the contracts under which VTNS is provided in order to ascertain exactly what services are being delivered. MCI Petition at 7-9.

9. Petitioners challenge AT&T's assertions that the price of VTNS IV covers the cost of providing this service to the customer. *Id.* at 5-6; US Sprint Petition at 4-8; IDCMA Petition at 8-9. MCI further questions the benefit to other AT&T customers of providing VTNS IV to this customer at a discount, especially when no "competitive necessity" defense is raised by AT&T. MCI Petition at 5-6. MCI also challenges the cross-elasticity assumption of AT&T, alleging that since 800 service numbers are not portable among interexchange carriers, it is unlikely that the VTNS IV customer would have taken its business to another carrier. MCI asserts that the lack of support for AT&T's claim regarding cross-elasticities supports a finding that AT&T has not complied with Section 61.38 of the Commission's Rules. *Id.* at 7.

10. US Sprint demonstrates that the average rate charged for each successive VTNS offering is decreasing, and asserts that not only are the rates charged for each VTNS option becoming increasingly non-compensatory, but that the discounts offered for VTNS service place upward pressure on AT&T's other rates. US Sprint Petition at 4-7. IDCMA also calculates rate comparisons between VTNS IV and other services of AT&T to demonstrate the discriminatory nature of the rates charged. IDCMA Petition at 8-9 & 9 n.15. US Sprint avers that the lack of data and the aggregation of other data provided by AT&T in support of its tariff filing is in violation of Section 61.38 of the Commission's Rules, and details inconsistencies it has calculated between the various VTNS options and other service offerings of AT&T. US Sprint Petition at 4-8.

11. PRTC argues that just because several VTNS options have been offered does not mean that the service is generally available. PRTC Petition at 2 n.3. The petitioners argue that VTNS is not generally available because it is available only to a specific customer, having only the detailed characteristics of the customer to whom the offer is made. US Sprint Petition at 1; IDCMA Petition at 5-7. This bundling of current services offered at a discount to a single customer is inconsistent with a system of tariffed services, argue the petitioners, and prevents resale. US Sprint Petition at 3-4; IDCMA Petition at 10. Therefore, this offering is in violation of the Commission's Private Line Guidelines[4] and is unlawful. US Sprint Petition at 4; IDCMA Petition at 10.

12. Petitioners also argue that because VTNS is like other services, only bundled to reflect a novel pricing structure, and is not generally available, the VTNS options constitute unreasonable discrimination on behalf of individual customers, and therefore violate Section 202(a) of the Act.[5] IDCMA notes that, to the degree VTNS purports to offer the equivalent of "fractional" 1.544 Mbps service at a discount, which is not available to other customers of AT&T, VTNS is unreasonably discriminatory. IDCMA Petition at 7-9. PRTC asserts that the use of the net revenue test is inappropriate because no competition exists for VTNS, VTNS contains unreasonable restrictions on resale, and the application of the net revenue test will permit cross-subsidization. PRTC Petition at 7-11. PRTC further asserts that the continued "approval" of VTNS will have an adverse impact on the delivery of universal service to the island of Puerto Rico. *Id.* at 11-13. All of the petitioners otherwise incorporate their remarks and objections from previous Tariff 12 pleadings filed with the Commission.

13. In its reply, AT&T asserts that its support material exceeds the requirements of the Commission's Rules, and that the support material demonstrates an increase in net earnings in the representative year of 1990.[6] AT&T reasserts that the customized configuration of voice and data provided by VTNS is not like any other existing tariff offering. AT&T also contends that not only does VTNS not contain explicit or implicit restrictions on resale, it furthers the Commission's resale policy because it is available to any customer, directly reflects costs, and allows for efficient use of AT&T's facilities. According to AT&T, VTNS complies with the private line guidelines. Moreover, AT&T asserts the non-tariffed practices that petitioners allege are not subject to review in tariff investigations, and that although VTNS does not involve the joint marketing of network services and CPE, AT&T would be permitted to engage in such activities pursuant to the Second Computer Inquiry Proceeding.[7]

14. AT&T also counters the arguments of petitioners that the tariff support material is insufficient. AT&T accuses MCI of questioning the customer's integrity when challenging AT&T's cross-elasticity adjustment, and asserts that contrary to US Sprint's claims of insufficient information, its filing was within the Commission's requirements. In addition, AT&T avers that the nationwide average for local exchange access costs is different in VTNS III and VTNS IV because the information used in the latter was unavailable when the former was filed. Even so, AT&T asserts that US Sprint's access costs adjustments would only amount to an insignificant amount, and would not affect the profitability of the offering.

15. AT&T furthermore asserts that the US Sprint comparisons of the VTNS options are inapt because each option is designed for a specific customer's needs, resulting in different configurations and facilities. Not only has the Commission found the assertions of US Sprint insufficient to warrant suspension or rejection in the past, asserts AT&T, such arguments are also unpersuasive here. AT&T Reply at 8-12. AT&T also challenges some petitioners' comparisons between VTNS IV rates and the rates for other AT&T services. AT&T avers that such comparisons "are wrong" because VTNS is not like any other AT&T service, and criticizes such comparisons as not taking into account the revenue commitment and unique calling

characteristics of VTNS which affect the rates charged for VTNS. Finally, AT&T asserts that VTNS revenues always exceed the relevant costs. *Id.* at 12-14.

IV. DISCUSSION

16. The Common Carrier Bureau has reviewed Transmittal No. 1409 and the pleadings filed by petitioners and by AT&T. We conclude that no compelling arguments have been presented that the tariff proposal is so patently unlawful as to warrant rejection.

17. We also conclude, however, that certain issues warrant further investigation. Inasmuch as we have already initiated an investigation to examine DTSN, VTNS I, VTNS II, and VTNS III, which present similar concerns, we will include this transmittal in the ongoing investigation of AT&T's Transmittal Nos. 895, 961, 1018, 1102, 1145, 1336, and 1349. We have also concluded that the VTNS IV offering should be subject to accounting safeguards to prevent subsidization of VTNS IV service with revenues from other services. This approach balances the interests of prospective VTNS IV customers, competing vendors, AT&T, and AT&T's ratepayers. We adopted similar mechanisms in our *DTSN Order*, *VTNS I Order*, *VTNS II Order*, and *VTNS III Order*, and found that such action provided a reliable safeguard against cross-subsidization.

18. Accordingly, we direct AT&T to offer the Virtual Telecommunications Network Service, Option IV, on a separate accounting basis. Specifically, revenue, cost, and investment amounts relating to the Virtual Telecommunications Network Service, Option IV, will be excluded from the Interim Cost Allocation Manual private line category for purposes of applying the equalization requirement and measuring compliance with applicable provisions of Part 65 of the Commission's Rules. This will ensure that rates for other AT&T Communications private line services are not increased to compensate for any earnings shortfall that may be produced by Virtual Telecommunications Network Service, Option IV. We waive the Interim Cost Allocation Manual and Part 65 requirements until further notice to the extent necessary to exclude the Virtual Telecommunications Network Service, Option IV.

V. ORDERING CLAUSES

19. Accordingly, IT IS ORDERED, that the petitions for rejection, suspension, and investigation of AT&T Communications Transmittal No. 1409 filed by the above-listed petitioners ARE GRANTED to the extent indicated herein, but are otherwise DENIED.

20. IT IS FURTHER ORDERED, pursuant to Sections 218 and 220(a) of the Communications Act, 47 U.S.C. §§ 218, 220(a), and the authority delegated under Sections 0.91(g) and 0.291 of the Commission's Rules, 47 C.F.R. §§ 0.91, 0.291, that AT&T shall separately account for revenues, costs, investment, and net earnings associated with Virtual Network Communications Service, Option IV, in accordance with para. 18, *supra*, until further notice.

21. IT IS FURTHER ORDERED that Part 65 of the Commission's Rules, 47 C.F.R. Part 65, IS WAIVED to the extent indicated in para. 18, *supra*.

22. IT IS FURTHER ORDERED, pursuant to Sections 4(i), 4(j), 201(b), 204(a), and 205 of the Communications Act, 47 U.S.C. §§ 154(i), 154(j), 201(b), 204(a) and 205, that an INVESTIGATION IS INSTITUTED into the lawfulness of the above-captioned tariff revisions and IS INCORPORATED into the Commission's ongoing investigation in CC Docket No. 87-568.

23. IT IS FURTHER ORDERED that American Telephone and Telegraph Company shall be a party to this proceeding.

FEDERAL COMMUNICATIONS COMMISSION

Gerald Brock
Chief, Common Carrier Bureau

FOOTNOTES

[1] The first four non-governmental offerings of custom service tariffs by AT&T are currently under investigation. These are Digital Tandem Switched Network (DTSN) Service (created for the General Electric Company), Transmittal Nos. 895 and 961, 2 FCC Rcd 5493 (1987) (*DTSN Order*), and Order Designating Issues for Investigation, CC Docket No. 87-568, 2 FCC Rcd 7389 (1987) (*DTSN Designation Order*); Virtual Telecommunications Network Service, Option I (VTNS I) (designed for the Dupont Company), Transmittal Nos. 1018 and 1102, 3 FCC Rcd 995 (1988) (*VTNS I Designation Order*) (designating issues for investigation and including them in the ongoing investigation in CC Docket No. 87-568); Virtual Telecommunications Network Service, Option II (VTNS II) (designed for the Ford Motor Company), Transmittal No. 1145, Memorandum Opinion and Order, 3 FCC Rcd 2837 (1988) (*VTNS II Order*) (indicating that VTNS II would be included in the CC Docket No. 87-568 investigation); and Virtual Telecommunications Network Service, Option III (VTNS III) (designed for American Express Company), Transmittal Nos. 1336 and 1349, Memorandum Opinion and Order, DA 88-1714, released Oct. 28, 1988 (*VTNS III Order*) (indicating that VTNS III would be included in the CC Docket No. 87-568 investigation) (collectively *Tariff 12 Investigation*).

[2] 47 C.F.R. § 61.38.

[3] IDCMA Petition at 3-4 (*citing* Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198, 205 (D.C.Cir. 1983)).

[4] 47 C.F.R. § 61.40.

[5] Communications Act of 1934, 47 U.S.C. 151 *et seq.* (Act). PRTC Petition at 4-7; US Sprint Petition at 4; IDCMA Petition at 7-9.

[6] AT&T Reply at 2-3. AT&T asserts that the net revenue standard is the appropriate standard for evaluating this offering, and that this information was provided in order to expedite the Commission's review of the tariff. AT&T characterizes Puerto Rico's objection to the use of the net revenue test as meritless because VTNS IV is justified on a fully distributed cost basis. *Id.* at 3 n.*.

[7] Furnishing of CPE and Enhanced Services by AT&T, 102 FCC 2d 655, 656 (1985), *on reconsideration*, 104 FCC 2d 739 (1986). *See AT&T* Reply at 2-8.