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FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Non-Accounting	)	CC Docket No. 96-149
Safeguards of Sections 271 and 272 of the	)	
Communications Act of 1934, as amended;	)	
	)	
and	)	
	)	
Regulatory Treatment of LEC Provision	)	
of Interexchange Services Originating in the	)	
LEC's Local Exchange Area	)	

NOTICE OF PROPOSED RULEMAKING

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TABLE OF CONTENTS

	<u>Paragraph</u>
I. INTRODUCTION . . . . .	1
A. <u>Background</u> . . . . .	5
B. <u>Overview of Sections 271 and 272</u> . . . . .	10
C. <u>Classification of Carriers as Dominant or Non-Dominant</u> . . . . .	15
II. SCOPE OF THE COMMISSION'S AUTHORITY . . . . .	19
A. <u>InterLATA Services and InterLATA Information Services</u> . . . . .	20
B. <u>Manufacturing Activities</u> . . . . .	30
III. ACTIVITIES SUBJECT TO SECTION 272 REQUIREMENTS . . . . .	31
A. <u>Manufacturing</u> . . . . .	35
B. <u>InterLATA Telecommunications Services</u> . . . . .	36
C. <u>InterLATA Information Services</u> . . . . .	41
1. Definition of "Information Services" . . . . .	42
2. InterLATA Nature of Information Services . . . . .	43

3.	Impact of the 1996 Act on Existing Commission Requirements for Information Services . . . . .	48
D.	<u>Overlap Between InterLATA Information Services and Services Subject to Other Statutory Requirements</u> . . . . .	51
IV.	STRUCTURAL SEPARATION REQUIREMENTS OF SECTION 272 . . . . .	55
A.	<u>Section 272(b)(1)</u> . . . . .	57
B.	<u>Section 272(b)(2)</u> . . . . .	61
C.	<u>Section 272(b)(3)</u> . . . . .	62
D.	<u>Section 272(b)(4)</u> . . . . .	63
E.	<u>Section 272(b)(5)</u> . . . . .	64
V.	NONDISCRIMINATION SAFEGUARDS . . . . .	65
A.	<u>Nondiscrimination Provisions of Section 272</u> . . . . .	65
B.	<u>Applicability of Pre-Existing Nondiscrimination Requirements</u> . . . . .	69
C.	<u>Section 272(c)(1)</u> . . . . .	72
D.	<u>Section 272(e)</u> . . . . .	80
1.	Section 272(e)(1) . . . . .	81
2.	Section 272(e)(2) . . . . .	86
3.	Section 272(e)(3) . . . . .	88
4.	Section 272(e)(4) . . . . .	89
VI.	MARKETING PROVISIONS OF SECTIONS 271 AND 272 . . . . .	90
VII.	ENFORCEMENT OF SECTIONS 271 AND 272 . . . . .	94
A.	<u>Mechanisms to Facilitate Enforcement of the Separate Affiliate and     Nondiscrimination Safeguards of Sections 271 and 272</u> . . . . .	94
B.	<u>Section 271 Enforcement Provisions</u> . . . . .	97
VIII.	CLASSIFICATION OF LECS AND THEIR AFFILIATES AS DOMINANT OR NON-DOMINANT CARRIERS . . . . .	108
A.	<u>Background</u> . . . . .	109
B.	<u>Definition of the Relevant Product and Geographic Markets</u> . . . . .	115
C.	<u>Classification of BOC Affiliates</u> . . . . .	130
D.	<u>Classification of Independent LECs or Their Affiliates</u> . . . . .	153
IX.	CONCLUSION . . . . .	163
X.	PROCEDURAL ISSUES . . . . .	164
A.	<u>Ex Parte Presentations</u> . . . . .	164
B.	<u>Regulatory Flexibility Analysis</u> . . . . .	165
C.	<u>Initial Paperwork Reduction Act of 1995 Analysis</u> . . . . .	166
D.	<u>Comment Filing Procedures</u> . . . . .	167

## I. INTRODUCTION

1. In February 1996, Congress passed and the President signed the "Telecommunications Act of 1996."<sup>1</sup> This legislation makes sweeping changes affecting all consumers and telecommunications service providers. The intent of this legislation is "to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."<sup>2</sup> Upon enactment, the 1996 Act permitted the Bell Operating Companies (BOCs)<sup>3</sup> to provide interLATA<sup>4</sup> services<sup>5</sup> that originate outside of their in-region states.<sup>6</sup> The

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<sup>1</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996 Act) to be codified at 47 U.S.C. §§ 151 et seq. (Hereinafter, all citations to the 1996 Act will be to the 1996 Act as it will be codified in the United States Code.) The 1996 Act amended the Communications Act of 1934 (Communications Act).

<sup>2</sup> See Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. Preamble (1996) (Joint Explanatory Statement); see also 47 U.S.C. § 706(a) (encouraging the deployment of advanced telecommunications capability to all Americans).

<sup>3</sup> For purposes of this proceeding, we define the term "BOCs" as that term is defined in 47 U.S.C. § 153(4).

<sup>4</sup> Under the 1996 Act, a "local access and transport area" (LATA) is "a contiguous geographic area (A) established before the date of enactment of the [1996 Act] by a [BOC] such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree; or (B) established or modified by a [BOC] after such date of enactment and approved by the Commission." 47 U.S.C. § 153(25). LATAs were created as part of the Modification of Final Judgment's (MFJ) "plan of reorganization" by which the BOCs were divested from AT&T. See United States v. Western Elec. Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983); United States v. Western Elec. Co., 569 F. Supp. 1057 (D.D.C. 1983) (Plan of Reorganization), aff'd sub nom. California v. United States, 464 U.S. 1013 (1983); see also United States v. Western Elec. Co., Civil Action No. 82-0192 (D.D.C. Apr. 11, 1996) (vacating the MFJ). Pursuant to the MFJ, "all BOC territory in the continental United States [was] divided into LATAs, generally centering upon a city or other identifiable community of interest." United States v. Western Elec. Co., 569 F. Supp. 990, 993 (D.D.C. 1983). The purpose of establishing the LATAs was only to delineate the areas within which the respective BOCs would be permitted to provide telecommunications services (i.e., intraLATA services); it was "not to distinguish the area in which a telephone call [would] be 'local' from that in which it [would] become a 'toll' or long distance call." Id. at 995. LATAs are comprised of combinations of local exchanges, and are generally much larger than the traditional local exchange areas and local calling areas defined by local regulators. While AT&T proposed to create 161 LATAs to cover the BOCs' territory, there were, at the time of the plan of reorganization, approximately 7,000 local exchanges within that territory. Id. at 993 n.9. There are currently 182 BOC LATAs. Bell Communications Research, Local Exchange Routing Guide, § 1, at 1-2 (Mar. 1, 1996) (Local Exchange Routing Guide).

1996 Act permits the BOCs to provide in-region interLATA services upon our finding that they have met the requirements of new section 271 of the Communications Act. Under section 271, we must determine, among other things, whether a BOC seeking to provide in-region interLATA services has complied with the safeguards imposed by new section 272 of the Communications Act and the rules that we adopt to implement the provisions of that section.<sup>7</sup>

2. In this Notice of Proposed Rulemaking (NPRM), we consider rules to implement, and, where necessary, to clarify the non-accounting separate affiliate and nondiscrimination safeguards prescribed by Congress in section 272. That section addresses the BOCs' provision of interLATA telecommunications services originating in states in which they provide local exchange and exchange access services, interLATA information services, and BOC manufacturing activities.<sup>8</sup> We also seek in this proceeding to determine whether to relax the dominant carrier classification that currently applies to the BOCs' provision of in-region, interstate, domestic interLATA services, and whether to apply the same regulatory classification to the BOCs' provision of in-region, international services.

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<sup>5</sup> The 1996 Act defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area." 47 U.S.C. § 153(21).

<sup>6</sup> See *id.* § 271(b)(2). For purposes of this proceeding, we define the term "in-region state" as that term is defined in 47 U.S.C. § 271(i)(1). We note that section 271(j) provides that a BOC's in-region services include 800 service, private line service, or their equivalents that terminate in an in-region state of that BOC and that allow the called party to determine the interLATA carrier, even if such services originate out-of-region. *Id.* § 271(j). See also Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, Report and Order, FCC 96-288 (rel. July 1, 1996) (Interim BOC Out-of-Region Order) (addressing BOC provision of out-of-region, domestic, interstate, interexchange services).

<sup>7</sup> 47 U.S.C. § 271(d)(3)(B). See discussion *infra* ¶ 10, regarding the requirements prescribed by section 271 for Commission approval of a BOC's application to provide interLATA services originating in its in-region states.

<sup>8</sup> The MFJ prohibited the BOCs from providing information services, providing interLATA services, or manufacturing and selling telecommunications equipment or manufacturing customer premises equipment (CPE). This prohibition was based on the theory that the BOCs could leverage their market power in the local market to impede competition in the interLATA services, manufacturing and information services markets. The information services restriction was modified in 1987 to allow BOCs to provide voice messaging services and to transmit information services generated by others. See United States v. Western Elec. Co., 673 F. Supp. 525 (D.D.C. 1987); United States v. Western Elec. Co., 714 F.Supp. 1 (D.D.C. 1988); 767 F.Supp. 308 (D.D.C. 1991). In 1991, the restriction on BOC ownership of content-based information services was lifted. United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991), *stay vacated*, United States v. Western Elec. Co., 1991-1 Trade Cases (CCH) ¶ 69,610 (D.C.Cir. 1991). The 1996 Act defines the term "AT&T Consent Decree" to refer to the MFJ and all subsequent judgments or orders related to the MFJ. 47 U.S.C. § 153(3). For the sake of clarity, in the text of this NPRM, we use the term "MFJ" only to refer to the initial decision reported at 552 F. Supp. 131, and will refer by specific citation to any subsequent related decisions.

3. This proceeding is one of a series of interrelated rulemakings that collectively will implement the 1996 Act. Certain of these proceedings focus on opening markets to entry by new competitors.<sup>9</sup> Other proceedings will establish fair rules for competition in these markets that are opened to competitive entry,<sup>10</sup> and yet other proceedings will focus on lifting outmoded legal and regulatory constraints.<sup>11</sup> We seek in the instant rulemaking to adopt safeguards to govern the BOCs' entry into certain new markets. Specifically, this proceeding focuses on the non-accounting BOC separate affiliate and nondiscrimination safeguards that Congress adopted in the 1996 Act to foster the development of robust competition in all telecommunications markets. As discussed more fully below, these safeguards are intended both to protect subscribers to BOC monopoly services, such as local telephony, against the potential risk of having to pay costs incurred by the BOCs to enter competitive services, such as interLATA services and equipment manufacturing, and to protect competition in those markets from the BOCs' ability to use their existing market power in local exchange services to obtain an anticompetitive advantage in those new markets the BOCs seek to enter.

4. This proceeding also examines whether the potential risks of BOCs' using market power in local exchange and exchange access services to obtain an advantage in the markets for BOC affiliates that provide in-region, interstate, domestic, interLATA services will be sufficiently limited such that we can relax the dominant carrier classification that under our current rules would apply to such interLATA services provided by a BOC affiliate. We also consider whether we should modify our existing rules for regulating the provision of in-region, interstate, interexchange services by an independent LEC (an exchange telephone company other than a BOC).<sup>12</sup> Finally, we consider whether to apply the same regulatory treatment to the BOC affiliates' and independent LECs' provision of in-region, international

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<sup>9</sup> See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Notice of Proposed Rulemaking, FCC 96-182 (rel. Apr. 19, 1996) (Interconnection NPRM).

<sup>10</sup> For example, we intend to address in an upcoming proceeding regarding local exchange carrier (LEC) provision of commercial mobile radio services (CMRS), whether and which safeguards should be established in order to ensure that LECs do not use their control over wireline local exchange facilities to gain an anticompetitive advantage in the CMRS market.

<sup>11</sup> See Common Carrier Bureau Seeks Suggestions on Forbearance, DA 96-798, Public Notice (rel. May 17, 1996); Policy and Rules Concerning the Interstate, Interexchange Marketplace: Implementation of Section 254(g) of the Communications Act of 1934, CC Docket No. 96-61, Notice of Proposed Rulemaking, FCC 96-123 (rel. Mar. 25, 1996) (Interexchange NPRM).

<sup>12</sup> We use the term "independent LECs" to refer to both the independent LECs and their affiliates. For purposes of this proceeding, we define an independent LEC's "in-region services" as telecommunications services originating in the independent LEC's local exchange areas or 800 service, private line service, or their equivalents that: (1) terminate in the independent LEC's local exchange areas, and (2) allow the called party to determine the interexchange carrier, even if the service originates outside the independent LEC's local exchange areas.

services, as we adopt for their provision of in-region, interstate, domestic, interLATA and in-region, interstate, domestic, interexchange services, respectively.

A. Background

5. The 1996 Act seeks to eliminate artificial legal and regulatory barriers, as well as economic impediments, to entry into telecommunications markets. This new scheme permits the BOCs to engage in the activities from which they were barred by the MFJ if they satisfy certain statutory conditions that are intended to prevent them from improperly using their market power in the local exchange market against their competitors in the interLATA telecommunications services, interLATA information services, and manufacturing markets, and from improperly allocating the costs of their new ventures to subscribers to local exchange access services, and if they have taken sufficient steps to open their local exchange networks to competition.

6. Enactment of the 1996 Act opens the way for BOCs to provide interLATA services in states in which they currently provide local exchange and exchange access services. Their provision of such interLATA services offers the prospect of increasing competition among providers of such services. BOCs can offer a widely recognized brand name that is associated with telecommunications services, the ability for consumers to purchase local, intraLATA and interLATA telecommunications services from a single provider (i.e., "one-stop shopping"),<sup>13</sup> and other advantages of vertical integration.<sup>14</sup> Similar benefits could follow from BOC provision of interLATA information services and BOC manufacturing activities.

7. In lifting or modifying the restrictions on the BOCs, the new regulatory scheme established by the 1996 Act indicates that BOC entry into in-region interLATA services raises issues for competition and consumers, even after a BOC has satisfied the requirements of section 271(d)(3)(A) and (C). BOCs currently provide an overwhelming share of local exchange and exchange access services in areas where they provide such

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<sup>13</sup> The BOCs' ability to offer a widely recognized brand name or one-stop shopping arises from economies of scope. There are economies of scope where it is less costly for a single firm to produce a bundle of goods or services together, than it is for two or more firms, each specializing in distinct product lines, to produce them separately. See, e.g., John C. Panzar and Robert D. Willig, Economies of Scope, 71 American Economic Review of Papers and Proceedings 268 (1981); William J. Baumol, John C. Panzar, and Robert D. Willig, Contestable Markets and the Theory of Industry Structure 71-79 (1982); Daniel F. Spulber, Regulation and Markets 114-15 (1989).

<sup>14</sup> Other firms may be able to provide similar benefits provided that they are able to provide local exchange services either through their own facilities or through resale of LEC services or network elements.

services -- approximately 99.5 percent of the market as measured by revenues.<sup>15</sup> If it is regulated under rate-of-return regulation, a price caps structure with sharing (either for interstate or intrastate services), a price caps scheme that adjusts the X-factor periodically based on changes in industry productivity, or if its entitlement to any revenues is based on costs recorded in regulated books of account, a BOC may have an incentive to improperly allocate to its regulated core business costs that would be properly attributable to its competitive ventures.

8. In addition, a BOC may have an incentive to discriminate in providing exchange access services and facilities that its affiliate's rivals need to compete in the interLATA telecommunications and interLATA information services markets. For example, a BOC could seek to grant undue preferences to its interLATA affiliate in furnishing such services and facilities, in order to gain a competitive advantage for its interLATA affiliate. Moreover, to the extent carriers offer both local and interLATA services as a bundled offering, if a BOC were to discriminate, it could entrench its position in local markets by making its rivals' offerings less attractive alternatives for local and access services. With respect to BOC manufacturing activities, a BOC may have an incentive to purchase only its own equipment, even if such equipment is more expensive or of lower quality than that available from other manufacturers. Although the 1996 Act permits the BOCs to engage in previously restricted activities, it imposes a mix of structural and non-structural safeguards that are intended to protect subscribers to BOC monopoly services and competitors against potential improper cost allocation and discrimination. Our goal in this proceeding is to establish non-accounting separate affiliate and nondiscrimination safeguards to implement Congress's objectives.

9. The emergence of efficient, facilities-based alternatives to the local exchange and exchange access services offered by the BOCs will, over time, eliminate the need for safeguards that Congress prescribed in the 1996 Act and the implementing rules that we will adopt in this proceeding.<sup>16</sup> We began the movement toward that ultimate goal when we adopted our NPRM to implement new section 251 of the Communications Act.<sup>17</sup> Other proceedings, such as our upcoming access reform rulemaking and the jurisdictional separations reform proceeding, also will contribute to achieving our goal of fostering efficient competition in local telecommunications markets. Until we reach that goal, we seek to minimize the burden on the BOCs of the rules that we adopt in this proceeding, but at the same time we seek to avoid the potential exposure of both ratepayers in local markets

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<sup>15</sup> Industry Analysis Division, Telecommunications Industry Revenue: TRS Worksheet Data, (Com. Car. Bur. Feb. 1996). Tables 18 and 15 show that BOC local and access revenues in 1994 were \$61.4 billion, while Competitive Access Provider local and access revenues both in and out of BOC regions was only \$281 million.

<sup>16</sup> The inclusion of sunset provisions within the section 272 regulatory scheme indicates a Congressional determination that ultimately most of the legislative safeguards will be unnecessary. See 47 U.S.C. § 272(f).

<sup>17</sup> See Interconnection NPRM.

controlled by the BOCs and competitors of the new BOC service providers to the potential risk of improper cost allocations and unlawful discrimination.

B. Overview of Sections 271 and 272

10. The 1996 Act conditions BOC entry into in-region interLATA service on compliance with certain provisions of sections 271 and 272. Section 271 sets forth prerequisites, including a competitive checklist requiring compliance with certain provisions in sections 251 and 252,<sup>18</sup> for approval of a BOC's application to provide in-region interLATA service. Section 271(b)(1) conditions a BOC's ability to provide interLATA service originating in its region upon receipt of Commission approval under section 271(d)(3). Section 271(d)(3), in turn, requires the Commission to make three findings before approving BOC entry. First, the Commission must find that the interconnection agreements or statements approved at the state level under section 252 satisfy the competitive checklist contained in section 271(c)(2)(B).<sup>19</sup> Second, the Commission must ensure that the structural and nondiscrimination safeguards mandated in section 272 will be met.<sup>20</sup> Finally, the Commission must find that BOC entry into the in-region interLATA market is "consistent with the public interest, convenience, and necessity."<sup>21</sup> In acting on a BOC's application for authority to provide in-region interLATA services, the Commission must consult with the Attorney General and give substantial weight to the Attorney General's evaluation of the BOC's application.<sup>22</sup> In addition, the Commission must consult with the applicable state commission to verify that the BOC complies with the requirements in subsection (c).<sup>23</sup>

11. Section 272 establishes separate affiliate requirements that apply to BOC provision of manufacturing of telecommunications equipment and CPE, interLATA telecommunications services that originate in-region (other than certain previously authorized activities<sup>24</sup> and certain incidental interLATA services<sup>25</sup>), and interLATA information services (in-region and out-of-region). The statutory separate affiliate requirements for manufacturing and in-region interLATA telecommunications services expire three years after a BOC or any

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<sup>18</sup> 47 U.S.C. § 271(c)(2)(B).

<sup>19</sup> Id. § 271(d)(3)(A). For purposes of section 271, such interconnection agreements must be made with a facilities-based competitor that meets specified criteria. See id. § 271(c)(1)(A).

<sup>20</sup> Id. § 271(d)(3)(B).

<sup>21</sup> Id. § 271(d)(3)(C).

<sup>22</sup> Id. § 271(d)(2)(A).

<sup>23</sup> Id. § 271(d)(2)(B).

<sup>24</sup> See id. § 272(a)(2)(B)(iii) and discussion infra ¶¶ 38-39.

<sup>25</sup> See id. § 272(a)(2)(B)(i) and discussion infra ¶ 37.

BOC affiliate is authorized to provide in-region interLATA services.<sup>26</sup> The statutory interLATA information services separate affiliate requirement expires four years after enactment of the 1996 Act.<sup>27</sup> The statute gives the Commission the discretion to extend either of these periods by rule or order.<sup>28</sup> This NPRM concerns the non-accounting separate affiliate and nondiscrimination requirements of sections 271 and 272.<sup>29</sup>

12. The structural separation requirements of section 272 are intended to prevent potential improper cost allocations by the BOCs in two principal ways. First, by requiring the BOCs and their separate affiliates to use different employees for their respective activities, section 272 allows the cost of each employee to be assigned directly to the appropriate entity thereby reducing the joint and common costs that require allocation between the telephone operating companies and the affiliates engaged in competitive businesses.<sup>30</sup> Second, by requiring a BOC to maintain appropriate records documenting transactions between the BOC and its affiliate, section 272 discourages the improper allocation of costs between the two entities by making detection of such practices easier.

13. The structural separation requirements of section 272, in conjunction with the affirmative nondiscrimination obligations imposed by that section, are intended to address concerns that the BOCs could potentially use local exchange and exchange access facilities to discriminate unlawfully against competitors in order to gain a competitive advantage for their affiliates that engage in competitive activities. These safeguards seek to prevent a BOC from discriminating in favor of its affiliates by, for example: 1) providing exchange access

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<sup>26</sup> Id. § 272(f)(1).

<sup>27</sup> Id. § 272(f)(2).

<sup>28</sup> Id. § 272(f). The statute does not specify the standard that the Commission should apply when deciding whether to extend the separate affiliate requirements beyond the sunset date.

<sup>29</sup> We have initiated a separate proceeding to address the non-accounting safeguards established by section 260 (applicable to LEC provision of telemessaging services), section 274 (applicable to BOC provision of electronic publishing), and section 275 (applicable to BOC/LEC provision of alarm monitoring services). See Implementation of the Telecommunications Act of 1996: Telemessaging, Electronic Publishing, and Alarm Monitoring Services, CC Docket No. 96-152, Notice of Proposed Rulemaking, FCC 96-310, (rel. July 18, 1996) (Electronic Publishing NPRM). We intend to address the safeguards established by section 273 (applicable to BOC provision of manufacturing activities) in a separate proceeding. The accounting safeguards required to implement sections 272 through 276 of the Communications Act are also addressed in a separate rulemaking proceeding. See Accounting Safeguards for Common Carriers Under the Telecommunications Act of 1996, CC Docket No. 96-150, Notice of Proposed Rulemaking, FCC 96-309, (rel. July 18, 1996) (Accounting Safeguards NPRM).

<sup>30</sup> In a regulatory context, costs are traditionally considered joint among two or more services when the services are produced in fixed proportions so that identification of separate incremental costs of each service is impossible even in the long run. A common cost is a cost that is shared among services that are produced in variable proportions, so that identification of incremental costs is possible, though perhaps difficult, in the long run. See Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 1 77-79 (1970).

services to its interLATA service affiliate at a lower rate than the rate offered to competing interLATA service providers; 2) providing a higher quality service to its interLATA service affiliate than the service it provides to competing interLATA service providers at the same price; 3) purchasing products needed for its local exchange network that are manufactured by its affiliate even when the affiliate's competitors offer the same or higher quality product at a lower price, or a higher quality product at the same price charged by the affiliate;<sup>31</sup> or 4) providing advance information about network changes to its competitive affiliates.

14. If a BOC charges its competitors prices for inputs that are higher than the prices charged, or effectively charged, to the BOC's affiliate, then the BOC can create a "price squeeze."<sup>32</sup> In that circumstance, the BOC affiliate could lower its retail price to reflect its unfair cost advantage, and competing providers would be forced either to match the price reduction and absorb profit margin reductions or maintain their retail prices at existing levels and accept reductions in their market shares. If the price squeeze was severe enough and continued long enough, the BOC affiliate's market share could become so large, and the competitors so weakened, that the affiliate could unilaterally raise and sustain a price above competitive levels by restricting its output.<sup>33</sup> Alternatively, the BOC affiliate could simply match its competitors' prices and extract supracompetitive profits. Unlawful discriminatory preferences in the quality of the service or preferential dissemination of information provided by BOCs to their affiliates, as a practical matter, can have the same effect as charging unlawfully discriminatory prices. If a BOC charged the same rate to its affiliate for a higher quality access service than the BOC charged to non-affiliates for a lower quality service, or disclosed information concerning future changes in network architecture to its manufacturing affiliate before the BOC disclosed it to others, the BOC could effectively create the same "price squeeze" discussed above.

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<sup>31</sup> To the extent that the price of a good exceeds the incremental cost of production, either to cover a fixed cost of production or because a firm is earning a higher than competitive level of profit, a BOC would prefer to purchase a good from its affiliate rather than an identical good at the same price from a competitor. Thus, a BOC would find it to be a profit maximizing strategy to purchase a lower quality product from its affiliate rather than a higher quality good from a competitor offered at the same price, if the benefits from "keeping the profit margin within the firm" exceed the benefits that can be derived from the superior quality of the competitor's product. Transactions between a parent and affiliate can potentially increase or decrease economic efficiency. See, e.g., F.M. Scherer, Industrial Market Structure and Economic Performance 300-306 (2d ed. 1980).

<sup>32</sup> See, e.g., P.L. Joskow, Mixing Regulatory and Antitrust Policies in the Electric Power Industry: The Price Squeeze and Retail Market Competition, in Antitrust and Regulation: Essays in Memory of John J. McGowan 173-239 (F.M. Fisher, ed. 1985); S.C. Salop and D.T. Scheffman, Raising Rivals' Costs, 73 *Amer. Econ. Rev. Papers & Proc.* 267 (1983); T.G. Krattenmaker and S.C. Salop, Anticompetitive Exclusion: Raising Rivals' Costs to Achieve Power over Price, 96 *Yale L.J.* 209 (1986).

<sup>33</sup> We note that this monopolistic price increase implicitly assumes: (1) the existence of barriers to entry into the interstate, interexchange market; and (2) limited capacity on the part of the affiliate's interexchange competitors.

C. Classification of Carriers as Dominant or Non-Dominant

15. Between 1979 and 1985, the Commission conducted the Competitive Carrier proceeding, in which it examined how its regulations should be adapted to reflect and promote increasing competition in telecommunications markets.<sup>34</sup> In a series of orders, the Commission distinguished two kinds of carriers -- those with market power (dominant carriers) and those without market power (non-dominant carriers).<sup>35</sup> In the Competitive Carrier Fourth Report and Order, the Commission defined market power alternatively as "the ability to raise prices by restricting output" and as "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."<sup>36</sup> The Commission recognized that, in order to assess whether a carrier possesses market power, one must first define the relevant product and geographic markets.<sup>37</sup> Throughout the Competitive Carrier proceeding, the Commission relaxed its tariff filing and facilities authorization requirements for non-dominant carriers and focused its regulatory efforts on constraining the ability of dominant carriers to exercise market power.<sup>38</sup>

16. This proceeding considers whether we should relax the dominant carrier regulation that under our current rules would apply to in-region, interstate, domestic, interLATA services provided by the BOCs' interLATA affiliates. As a preliminary matter, we note that there are two ways in which a carrier can profitably raise and sustain prices above competitive levels and thereby exercise market power. First, a carrier may be able to raise and sustain prices by restricting its own output (which usually requires a large market share); second, a carrier may be able to raise and sustain prices by increasing its rivals' costs or by restricting its rivals' output through the carrier's control of an essential input, such as

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<sup>34</sup> Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1 (1980) (Competitive Carrier First Report and Order); Fourth Report and Order, 95 FCC 2d 554 (1983) (Competitive Carrier Fourth Report and Order), vacated, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), cert. denied, MCI Telecommunications Corp. v. AT&T, 113 S. Ct. 3020 (1993); Fifth Report and Order, 98 FCC 2d 1191 (1984) (Competitive Carrier Fifth Report and Order) (collectively referred to as the Competitive Carrier Proceeding).

<sup>35</sup> See 47 C.F.R. § 61.3(o)

<sup>36</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 558, ¶¶ 7-8 (citing A. Areeda & D. Turner, Antitrust Law 322 (1978); Broadcast Music v. Columbia Broadcasting System, 441 U.S. 1, 20 (1979); W.M. Landes & R.A. Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937, 937 (1981)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as "the ability profitably to maintain prices above competitive levels for a significant period of time." 1992 Department of Justice/Federal Trade Commission Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104, at 20,569 (1992 Merger Guidelines).

<sup>37</sup> Competitive Carrier Fourth Report and Order, 95 FCC 2d at 562, ¶ 13.

<sup>38</sup> Id. at 575-80, ¶¶ 31-38; Competitive Carrier Fifth Report and Order, 98 FCC 2d at 1195-1200, ¶¶ 6-11.

access to bottleneck facilities, that its rivals need to offer their services. We seek comment on whether the BOC affiliates should be classified as dominant carriers under our rules only if we find that they have the ability profitably to raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting their own output, or whether the affiliates should be classified as dominant if the BOCs have the ability to raise and sustain prices of such interLATA services significantly above competitive levels by raising the costs of their affiliates' interLATA rivals.

17. We then seek comment, with respect to both types of market power, on whether the BOC affiliates should be classified as dominant or non-dominant. In considering whether a BOC affiliate could raise its prices by restricting its own output, we seek comment on whether, in light of the requirements established by, and pursuant to, sections 271 and 272, together with other existing Commission rules, the BOCs will be able to use, or leverage, their market power in the local exchange and exchange access markets to such an extent that their interLATA affiliates could profitably raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting their own output. In considering whether a BOC affiliate could cause increases in prices for in-region, interstate, domestic, interLATA services by raising the costs of its affiliate's interLATA rivals, we seek comment whether the statutory and regulatory safeguards will prevent a BOC from engaging in unlawful discrimination or other anticompetitive conduct that will raise its affiliate's rivals' costs. We also seek comment on whether regulating BOC in-region interLATA affiliates as dominant would help to prevent improper allocations of costs or discrimination by the BOCs in favor of their interLATA affiliates, or would at least mitigate the effects of such activities. We also consider whether we should modify our existing rules for regulating independent LECs' provision of in-region, interstate, interexchange services.<sup>39</sup>

18. Finally, we consider whether to apply the same regulatory classification to the BOC affiliates' and independent LECs' provision of in-region, international services as we adopt for their provision of in-region, interstate, domestic, interLATA services and in-region, interstate, domestic, interexchange services, respectively. In doing so, we emphasize that there is more than one basis for finding a United States (U.S.) carrier dominant in the provision of international services. The issue we address in this NPRM is whether a BOC

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<sup>39</sup> In our recent order addressing BOC provision of interLATA services originating out-of-region, we considered whether, on an interim basis, BOC provision of out-of-region services should remain subject to dominant carrier regulation. Interim BOC Out-of-Region Order at ¶ 2. We found, inter alia, that, on an interim basis, if a BOC provides out-of-region domestic, interstate, interexchange services offered through an affiliate that satisfies the separation requirements imposed on independent LECs in the Competitive Carrier Fifth Report and Order, we would remove dominant carrier regulation for such services. Id. In the Interexchange NPRM, we asked whether we should modify or eliminate the separation requirements imposed as a condition for non-dominant treatment of independent LEC provision of interstate, interexchange services originating outside their local exchange areas. Interexchange NPRM at ¶ 61. We also sought comment on whether, if we modify or eliminate these separation requirements for independent LECs, we should apply the same requirements to BOC provision of out-of-region interstate, interexchange services. Id.

affiliate or independent LEC should be regulated as dominant in the provision of in-region, international services because of the BOC or independent LEC's current retention of bottleneck facilities on the U.S. end of an international link. The separate issue of whether a BOC, an independent LEC, or any other U.S. carrier should be regulated as dominant in the provision of international services because of the market power of an affiliated foreign carrier in a foreign destination market was addressed by the Commission last year in the Foreign Carrier Entry Order.<sup>40</sup> That decision adopted a separate framework for regulating U.S. international carriers (including BOCs or independent LECs ultimately authorized to provide in-region international services) as dominant on routes where an affiliated foreign carrier has the ability to discriminate in favor of its U.S. affiliate through control of bottleneck services or facilities in the foreign destination market. No carriers are exempt from this policy to the extent they have foreign affiliations.

## II. SCOPE OF THE COMMISSION'S AUTHORITY

19. As a preliminary matter, we address the scope of the Commission's authority to adopt rules implementing the non-accounting provisions of sections 271 and 272 of the Communications Act, as amended. In the following subsections, we address the scope of the Commission's authority over interLATA services and interLATA information services and its authority over manufacturing activities.<sup>41</sup>

### A. InterLATA Services and InterLATA Information Services

20. Sections 271 and 272 by their terms address BOC provision of "interLATA" services and "interLATA" information services. Many states contain more than one LATA, and thus, interLATA traffic may be either interstate or intrastate.<sup>42</sup> Accordingly, we must determine whether sections 271 and 272, and our authority pursuant to those sections, apply

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<sup>40</sup> Market Entry and Regulation of Foreign-affiliated Entities, IB Docket No. 95-22, Report and Order, 11 FCC Rcd 3873 (1995) (Foreign Carrier Entry Order), recon. pending. Section 63.10(a) of the Commission's rules provides that: (1) carriers having no affiliation with a foreign carrier in the destination market are presumptively non-dominant for that route; (2) carriers affiliated with a foreign carrier that is a monopoly in the destination market are presumptively dominant for that route; (3) carriers affiliated with a foreign carrier that is not a monopoly on that route receive closer scrutiny by the Commission; and (4) carriers that serve an affiliated destination market solely through the resale of an unaffiliated U.S. facilities-based carrier's switched services are presumptively nondominant for that route. See also Regulation of International Common Carrier Services, CC Docket No. 91-360, Report and Order, 7 FCC Rcd 7331, 7334, ¶¶ 19-24 (1992) (International Services Order).

<sup>41</sup> Under the Communications Act, the term "manufacturing" has the same meaning as such term had under the MFJ. 47 U.S.C. § 273(h).

<sup>42</sup> For example, a call from San Francisco to Los Angeles is an intrastate interLATA call. Approximately 30 percent of interLATA traffic in 1994 was intrastate. See Industry Analysis Division, Telecommunications Industry Revenue: TRS Fund Worksheet Data, Table 6 (Com. Car. Bur. Feb. 1996).

only to interstate interLATA services and interstate interLATA information services, or to interstate and intrastate interLATA services and interstate and intrastate interLATA information services.

21. The MFJ, when it was in effect, governed BOC provision of both interstate and intrastate services. The 1996 Act provides:

Any conduct or activity that was, before the date of enactment of this Act, subject to any restriction or obligation imposed by the [MFJ] shall, on and after such date, be subject to the restrictions and obligations imposed by the Communications Act of 1934 as amended by this Act and shall not be subject to the restrictions and the obligations imposed by [the MFJ].<sup>43</sup>

This section supersedes the MFJ, and explains that the Communications Act is to serve as its replacement. As set forth below, we believe that section 271 and 272 of the Act were intended to replace the MFJ as to both interstate and intrastate interLATA services and interLATA information services. Thus, we propose that our rules implementing these sections apply to both interstate and intrastate services. We seek comment on this tentative conclusion, on our analysis, and on any alternative views that commenters may propose.

22. Sections 271 and 272 make no explicit reference to interstate and intrastate services, but they do make reference to a different geographic boundary -- the LATA, as originally defined by the MFJ and now by the 1996 Act. The interLATA/intraLATA distinction appears to some extent to have supplanted the traditional interstate/intrastate distinction for purposes of these sections.

23. As to interLATA services, the MFJ prohibited the BOCs and their affiliates from providing any interLATA services, interstate or intrastate, unless specifically authorized by the MFJ or a waiver thereunder.<sup>44</sup> Reading sections 271 and 272 as applying to all interLATA services fits well with the structure of the statute as a whole. Sections 251 and 252 of the Act establish rules and procedures for competitive entry into local exchange markets. In the Interconnection NPRM, we tentatively concluded that Congress intended these sections to apply to both interstate and intrastate aspects of interconnection.<sup>45</sup> These new obligations imposed on BOCs (as well as other LECs), enacted at the same time as sections 271 and 272, clearly are part of the process for entry into the interLATA marketplace. Indeed, BOCs are permitted to provide in-region interLATA services only after

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<sup>43</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, sec. 601(a), 110 Stat. 56, 143 (to be codified as a note following 47 U.S.C. § 152).

<sup>44</sup> United States v. Western Elec. Co., 552 F. Supp. 131, 227 (D.D.C. 1982) (subsequent history omitted).

<sup>45</sup> Interconnection NPRM at ¶ 25.

they have met the requirements of section 271, including a competitive checklist requiring compliance with certain provisions in sections 251 and 252.<sup>46</sup>

24. We note also that the structure of sections 271 and 272 themselves indicates that these sections were intended to address both interstate and intrastate services. For instance, BOCs are directed to apply for interLATA entry on a state-by-state basis, and the Commission is directed to consult with the relevant State Commission before making any determination with respect to an application in order to verify the BOC's compliance with the requirements for providing in-region interLATA services.<sup>47</sup> As we believe it did in sections 251 and 252, Congress appears to have put in place rules to govern both interstate and intrastate services, and provided a role for both the Commission and the states in implementing those rules.

25. By contrast, reading sections 271 and 272 as limited to the provision of interstate services would mean that the BOCs would have been permitted to provide in-region, intrastate, interLATA services upon enactment and without any guidance from Congress as to entry requirements or safeguards, subject only to any pre-existing state rules on interexchange entry. Any such rules, presumably, would not have been directed at BOC entry, which had for many years been prohibited. Concerns about BOC control of bottleneck facilities over the provision of in-region interLATA services are equally important for both interstate and intrastate services. Thus, the reasons for imposing the procedures and safeguards of sections 271 and 272 apply equally to the BOCs' provision of both intrastate and interstate, in-region, interLATA services. We find it implausible that Congress could have intended to lift the MFJ's ban on BOC provision of interLATA services without making any provision for orderly entry into intrastate interLATA services, which constitute approximately 30 percent of interLATA traffic.<sup>48</sup> Based on the preceding analysis, we tentatively conclude that our authority under sections 271 and 272 applies to intrastate and interstate interLATA services and intrastate and interstate interLATA information services provided by the BOCs or their affiliates.

26. We believe that section 2(b) of the Communications Act does not require a contrary result. Section 2(b) provides that, except as provided in certain enumerated sections not including sections 271 and 272, "nothing in [the Communications Act] shall be construed to apply or to give the Commission jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service by wire or radio of any carrier . . . ." <sup>49</sup> In enacting sections 271

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<sup>46</sup> 47 U.S.C. § 271(c).

<sup>47</sup> See id. § 271(d)(2)(B).

<sup>48</sup> See supra n.42.

<sup>49</sup> 47 U.S.C. § 152(b).

and 272 after section 2(b) and squarely addressing therein the issues before us, we tentatively conclude that Congress intended for sections 271 and 272 to take precedence over any contrary implications based on section 2(b). We note also, that in enacting the 1996 Act, there are instances where Congress indisputably gave the Commission intrastate jurisdiction without amending section 2(b).<sup>50</sup> Thus, we believe that the lack of an explicit exception in section 2(b) should in this instance create less of a presumption that the Commission's jurisdiction under sections 271 and 272 is limited to interstate services than would ordinarily be the case.

27. We seek comment on the jurisdictional analysis set forth above. In particular, we ask that parties disagreeing with this analysis set forth their own alternative analysis of how sections 271 and 272 apply to interstate and intrastate interLATA services and interLATA information services.

28. To the extent that commenters disagree with the analysis set forth above, we also seek comment on the extent to which the Commission may have authority to preempt state regulation with respect to some or all of the non-accounting matters addressed by sections 271 and 272. The Commission has authority to preempt state regulation of intrastate communications services where such state regulation would thwart or impede the Commission's exercise of its lawful authority over interstate communications services, such as when it is not "possible to separate the interstate and intrastate portions of the asserted FCC regulation."<sup>51</sup> Thus, we seek specific comment on (1) the extent to which it may not be possible to separate the interstate and intrastate portions of the regulations we propose here to implement sections 271 and 272, and (2) the extent to which state regulation inconsistent with our regulations may thwart or impede the Commission's exercise of lawful authority over interstate interLATA services. We seek comment, for example, on potentially inconsistent state regulations regarding: (1) a BOC affiliate's ability to use, co-use, or co-own facilities with the BOC; (2) a BOC affiliate's ability to share personnel with the BOC; and (3) a BOC's ability to discriminate in favor of its affiliate.

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<sup>50</sup> See, e.g., section 251(e)(1), which provides that "[t]he Commission shall have exclusive jurisdiction over those portions of the North American Numbering Plan that pertain to the United States;" section 276(b), which directs the Commission to "establish a per call compensation plan to ensure that payphone service providers are fairly compensated for each and every completed intrastate and interstate call;" and section 276(d), which provides that "[t]o the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements."

<sup>51</sup> Louisiana Public Service Comm'n, 476 U.S. 355, 375 n.4 (1986) (Louisiana PSC). See also California v. FCC, 39 F.3d 919, 932-33 (9th Cir. 1994) (California III), cert. denied, 115 S.Ct. 1427 (1995); Maryland Public Service Comm'n v. FCC, 909 F.2d 1510, 1515 (D.C. Cir. 1990); Texas Public Util. Comm'n v. FCC, 886 F.2d 1325, 1331 (D.C. Cir. 1989); Illinois Bell Tel. Co. v. FCC, 883 F.2d 104, 116 (D.C. Cir. 1989); National Ass'n of Regulatory Utils. Comm'rs v. FCC, 880 F.2d 422, 430 (D.C. Cir. 1989); North Carolina Util. Comm'n v. FCC, 552 F.2d 1036, 1043 (4th Cir.) (NCUC I), cert. denied, 434 U.S. 874 (1977); North Carolina Utils. Comm'n v. FCC, 537 F.2d 787, 793-94 (4th Cir.) (NCUC II), cert. denied, 429 U.S. 1027 (1976).

29. We note that when the Commission adopted rules to govern the BOCs' provision of enhanced services rules prior to the enactment of the 1996 Act,<sup>52</sup> it preempted certain inconsistent state structural separation requirements dealing with the intrastate portion of jurisdictionally mixed enhanced services.<sup>53</sup> The U.S. Court of Appeals for the Ninth Circuit upheld this exercise of our preemption authority, agreeing that the state separation requirements would essentially negate the Commission's goal of allowing BOC provision of interstate enhanced services on a non-separated basis.<sup>54</sup> Along the same lines, it is conceivable that a state may try to impose separate affiliate or nondiscrimination requirements on the intrastate portion of jurisdictionally mixed services that are inconsistent with the requirements in section 272. We believe that California III may provide support for Commission preemption of such inconsistent state regulations, to the extent that the regulations would thwart or impede the Commission's exercise of its authority over interstate interLATA services or interstate interLATA information services pursuant to sections 271 and 272. We seek comment on this analysis. We also seek comment on whether state regulation of intrastate services that is less stringent than the Commission's regulation of interstate services could thwart or impede the Commission's exercise of its authority over interstate, interLATA, information services.

#### B. Manufacturing Activities

30. To the extent that sections 271 and 272 address BOC manufacturing activities, we believe that the same statutory analysis set forth above would apply.<sup>55</sup> We see no basis for distinguishing among the various subsections of sections 271 and 272. Even apart from that analysis, however, we believe that the provisions concerning manufacturing clearly apply to all manufacturing activities. Section 2(b) of the Communications Act limits the Commission's authority over "charges, classifications, practices, services, facilities, or regulation for or in connection with intrastate communications service."<sup>56</sup> We believe that the manufacturing activities addressed by sections 271 and 272, however, are not within the scope of section 2(b). Alternatively, if section 2(b) applies with respect to BOC manufacturing, we believe that such manufacturing activities plainly cannot be segregated into interstate and intrastate portions. Thus, any state regulation inconsistent with sections 271 and 272 or our implementing regulations would necessarily thwart and impede federal policies, and should be preempted. We tentatively conclude, therefore, that our authority

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<sup>52</sup> See discussion infra ¶ 42, of relationship between "information services" and "enhanced services."

<sup>53</sup> Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, Report and Order, 6 FCC Rcd 7571, 7630, ¶ 121 (1991) (BOC Safeguards Order).

<sup>54</sup> See California III, 39 F.3d 919, 932-33 (1994).

<sup>55</sup> See infra ¶¶ 20-26.

<sup>56</sup> 47 U.S.C. § 152(b).

under section 272 extends to all BOC manufacturing of telecommunications equipment and CPE. We seek comment on this tentative conclusion.

### III. ACTIVITIES SUBJECT TO SECTION 272 REQUIREMENTS

31. Section 272 provides that a BOC (including any affiliate) that is a LEC subject to the requirements of section 251(c) may provide certain services only through a separate affiliate.<sup>57</sup> Under section 272, BOCs (or BOC affiliates) may engage in the following activities only through one or more affiliates that are separate from the incumbent LEC entity: (A) manufacturing activities;<sup>58</sup> (B) interLATA telecommunications services that originate in-region;<sup>59</sup> and (C) interLATA information services.<sup>60</sup> We discuss each of these activities separately below and seek comment where necessary about which activities are subject to the section 272 separate affiliate requirements.

32. We tentatively conclude that the separate affiliate and nondiscrimination safeguards adopted in this proceeding pursuant to section 272 will apply to a BOC's provision of both domestic and international interLATA telecommunications services that originate in a BOC's in-region states. The 1996 Act defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area."<sup>61</sup> Because this definition does not distinguish between domestic and international calls, we tentatively conclude that Congress intended to apply the same safeguards to BOC provision of domestic and international interLATA services that originate in-region. Similarly, in the provisions concerning interLATA information services, Congress has not distinguished between domestic and international provision of these services. The

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<sup>57</sup> Id. § 272(a)(1).

<sup>58</sup> Manufacturing activities are defined at 47 U.S.C. § 273(h). This subsection states that "manufacturing" has the same meaning as it had under the AT&T Consent Decree. Thus, "manufacturing" refers not only to the fabrication of telecommunications equipment and CPE, but also to the design and development of equipment. See United States v. Western Elec. Co., 675 F. Supp. 655, 663-64 (D.D.C. 1987) (subsequent history omitted).

<sup>59</sup> Section 272(a)(2)(B) exempts from the separate affiliate requirement for interLATA telecommunications services certain incidental interLATA services (as described in sections 271(g)(1), (2), (3), (5), and (6)), out-of-region services (as described in section 271(b)(2)), and previously authorized activities (as described in section 271(f)).

<sup>60</sup> Although they are information services (see 47 U.S.C. §§ 153(20), 272(a)(2)(C)), electronic publishing (as defined in section 274(h)) and alarm monitoring services (as defined in section 275(e)) are exempted from the section 272 separate affiliate requirements, and are subject to their own specific statutory separate affiliate and/or nondiscrimination requirements. See Electronic Publishing NPRM.

<sup>61</sup> 47 U.S.C. § 153(21).

1996 Act does not specify a definition for "interLATA information services."<sup>62</sup> Consequently, we tentatively conclude that the safeguards adopted in this proceeding will apply to BOC provision of both domestic and international interLATA information services. We seek comment on these tentative conclusions.

33. As a threshold matter, we note that section 272(a)(1) requires a BOC to provide services subject to the section 272 separate affiliate requirements through "one or more affiliates."<sup>63</sup> Based on this statutory language, we tentatively conclude that a BOC may, if it chooses, conduct all, or some combination, of its manufacturing activities, interLATA telecommunications services, and interLATA information services in a single separate affiliate, as long as all the requirements imposed pursuant to the statute and our regulations are otherwise met.<sup>64</sup> We seek comment on this tentative conclusion. If a BOC places its local exchange operations in a separate affiliate, pursuant to section 272(a)(1), the local exchange affiliate must be separate from the BOC affiliate or affiliates engaged in covered competitive activities.<sup>65</sup>

34. Section 272(h) provides that "[w]ith respect to any activity in which a Bell operating company is engaged on the date of enactment of the Telecommunications Act of 1996, such company shall have one year from such date of enactment to comply with the requirements of this section." Section 271(f) states "[n]either [section 271(a)] nor section 273 shall prohibit a [BOC] from engaging, at any time after the date of enactment of the [1996 Act], in any activity to the extent authorized by, and subject to the terms and conditions contained in" an order of the MFJ Court. As further discussed below, section 272(h) appears to cover activities included in the definition of "previously authorized activities" described in section 271(f).<sup>66</sup> We therefore seek comment on whether, subject to the exceptions discussed below, section 272(h) applies to the activities listed in section 272(a)(2)(A)-(C) that the BOCs were providing on the date the 1996 Act was passed. Parties contending that section 271(f) bars the Commission from applying section 272(h) to such activities should explain their interpretation of the requirements of section 272(h).

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<sup>62</sup> We seek comment on how to distinguish between interLATA and intraLATA information services *infra* in Section III.C.2.

<sup>63</sup> 47 U.S.C. § 272(a)(1).

<sup>64</sup> The Joint Explanatory Statement notes that the section 272 requirements were adopted from the Senate bill with several modifications. *See* Joint Explanatory Statement at 152. The Senate bill contained a separate affiliate requirement similar to that in the 1996 Act. *See* S. 652, 104th Cong., 1st Sess. § 252 (1995). The Senate Report noted that, "[w]here consistent with the requirements of this section, the activities required to be carried out through a separate subsidiary under this section may be conducted through a single entity that is separate and distinct from the entity providing telephone exchange service." *See* S. Rep. No. 104-23, 104th Cong., 1st Sess. 23 (1995).

<sup>65</sup> 47 U.S.C. § 272(a)(1).

<sup>66</sup> *See* discussion *infra* ¶¶ 38-39.

A. Manufacturing

35. Section 273(a) allows a BOC to manufacture and provide telecommunications equipment, and to manufacture CPE, if the Commission has authorized that BOC or any BOC affiliate to provide in-region interLATA services under section 271(d). BOCs may only engage in manufacturing activities through a separate affiliate that meets the requirements of section 272.<sup>67</sup> Section 273 sets out certain additional safeguards and nondiscrimination requirements applicable to BOC entry into manufacturing activities, including separate affiliate requirements applicable to entities that certify either telecommunications equipment or CPE manufactured by unaffiliated entities. As noted above, in this NPRM we address the non-accounting separate affiliate and nondiscrimination requirements of sections 271 and 272; we will address the additional safeguards established in section 273 in a separate proceeding.

B. InterLATA Telecommunications Services

36. Section 271 addresses the entry of the BOCs into the provision of three categories of interLATA telecommunications services: services that originate in-region, services that originate out-of-region, and incidental interLATA services. Section 272, in turn, requires a BOC to establish a separate affiliate for:

- (B) Origination of interLATA telecommunications services, other than
  - (i) incidental interLATA services described in paragraphs (1), (2), (3), (5), and (6) of section 271(g);
  - (ii) out-of-region services described in section 271(b)(2); or
  - (iii) previously authorized activities described in section 271(f).<sup>68</sup>

37. Under the 1996 Act, BOC provision of "incidental interLATA services" is treated differently than BOC provision of other in-region interLATA telecommunications services in two respects. First, section 271(b)(3) specifies that a BOC, or any BOC affiliate, may provide incidental interLATA services originating in any state immediately after the date of enactment of the 1996 Act, while section 271(b)(1) conditions BOC provision of other in-region interLATA services upon prior approval by the Commission. Second, section 272(a)(2)(B)(i) exempts from the section 272 separate affiliate requirement all of the

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<sup>67</sup> 47 U.S.C. § 272(a)(2)(A).

<sup>68</sup> Id. § 272(a)(2)(B). The 1996 Act defines "telecommunications" as "the transmission, between or among points specified by the user of information of the user's choosing without change in the form or content of the information as sent and received." Id. § 153(43). "Telecommunications service" is defined as "the offering of telecommunications for a fee directly to the public or to such classes of users as to be effectively available directly to the public regardless of facilities used." Id. § 153(46).

incidental interLATA telecommunications services listed in subsection 271(g),<sup>69</sup> except a BOC's provision of a service "that permits a customer that is located in one LATA to retrieve stored information from, or file information for storage in, information storage facilities of such company that are located in another LATA."<sup>70</sup> Section 271(h) requires that the Commission ensure that the provision of incidental services by a BOC or its affiliate "will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market," and states that the provisions of section 271(g) "are intended to be narrowly construed." We seek comment on what, if any, non-accounting structural or nonstructural safeguards the Commission should establish to implement the requirements of section 271(h). We seek comment regarding the interplay between section 271(h) and section 254(k), which prohibits telecommunications carriers from "us[ing] services that are not competitive to subsidize services that are subject to competition."<sup>71</sup> Parties proposing that the Commission adopt specific safeguards to implement section 271(h) should explain how these

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<sup>69</sup> Section 271(g) provides:

For purposes of this section, the term "incidental interLATA services" means the interLATA provision by a Bell operating company or its affiliate-

- (1)(A) of audio programming, video programming, or other programming services to subscribers to such services of such company or affiliate;
- (B) of the capability for interaction by such subscribers to select or respond to such audio programming, video programming, or other programming services;
- (C) to distributors of audio programming or video programming that such company or affiliate owns or controls, or is licensed by the copyright owner of such programming (or by an assignee of such owner) to distribute; or
- (D) of alarm monitoring services;

(2) of two-way interactive video services or Internet services over dedicated facilities to or for elementary and secondary schools as defined in section 254(h)(5);

(3) of commercial mobile services in accordance with section 332(c) of this Act and with the regulations prescribed by the Commission pursuant to paragraph (8) of such section;

(4) of a service that permits a customer that is located in one LATA to retrieve stored information from, or file information for storage in, information storage facilities of such company that are located in another LATA;

(5) of signaling information used in connection with the provision of telephone exchange services or exchange access by a local exchange carrier; or

(6) of network control signaling information to, and receipt of such signaling information from, common carriers offering interLATA services at any location within the area in which such Bell operating company provides telephone exchange services or exchange access.

<sup>70</sup> 47 U.S.C. § 271(g)(4).

<sup>71</sup> Id. § 254(k).

safeguards would be consistent with section 272(a)(2)(B)(i), which exempts incidental interLATA services from the section 272 separate affiliate requirements.

38. Section 272(a)(2)(B)(iii) exempts from "origination of interLATA telecommunications services" for which a separate affiliate is required "previously authorized activities described in section 271(f)."<sup>72</sup> We seek comment on whether, in light of section 272(h), Congress intended section 272(a)(2)(B)(iii) to grant a permanent exemption for previously authorized activities from the separate affiliate requirements of section 272.

39. We note that section 272(a)(2)(B)(iii) refers to "previously authorized activities" as defined in section 271(f), which includes manufacturing activities and interLATA information services. We also note that section 272(a)(2)(A) and (C) expressly require the BOCs to engage in manufacturing activities and the provision of interLATA information services in accordance with section 272. Therefore, we seek comment on whether sections 272(a)(2)(A) and (C), in combination with section 272(h), require that BOCs come into compliance with section 272, within one year of the date of passage of the 1996 Act, with respect to any manufacturing activities or interLATA information services in which they were engaged on the date of passage. We seek comment, in particular, on whether Congress intended to treat previously authorized manufacturing and interLATA information services differently from previously authorized interLATA telecommunications services.

40. Subject to the exceptions discussed in the preceding paragraphs, section 272 safeguards apply to interLATA telecommunications services which originate within a BOC's region.<sup>73</sup> Section 271(i)(1) defines an in-region state as "a State in which a Bell operating company or any of its affiliates was authorized to provide wireline telephone exchange service pursuant to the reorganization plan approved under the AT&T Consent Decree, as in effect on the day before the date of enactment of the Telecommunications Act of 1996." Section 153(4)(B) indicates that the definition of a BOC includes "any successor or assign of any such company that provides wireline telephone exchange service." We note that two pairs of BOCs have proposed to merge their operations (through both mergers and acquisitions).<sup>74</sup> If these or other mergers among the BOCs are completed, we believe, pursuant to section 153(4)(B), that the in-region states of the merged entity shall include all of the in-region states of each of the BOCs involved in the merger. We seek comment on

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<sup>72</sup> Section 271(f) is quoted *supra* ¶ 34.

<sup>73</sup> 47 U.S.C. § 272(a)(2)(B).

<sup>74</sup> See \$23-Billion Bell Atlantic-NYNEX Merger Draws Praise, Fire, Comm. Daily, Apr. 23, 1996 at 1; SBC-Pacific Telesis Merger Deal Could Trigger More Industry Consolidation, Analysts Say, Telecom. Rep., Apr. 8, 1996 at 1. Although initially proposed as a merger, the Bell Atlantic-NYNEX transaction has recently been recast as an acquisition of NYNEX by Bell Atlantic. See Bell Atlantic and NYNEX Submit Merger Details to State Commissions, Comm. Daily, Jul. 5, 1996 at 2. Our discussion in this section refers to both mergers and acquisitions.

this interpretation.<sup>75</sup> We are concerned, however, that our existing and proposed safeguards may not be sufficient to address potential concerns about the practices of proposed merger partners during the pendency of the merger. Specifically, a BOC could potentially discriminate, during this period, in favor of the interLATA affiliate of the BOC's future merger partner that is offering service in the BOC's in-region area. Therefore, we seek comment on what effect, if any, the entry into a merger agreement by two or more of the BOCs has upon the application of the section 271 and 272 non-accounting separate affiliate and nondiscrimination requirements to the BOCs that are parties to the agreement, and what, if any, additional safeguards are required to ensure that these BOCs do not provide the affiliates of their merger partners with an unfair competitive advantage during the pendency of their merger agreement. We note also the possibility that the BOCs may enter into joint ventures for the provision of interLATA services.<sup>76</sup> We seek comment regarding what effect, if any, joint venture arrangements involving two or more of the BOCs have upon the application of the section 271 and 272 requirements to those BOCs.

### C. InterLATA Information Services

41. The MFJ originally barred the BOCs from providing information services.<sup>77</sup> This restriction was subsequently narrowed,<sup>78</sup> and then eliminated entirely in 1991.<sup>79</sup> As a consequence, the BOCs were providing information services at the time the 1996 Act became law. We note that, although the 1996 Act distinguishes between in-region interLATA telecommunications services and out-of-region interLATA telecommunications services, no such distinction is made with respect to interLATA information services.<sup>80</sup> Specifically, section 272(a)(2)(B) excepts out-of-region interLATA telecommunications services described in section 271(b)(2) from the section 272 separate affiliate requirements. By contrast, section 272(a)(2)(C) states that a separate affiliate is required to provide "[i]nterLATA information services, other than electronic publishing (as defined in section 274(h)) and alarm monitoring

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<sup>75</sup> See also Interim BOC Out-of-Region Order, at ¶¶ 33-34 (discussing treatment of the provision of out-of-region services by BOCs that have entered a merger agreement).

<sup>76</sup> See Leslie Cauley, Long-Distance Alliance Set by Three Bells, Wall Street Journal, May 2, 1996 at A3; BellSouth, Pacific Bell and SBC Considering Joint Long Distance Buying, Comm. Daily, May 3, 1996 at 1.

<sup>77</sup> United States v. Western Elec. Co., 552 F. Supp. 131, 188-89 (D.D.C. 1982) (subsequent history omitted).

<sup>78</sup> United States v. Western Elec. Co., 714 F. Supp. 1 (D.D.C. 1988) (subsequent history omitted).

<sup>79</sup> United States v. Western Elec. Co., 767 F. Supp. 308 (D.D.C. 1991) (subsequent history omitted).

<sup>80</sup> As noted supra n.5, the 1996 Act defines "interLATA service" as referring to telecommunications service. See 47 U.S.C. § 153(21). Thus, where the 1996 Act draws distinctions between in-region and out-of-region "interLATA services," as it does in section 271(b), these distinctions do not apply to information services.

services (as defined in section 275(e))." Based on the statutory language, we tentatively conclude that the BOCs must provide interLATA information services through a separate affiliate, regardless of whether these services are provided in-region or out-of-region. We seek comment on this tentative conclusion.

#### 1. Definition of "Information Services"

42. The 1996 Act defines "information service" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control, or operation of a telecommunications system or the management of a telecommunications service."<sup>81</sup> We seek comment on what services are included in the statutory definition of information services. In this regard, we note that in the Computer III proceeding,<sup>82</sup> the Commission established rules for BOC provision of "enhanced services,"<sup>83</sup> pursuant to which the BOCs were permitted to provide certain enhanced services prior to the passage of the 1996 Act.<sup>84</sup> We seek comment on whether all activities that the Commission classifies as "enhanced services" fall within the

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<sup>81</sup> Id. § 153(20).

<sup>82</sup> Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer III), CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) (Phase I Order), recon., 2 FCC Rcd 3035 (1987) (Phase I Reconsideration Order), further recon., 3 FCC Rcd 1135 (1988) (Phase I Further Reconsideration Order), second further recon., 4 FCC Rcd 5927 (1989) (Phase I Second Further Reconsideration Order); Phase I Order and Phase I Reconsideration Order vacated, California v. FCC, 905 F.2d 1217 (9th Cir. 1990) (California I); Phase II, 2 FCC Rcd 3072 (1987) (Computer III Phase II Order), recon., 3 FCC Rcd 1150 (1988) (Phase II Reconsideration Order), further recon., 4 FCC Rcd 5927 (1989) (Phase II Further Reconsideration Order); Phase II Order vacated, California I, 905 F.2d 1217 (9th Cir. 1990); Computer III Remand Proceeding, 5 FCC Rcd 7719 (1990) (ONA Remand Order), recon., 7 FCC Rcd 909 (1992), pets. for review denied, California v. FCC, 4 F.3d 1505 (9th Cir. 1993) (California II); BOC Safeguards Order, 6 FCC Rcd 7571 (1991), vacated in part and remanded, California v. FCC, 39 F.3d 919 (9th Cir. 1994) (California III), cert. denied, 115 S. Ct. 1427 (1995).

<sup>83</sup> The Commission's existing regulatory framework distinguishes between "basic" services and "enhanced" services. Basic services are common carrier transmission services, and are subject to Title II regulation. Enhanced services, which combine common carrier services with non-common carrier services, are not subject to Title II regulation. Under the Commission's rules, the term "enhanced services" refers to "services, offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different, or restructured information; or involve subscriber interaction with stored information." See 47 C.F.R. § 64.702(a).

<sup>84</sup> Examples of services that the Commission has treated as enhanced services include: voice mail, fax, interactive voice response, protocol processing, gateway and audiotext information. See Bell Operating Companies Joint Petition for Waiver of Computer II Rules, 10 FCC Rcd 13,758, 13,770-74, app. A (1995) (BOC CEI Plan Approval Order).

statutory definition of "information service."<sup>85</sup> We note that the Joint Explanatory Statement states that the definition of "information services" used in the 1996 Act was based on the definition used in the MFJ.<sup>86</sup> If parties contend that "information services" differ from "enhanced services" in any regard, they should identify the distinctions that should be drawn between the two categories, describe any overlap between the two categories, and delineate the particular services that would come within one category and not the other.

## 2. InterLATA Nature of Information Services

43. Section 272(a)(2)(C) requires that a BOC provide interLATA information services only through a separate affiliate. In contrast, the 1996 Act does not establish any separate affiliate requirement for the provision of intraLATA information services. Under the Commission's existing regulatory scheme, enhanced services have not been regulated under Title II. Thus, the Commission previously has not made a regulatory distinction between intraLATA and interLATA information services, as the 1996 Act now does.

44. In order to determine which activities are subject to the separate affiliate requirement, we invite parties to comment on how we should distinguish between an interLATA information service and an intraLATA information service. In general, BOC provision of information services involves both basic underlying transmission components, which transmit end-user information without change in the form or content of the information, and enhanced or information service functionality, which generates, acquires, stores, transforms, processes, retrieves, utilizes or makes available end-user information. We seek comment regarding whether an information service (such as voicemail) should be considered an interLATA service only when the service actually involves an interLATA telecommunications transmission component. In the alternative, should we classify as an interLATA information service any information service that potentially involves an interLATA telecommunications transmission component (e.g., the service can be accessed across LATA boundaries)? We ask parties to comment with specificity upon the types of services that should be classified as interLATA or intraLATA information services.

45. We further request comment regarding whether and how the manner in which a BOC structures its provision of an information service affects whether the service is classified as interLATA, and thus subject to the separate affiliate and nondiscrimination

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<sup>85</sup> We note that prior to passage of the 1996 Act, neither the Commission nor the MFJ court resolved the question of whether enhanced services were equivalent to information services under the MFJ. Compare, e.g., United States v. Western Elec., 552 F. Supp. 131, 178, n.198 (D.D.C. 1982) (subsequent history omitted) (enhanced services "are essentially the equivalent of the 'information services' described in the proposed [consent] decree") with Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications by the Bell Operating Companies, 95 FCC 2d 1117, 1126, ¶ 21 (1983) (BOC Separations Order) (unclear whether the scope of enhanced services is congruent to that of information services).

<sup>86</sup> Joint Explanatory Statement at 116.