

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

CC Docket No. 87-568

In the Matter of

AT&T COMMUNICATIONS Transmittal Nos. 1336  
Revisions to Tariff F.C.C. No. 12 and 1349

### MEMORANDUM OPINION AND ORDER

Adopted: October 28, 1988; Released: October 28, 1988

By the Chief, Common Carrier Bureau:

#### I. BACKGROUND

1. On September 1, 1988, American Telephone and Telegraph Company (AT&T) filed Transmittal No. 1336 to introduce Option III of the Virtual Telecommunications Network Service (VTNS). On September 9, 1988, AT&T filed supplemental Transmittal No. 1349 which included automatic number identification (ANI) as a feature within VTNS Option III (VTNS III). Although VTNS III is described as a "generally available interstate service,"<sup>1</sup> VTNS III is an integrated voice and data network designed specifically for the use of American Express Company (American Express). This is the fourth 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.<sup>2</sup> VTNS III is scheduled to become effective on October 31, 1988.

2. On September 16, 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 September 26, 1988.

#### II. SERVICE DESCRIPTION

3. AT&T states that VTNS is generally available at the request of customers, and that VTNS III is offered pursuant to a customer's request for a service that met their specific needs and was functionally and economically competitive with other alternatives, including the offerings of other service providers or a customer owned network. D&J at 1-3. Accordingly, the rates for this service were set not only to recover the costs of providing the levels and quantities of service required by the customer, but also to be competitive with the customer's other alternatives. *Id.* at 6-7.

4. VTNS III is generally the same as the previous VTNS offerings, but offers a number of new or different features, and is priced differently from previous VTNS offerings.

VTNS III accommodates calls to or from customer specified non-port locations, provides 1.544 Mbps Data Transmission Capabilities (DTCs), and includes additional rate schedules and customer choices. *Id.* at 4-6. The initial rate period under Rate Schedules A-C is 18 seconds with one second increments. Ports which are used only for terminating traffic with the use of port access telephone numbers, when customer equipment provides answer supervision on the first ring in 90 out of every 100 calls, are charged under Rate Schedules D and E pursuant to a six second initial period with one second increments. *Id.* at 11-15. The customer must preselect one of two rate options for measured remote ports, option one for ports which both originate and terminate traffic, and option two for ports which only terminate traffic. *Id.* at 15. At the request of the customer, 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 exceeds \$30,000.00. *Id.* at 17. Two other new features included in VTNS III are a network prompter which allows a call to be routed by codes provided the caller by the network (*id.* at 18), and ANI. AT&T Transmittal No. 1349.

5. AT&T provides demand and revenue information regarding the impact of VTNS III on the other services of AT&T, and supporting financial information indicating that VTNS III recovers its costs on a fully distributed basis and on a revenue less costs basis. According to AT&T, prospective cost studies indicate that VTNS III will have a positive impact on net earnings in 1990 in both the private line and switched services categories, and on total interstate earnings. D&J at 28-35.

#### III. PLEADINGS

6. IDCMA asserts that VTNS III should be rejected because it is patently unlawful. In support of this claim, it demonstrates that each of the VTNS options are as individual as the customers themselves, and observes that not only are 1.544 Mbps DTCs being offered for the first time with a VTNS offering, but that the rates and elements of the three VTNS options differ substantially. IDCMA Petition at 7-8 & Appendix A. While AT&T has created general regulations for VTNS, the options themselves are not more generalized, asserts IDCMA. Since VTNS is not a generalized offering, it violates the basic tenet of common carriage that a common carrier "undertakes to carry for all people indifferently."<sup>3</sup> IDCMA further asserts that the pricing and conditions of service for VTNS III are unlawfully discriminatory, noting that AT&T does not deny that VTNS provides options to a customer that are not otherwise available. AT&T instead asserts that the bundled service capabilities for single customers achieve "economies" which are translated into customer specific discounts. IDCMA charges that AT&T never provides an explanation of these economies, nor explains why these cannot be made generally available. IDCMA asserts that this black box solution is simply a source of cheap bandwidth discounts to individual customers. *Id.* at 7-10 & n.8.

7. Allowing AT&T to justify these tariffs on the basis that "every customer is different," contends IDCMA, will effectively deregulate AT&T. IDCMA urges the Commission to conclude the pending Tariff 12 investigation immediately, and suspend VTNS III pending that decision.

The solution of the broader legal principles in the Tariff 12 investigation could then be applied to VTNS III. IDCMA contends that the continuing investigation allows the "commercial expectations" of AT&T to take precedence over the non-discrimination provisions of the Communications Act.<sup>4</sup> IDCMA believes that the Commission's failure to conclude the Tariff 12 investigation permits AT&T to continue to market Tariff 12 offerings, causing continued damage to the systems integrators market, and "raise the expectations of a major user of telecommunications services." *Id.* at 5-6, 17-19.

8. According to IDCMA, AT&T has claimed no new functionalities for VTNS; as a new service it uses the same facilities as AT&T's old services. The fact that VTNS III allows the customer to reduce the total number of ports and DTCs by as much as 50 percent, IDCMA continues, undercuts AT&T's arguments of the uniqueness of the offering, and the special knowledge of the customer's network required to construct VTNS. IDCMA compares the price of a number of components of VTNS III with AT&T's generally tariffed rates to calculate a discount of 33 percent for VTNS III 1.544 Mbps service. IDCMA asserts that this and other discounts, as well as the preferential treatment for fractional T-1 service to the VTNS III user, makes this offering inherently discriminatory. IDCMA interprets the location of Hubs and Measured Ports at AT&T's central offices, rather than at the customer's premises, as indicative of collocation, which is discriminatory in the provision of collocation opportunities. *Id.* at 11-15. IDCMA reasserts that the legal precepts for VTNS are deficient; not only is the legal basis unsound, the only unique feature of this service is its discriminatory pricing scheme. These facts, in addition to the inherent violation of the Commission's rate structure and resale guidelines, concludes IDCMA, requires rejection of the tariff. *Id.* at 15-17.

9. Finally, IDCMA maintains that the discriminatory method of providing transmission service represented by VTNS offerings violate the language and purpose of the Act, and that VTNS threatens to foreclose all competition from systems integrators. IDCMA Petition at 1-3. Not only are service integrators precluded from utilizing VTNS, because only AT&T knows what comprises VTNS, they cannot acquire transmission service at the same rates and conditions as provided by AT&T in its discounted bundle of services. IDCMA charges that AT&T's practice of filing VTNS tariffs after closing its deal further precludes the use of AT&T transmission services by system integrators competing in this market. According to IDCMA, VTNS reduces systems integrators to the role of commodity suppliers. In order to acquire AT&T transmission services for a customized package, systems integrators are left only with the choice of an unwanted partnership with AT&T. IDCMA asserts that this exposes the systems integrators to the risk of AT&T walking away with a customer once provided with the equipment based solution. *Id.* at 3-4.

10. US Sprint asserts that, even though AT&T describes this offering as generally available, the extensively detailed requirements for the number of ports in specific local access and transport areas (LATAs) and other aspects of this offering make clear that this offering is for the exclusive use of one customer. The only customization, asserts US Sprint, is the customized price, which includes shorter call duration periods than VTNS I and II, and volume discounts, both provided at the request of American Express. US Sprint Petition at 1-3 & n.2. US Sprint argues

that the bundling involved in VTNS III makes this offering effectively available to only one customer, which is inconsistent with a system of tariff regulation. US Sprint asserts that the tariff violates Section 202(a) of the Act by failing to be as generalized as possible, precluding resale, and evading the Commission's Private Line Guidelines.<sup>5</sup>

11. US Sprint further maintains that the tariff must be rejected or suspended because of serious deficiencies in the supporting information filed. Not only is the information on the MR-1 form meager, says US Sprint, the alleged profitability of VTNS III through an analysis of the rates charged under various schedules and the charges for access incorporated in various schedules is also questionable. US Sprint then protests the continued reduction of the information supplied regarding the expenses associated with VTNS offerings, and observes that many of these expense categories appear understated when compared with the information filed with the VTNS II tariff proposal. Without further information, concludes US Sprint, the reasonableness of the rates cannot be determined. *Id.* at 4-8.

12. MCI maintains that all four Tariff 12 arrangements resulted from one-on-one negotiations, and that such arrangements result in the capture of business for extended time periods. MCI Petition at 3. Issues of unjust and unreasonable advantages being given to VTNS customers to the detriment of other customers of AT&T, subsidies of VTNS by other AT&T customers, and compliance with the Commission's *Private Line Guidelines* and resale guidelines exist in this filing, as they do in all of AT&T's VTNS filings. *Id.* at 4-5. MCI asserts that without a timely analysis and conclusion of this matter, the Commission will only be "paying lip service" to its regulatory obligations, and that AT&T's potential customers will perceive little or no regulatory risk of the offers being rejected by the Commission. Under the current circumstances, the exceptions being created with the unresolved Tariff 12 filings will become the rule, with AT&T having effectively achieved deregulation without Commission action. *Id.* at 5-6.

13. MCI urges the Commission to require VTNS to be offered by a general tariff. *Id.* at 7. MCI contends that even AT&T recognizes the broader appeal of VTNS as AT&T itself describes VTNS as a generally available interstate service, yet the few general regulations in the VTNS tariff address none of the integral components of the offering. *Id.* at 8. The result, avers MCI, is a defensive "lock in" strategy which AT&T uses to capture targeted users and preserve the majority of the large user market. Although individual case basis rates are authorized by the Commission, notes MCI, these are allowed under only limited circumstances, none of which are present with the VTNS tariffs. *Id.* at 9. The failure of the Commission to require VTNS to be offered by general tariff will permit AT&T to continue to negotiate individual deals with targeted customers, an activity which MCI asserts the law does not allow. *Id.* at 10.

14. MCI further states that VTNS II and III must be examined, as VTNS I has been, to determine not only whether it is unjustly and unreasonably discriminatory but also whether there is discrimination among the three offerings.<sup>6</sup> It asserts that the Commission must apply a three part test which would compare services to determine if they are "like" services, determine if there is a disparity in the charges for or conditions of service, and analyze the disparity for justification.<sup>7</sup> MCI details a num-

ber of specific aspects of VTNS Options I, II, and III which differ, and suggests they should be investigated for discrimination. MCI asserts that only the offering of VTNS on an unbundled, general basis can prevent discrimination among present and future VTNS customers. *Id.* at 12-13. MCI also questions whether VTNS III is cross-subsidized at the expense of other AT&T customers, specifically identifying the difference in rates among the three VTNS options, the failure of AT&T to identify the cost causation or efficiencies which contribute to the alleged decrease in cost of service for these customers, and the unlikelihood that the Installation Charge recovers the marketing and sales expense resulting from nine months of negotiations, or the engineering and design expenses required to "customize" VTNS III. *Id.* at 13-15.

15. MCI also argues that VTNS III violates the Commission's *Private Line Guidelines*, and that AT&T fails to meet the burden of proof that dominant carriers must satisfy to justify departure from these requirements. According to MCI, VTNS III is not integrated into the same rate structures as its components, is restricted to a single customer, and fails to employ consistently-defined rate elements.<sup>8</sup> Finally, MCI asserts that VTNS III violates the Commission's policy against unreasonable restrictions against resale,<sup>9</sup> which protect against the targeting of preferential service to one customer to the exclusion of others. *Id.* at 17.

16. PRTC asserts that the prohibitions of Section 202(a) of the Act are very broad and prevent discriminatory tariffs like VTNS III, a tariff which is custom only in the sense that it provides favored rates to selected customers. PRTC Petition at 1-3. PRTC notes that AT&T attempts to justify VTNS III through the use of the net revenue standard, originally developed for optional calling plans,<sup>10</sup> but asserts that the use of this standard is improper in the present context. PRTC asserts that AT&T's overwhelming competitive advantage in the custom-designed services market, as well as the small size of this market, is much different than the large message telecommunications service (MTS) market in which there are many competitors, and therefore does not justify the expansion of the net revenue standard beyond the MTS market. The use of the net revenue test is also inappropriate, avers PRTC, where resale is impossible, as it is with VTNS offerings. PRTC also reasons that AT&T's expansion of the net revenue test from switched revenues to firm-wide revenues would allow for cross-subsidization from any of AT&T's service offerings, including non-regulated offerings. *Id.* at 3-6. Finally, PRTC objects to VTNS III on the basis that offerings such as this will inhibit the ability of PRTC and other "Commonwealth communications" entities to compete against AT&T, thereby threatening the basic sources of revenues for these companies, and eventually threatening universal service in Puerto Rico and other areas. *Id.* at 6-8.

17. In its reply, AT&T asserts that VTNS III was developed, as were all of the VTNS offerings, in response to the specific needs of individual customers, subject to the general VTNS regulations. AT&T maintains that it has provided all of the data required by the Commission's Rules, including fully distributed cost information showing a net profit in a representative year. AT&T Reply at 1-4. AT&T asserts that VTNS III is not limited to one customer, but that even if it were, nothing in the Act precludes a carrier from responding to a reasonable request for service from a customer. In fact, argues AT&T, such response would be

required by Section 201(a) of the Act. *Id.* at 4-6. AT&T states that to offer VTNS via a general tariff would destroy the unique economies of integration and design inherent to VTNS. It also asserts that VTNS does not restrict resale, and is in compliance with the Commission's *Private Line Guidelines*. Furthermore, AT&T claims, both MCI and US Sprint offer customized services, therefore any arguments of illegality would apply to them as well. *Id.* at 6-8. In response to the petition by IDCMA, AT&T states that tariff proceedings are not the proper vehicle for contesting untariffed practices, such as CPE marketing and collocation. AT&T avers that even though these are not part of VTNS III, such an offering would be consistent with the non-structural separations rules of the Commission, and in furtherance of the benefits the Commission intended to flow from the removal of structural separations.<sup>11</sup> AT&T concludes that its cost support is sound and that the attacks of the petitioners based upon the cost and other financial information provided misinterpret the materials provided by AT&T, or are wrong. *Id.* at 10-18.

#### IV. DISCUSSION

18. The Common Carrier Bureau has reviewed Transmittal Nos. 1336 and 1349 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.

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

20. Accordingly, we direct AT&T to offer the Virtual Telecommunications Network Service, Option III, on a separate accounting basis. Specifically, revenue, cost, and investment amounts relating to the Virtual Telecommunications Network Service, Option III, 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 III. We waive the Interim Cost Allocation Manual and Part 65 requirements through December 31, 1988, to the extent necessary to exclude the Virtual Telecommunications Network Service, Option III.

### V. ORDERING CLAUSES

21. Accordingly, IT IS ORDERED, that the petitions for rejection, suspension, and investigation of AT&T Communications Transmittal Nos. 1336 and 1349 ARE GRANTED to the extent indicated herein, but are otherwise DENIED.

22. IT IS FURTHER ORDERED, pursuant to Sections 218 and 220(a) of the Communications Act, 47 U.S.C. §§ 218 and 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 and 0.291, that AT&T shall separately account for revenues, costs, investment, and net earnings associated with Virtual Network Communications Service in accordance with para. 20, *supra*, until further notice.

23. 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. 20, *supra*.

24. 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.

25. 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

<sup>1</sup> AT&T Description and Justification (D&J) at 1.

<sup>2</sup> The first three 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); and 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) (collectively *Tariff 12 Investigation*).

<sup>3</sup> IDCMA Petition at n.5 (quoting *National Association of Regulatory Utility Commissioners v. F.C.C.*, 525 F.2d 601, 641 (D.C. Cir. 1976)).

<sup>4</sup> Communications Act of 1934, 47 U.S.C. 151 *et seq.* (Act).

<sup>5</sup> US Sprint Petition at 4. 47 C.F.R. § 61.40 (*Private Line Guidelines*).

<sup>6</sup> MCI Petition at 10-11. MCI comments that AT&T has a superior ability to engage in discrimination because of the unique ability AT&T has to provide a complete network solution through a combination of its own tariffed and non-regulated offerings and equipment. *Id.* at 11 n.22.

<sup>7</sup> *Id.* at 11 (referencing *MCI Telecommunications Corp. v. F.C.C.*, No. 86-1181, slip op. at 15 (D.C. Cir., Mar. 29, 1988)). MCI notes that although discrimination may be justified under a competitive necessity theory, no such claim is made here by AT&T (citing *AT&T v. F.C.C.*, 449 F.2d 439 (2d Cir. 1971)).

<sup>8</sup> *Id.* at 15-17 (citing specific language from *Private Line Rate Structure and Volume Discount Practices*, CC Docket No. 79-246, Report and Order, 97 F.C.C. 2d 923, 929-941 (1984)).

<sup>9</sup> *Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, 60 FCC 2d 261 (1976).

<sup>10</sup> *Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans*, CC Docket No. 84-1235, 50 Fed. Reg. 42945 (1985) (*OCP Guidelines Order*).

<sup>11</sup> AT&T Reply at 8-10 & n.\* (citing *Furnishing of CPE and Enhanced Services by AT&T*, 102 FCC 2d 655, 656, 678 (1985), on *reconsideration*, 104 FCC 2d 739 (1986)).