271 and 272, or whether less intrusive measures would be sufficient.

3. Section 275 - Alarm Monitoring Services

51. Section 275(e) defines "alarm monitoring service" as "a service that uses a device located at a residence, place of business, or other fixed premises (1) to receive signals from other devices located at or about such premises regarding a possible threat at such premises to life, safety, or property, from burglary, fire, vandalism, bodily injury, or other emergency, and (2) to transmit a signal regarding such threat by means of transmission facilities of a local exchange carrier or one of its affiliates to a remote monitoring center to alert a person . . ." about the emergency.[91] Section 275(a)(1) delays entry by the BOCs not already providing alarm monitoring services until five years from the date of enactment of the 1996 Act.[92] If a BOC or BOC affiliate provided alarm monitoring services as of November 30, 1995, it may continue to do so, but cannot expand its alarm monitoring business by acquiring "any equity interest in, or obtain financial control of, any unaffiliated alarm monitoring service entity" during the five-year period.[93]

52. Section 275(b)(2) specifies that an incumbent local exchange carrier engaged in the provision of alarm monitoring services "not subsidize its alarm monitoring services either directly or indirectly from telephone exchange service operations."[94] As with the prohibition against subsidizing telemessaging services, this prohibition against subsidizing alarm monitoring services specifically applies to incumbent local exchange carriers.[95]

53. We currently require carriers to treat alarm monitoring services as nonregulated activities for Title II accounting purposes. Accordingly, the Part 64 cost allocation rules require incumbent local exchange carriers to allocate the costs of those services to nonregulated activities. We invite comment on whether our present rules are necessary or sufficient to prevent subsidization of alarm monitoring services as defined in Section 275(e). Commenters asserting that our existing rules would not meet this objective should identify with specificity any deficiency in our rules, explain the nature of the deficiency, and describe, in

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[91] 47 U.S.C. § 275(e).

[92] Id. at § 275(a)(1).

[93] Id. at § 275(a)(2).

[94] Id. at § 275(b)(2).

[95] The provisions of the Act prohibiting the subsidy of alarm monitoring services "apply to incumbent exchange carriers rather than to all common carriers." S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 42 (1996).

detail, how the rules can be modified to remove that deficiency. We ask commenters asserting that rules are not necessary to identify which rules are not necessary and why they are not necessary.

54. Alarm monitoring, as defined in Section 275(e), appears to fall within the definition of "information service" in Section 3(20) of the Act. Alarm monitoring services, however, are specifically exempted from the separate affiliate and nondiscrimination requirements of Section 272. We seek comment on the extent of our authority, if any, under Section 275 over intrastate alarm monitoring services.

55. We further seek comment on what role States might have in implementing Section 275(b)(2)'s prohibition against subsidization of "alarm monitoring services either directly or indirectly from . . . telephone exchange service operations." We ask commenters to address whether we must change our policy, adopted prior to the enactment of the 1996 Act, of not preempting States from using their own cost allocation procedures for intrastate purposes.[96] We also invite comment on whether, in enacting Section 275(b)(2), Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures for alarm monitoring services in the States' regulation of "charges . . . for or in connection with intrastate communications service[s]."[97]

56. We also seek comment on whether, if Section 275 does not itself preempt, we have authority to preempt State regulation with respect to the accounting matters addressed by Section 275(b)(2) pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority.[98] We tentatively conclude that even if Section 275 does not itself preempt and if we have that authority pursuant to *Louisiana PSC*, we should refrain from exercising it in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular, whether preemption in this area would be necessary to achieve the intent behind Section 275(b)(2) or whether less intrusive measures would be sufficient.

4. Section 276 - Payphone Services

57. Section 276(a)(1) states that "any Bell operating company that provides payphone service shall not subsidize its payphone service directly or indirectly from its telephone

[96] Joint Cost Order, 2 FCC Rcd at 1310, paras. 88-93; id. at 1335-36, para. 293.

[97] See 47 U.S.C. § 152(b).

[98] Louisiana PSC, 476 U.S. at 375 n.4.

exchange service operations or its exchange access operations."[99] This prohibition against subsidization is an integral part of Congress's plan "to promote competition among payphone providers and promote the widespread deployment of payphone services to the benefit of the general public."[100] To implement the prohibition, Section 276(b)(1)(C) directs the Commission to prescribe nonstructural safeguards for BOC payphone service that, "at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding."[101] The Act defines the term "payphone service" as "the provision of public or semi-public pay telephones, the provision of inmate telephone service in correctional institutions, and any ancillary services."[102]

58. We tentatively conclude that we should apply accounting safeguards identical to those safeguards adopted in Computer Inquiry-III to prevent the subsidization of payphone services by BOC telephone exchange service or exchange access operations. We seek comment on this tentative conclusion. Commenters asserting that additional accounting safeguards are necessary to fulfill our responsibilities under Sections 276(a)(1) and (b)(1)(C) should identify the alternative safeguards and explain why they would better prevent the subsidies referred to in Section 276(a)(1).

59. All of the BOCs provide payphone service. In the past, we have treated payphone service as a regulated activity with applicable Part 32 plant, expense, and revenue accounts.[103] This classification appears inconsistent with the mandate in Section 276(b)(1)(C) that we prescribe nonstructural safeguards for payphone service because this past treatment allows payphone investment and expenses to be recorded as costs of the regulated service. We tentatively conclude that the new rules required by that section should reclassify payphone service as a nonregulated activity so that its costs should be separated from the telephone exchange service and exchange access operations that would continue to be regulated activities. Under this approach, the BOCs would continue to use the Commission's Part 32 accounts to record their payphone service activities, but would classify their payphone investment, expenses and revenues as nonregulated for Title II accounting purposes. We seek comment on this tentative conclusion and overall approach and, in particular, ask whether this proposal would comply with the 1996 Act's mandate to prescribe nonstructural accounting safeguards for the

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[99] 47 U.S.C. § 276(a)(1).

[100] Id. at § 276(b)(1).

[101] Id. at § 276(b)(1)(C).

[102] Id. at § 276(d).

[103] See 47 C.F.R. §§ 32.2351, 32.6351, 32.6623, and 32.5010.

BOCs' payphone services at least equal to those adopted in the Computer Inquiry-III proceeding. We also invite comment on whether this approach would prevent the subsidization of "payphone service" as defined in Section 276(d) by BOC telephone exchange service or exchange access operations.[104]

60. Section 276 does not prescribe or direct the Commission to prescribe accounting safeguards to govern the provision of payphone service by incumbent local exchange carriers other than the BOCs. We seek comment on whether we can and should require these other incumbent local exchange carriers to reclassify their payphone service operations as a nonregulated activity for Title II accounting purposes.

61. Section 276(c) states 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."[105] Thus, it is clear that the statute itself preempts any State regulations that may be inconsistent with our own. We invite comment on what role States might have in implementing Section 276(a)(1)'s prohibition against subsidization of "payphone service directly or indirectly from . . . telephone exchange service operations or . . . exchange access operations," given this clear statutory language and, in particular, whether in enacting Section 276(c), Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures in their regulation of "charges . . . for or in connection with intrastate communications service[s]."[106]

III. SAFEGUARDS FOR SEPARATED OPERATIONS

A. General

62. Section 272(a)(2) of the 1996 Act allows BOCs to provide the following services only through a separate subsidiary: manufacturing of telecommunications equipment and customer premises equipment;[107] origination of interLATA telecommunications services, other than incidental, out-of-region, and previously authorized services; and interLATA information services other than electronic publishing and alarm monitoring services.[108] Section

[104] 47 U.S.C. § 276(d).

[105] Id. at § 276(c).

[106] Id. at § 152(b).

[107] Pursuant to Section 273(h), 'manufacturing has the same meaning as such term has under the AT&T Consent Decree." Id. at § 273(h).

273(d)(3) requires "any entity which certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity . . . only [to] manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity for such class of equipment through a separate affiliate."[109] Section 274(a) requires that BOCs providing electronic publishing must do so only through a "separated affiliate" or electronic publishing joint venture.[110] These requirements for "separate" or "separated" affiliates or joint ventures implicitly assume that structural safeguards limit the carrier's ability to engage in subsidization.

63. In this section, we discuss the accounting safeguards needed to prevent subsidization where telephone operating companies do business with their nonregulated and regulated affiliates. In the *Joint Cost Order*, we adopted rules to govern the way costs are recorded, for Title II accounting purposes, when a regulated carrier does business with nonregulated affiliates.[111] These affiliate transactions rules are designed to protect interstate ratepayers from subsidizing the competitive ventures of incumbent local exchange carrier affiliates. The affiliate transactions rules do not require carriers or their affiliates to charge any particular prices for assets transferred or services provided; rather, the rules require carriers to use certain specified valuation methods in determining the amounts to record in their Part 32 accounts, regardless of the prices charged.[112]

64. We tentatively conclude that, except where the 1996 Act imposes specific additional requirements,[113] our current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services.[114] We invite comment on this tentative conclusion. We

[108] Id. at § 272(a)(2).

[109] Id. at § 273(d)(3). Section 273(d)(8)(D) defines "certification" as "any technical process whereby a party determines whether a product, for use by more than one local exchange carrier, conforms with the specified requirements pertaining to such product." Id. at § 273(d)(8)(D).

[110] Id. at § 274(a). Note that Section 274(h)(1) generally defines electronic publishing to mean the "[dissemination], provision, publication, or sale to an unaffiliated entity or persons" of certain enumerated services like, for example, news, entertainment, business, financial and legal information. Section 274(h)(2) exempts from the definition of electronic publishing various services, like e-mail, language translation services and network services upgrades. Id. at § 274(h)(1) and (2).

[111] See Joint Cost Order, 2 FCC Rcd at 1335-37, paras. 290-301.

[112] See 47 C.F.R. § 32.27.

[113] See, e.g., Section III.B.1.b., infra.

have previously concluded that these rules provide effective safeguards against subsidization.[115] Incumbent local exchange carriers have implemented internal accounting systems for affiliate transactions to help ensure their compliance with these rules. Redesigning these internal systems to accommodate a fundamentally different approach to affiliate transactions accounting systems would impose substantial costs on the carriers. We seek comment on these matters and, in particular, on whether the benefits of any fundamentally different approach to affiliate transactions would be outweighed by the costs that implementation of such a system might entail.

65. Although we do not propose an approach for affiliate transactions that is fundamentally different from our existing rules, we seek comment on whether we should modify our affiliate transactions rules in certain respects. The Commission and the telephone industry have had more than eight years experience with the cost allocation regime created by the *Joint Cost Order*. This experience has made us aware that amending certain aspects of the affiliate transactions rules might provide more optimal protection against subsidization.[116] In 1993, we released an *Affiliate Transactions Notice* proposing such rule changes, including changes in how subject carriers would value for Title II accounting purposes services they provide, or receive from, nonregulated affiliates.[117] We invite comment on whether, in implementing the 1996 Act's provisions regarding subsidization, we should amend the current affiliate transactions rules to incorporate certain of the modifications proposed in the *Affiliate Transactions Notice*.[118] We discuss these modifications below. We also invite comment on whether any additional changes to those rules might be necessary or appropriate to implement the requirements of the 1996 Act.

66. As a general matter, we solicit comment on how and to whom the affiliate transactions rules should be applied. For example, we could apply the accounting safeguards for affiliate transactions discussed in this Notice only to those entities that engage in activities for which the 1996 Act requires the use of a separate or separated subsidiary.[119] We could also

[114] 47 U.S.C. §§ 260, 272-276.

[115] Computer III Remand, 6 FCC Rcd at 7591, para. 46.

[116] See Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, 8 FCC Rcd 8071, 8076, para. 9 (1993) ("Affiliate Transactions Notice").

[117] Id.

[118] Id. This Notice largely supersedes the prior Affiliate Transactions Notice. We intend to address in a subsequent order in Docket No. 93-251 any matters in that rulemaking that remain unaddressed after completion of this proceeding.

[119] 47 U.S.C. §§ 272-274.

extend application of these safeguards to those incumbent local exchange carriers that engage in activities for which the 1996 Act allows, but does not require, the use of a separate subsidiary.[120] We discuss these approaches below. Finally, we invite comment on whether we should also apply any modifications to our affiliate transactions rules that we make in this proceeding to all transactions between incumbent local exchange carriers and their affiliates.[121]

B. Specific Services

1. Section 272 - Manufacturing and InterLATA Services

a. Statutory Language

67. Section 272(a) prohibits a "Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c)" from "provid[ing] any service described in [Section 272(a)(2)] unless it provides that service through one or more affiliates that (A) are separate from any operating company entity that is subject to the requirements of section 251(c); and (B) meet the requirements of [Section 272(b)]."[122] Section 272(a)(2) states that:

> [t]he services for which a separate affiliate is required by [Section 272(a)(1)] are: (A) [m]anufacturing activities (as defined in section 273(h)); (B) [o]rigination of interLATA telecommunications services, other than (i) incidental interLATA services described in [Section 271(g)(1)-(3) and (5)-(6)]; (ii) out-of-region services described in section 271(b)(2); or (iii) previously authorized activities described in section 271(f); [and] (C) [i]nterLATA information services, other than electronic publishing (as defined in section 274(h)) and alarm monitoring services (as defined in section 275(e)).[123]

Section 272(b)(2) requires each of these separate affiliates to "maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books,

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[120] For example, as discussed in Section III.B.4, infra, the 1996 Act does not require a non-BOC incumbent local exchange carrier to use an affiliate to provide telemessaging services. Thus, we seek comment here on whether our affiliate transactions rules should apply to transactions between a non-BOC incumbent local exchange carrier and its telemessaging affiliate.

[121] See 47 C.F.R. § 32.27.

[122] 47 U.S.C. § 272(a)

[123] Id. at § 272(a)(2).

records, and accounts maintained by the [BOC] of which it is an affiliate."[124] Under Section 272(b)(5), each of these separate affiliates must "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection."[125] Pursuant to Section 272(c)(2), BOCs must account for all transactions with these affiliates "in accordance with accounting principles designated or approved by the Commission."[126]

b. Accounting Requirements of Sections 272(b)(2) and (c)(2)

68. Section 272(b)(2) requires the separate affiliates prescribed under Section 272(a)(2) to "maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate." We invite comment on the steps we should take to implement this provision and, in particular, whether we should mandate that the separate affiliates required under Section 272(a)(2) maintain their books, records, and accounts in accordance with generally accepted accounting principles ("GAAP"). We ask the commenters to address whether it is necessary to adopt any additional accounting, bookkeeping, or record keeping requirements for these affiliates and, if so, what those additional requirements should be.

69. Pursuant to Section 272(c)(2), BOCs must account for all transactions with their separate affiliates required under Section 272(a)(2) "in accordance with accounting principles designated or approved by the Commission."[127] We invite comment on how we should implement this provision. To ensure that the amounts recorded in Part 32 accounts are based on reliable financial data, the *Affiliate Transactions Notice* proposed that, except as otherwise ordered by this Commission, all accounting related to affiliate transactions must comply with GAAP.[128] We invite comment on whether requiring such accounting would assist us in fulfilling our statutory obligation to ensure that each affiliate required under Section 272(a)(2) will "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis"[129] and, if so, whether we should adopt such a requirement.

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[124] Id. at § 272(b)(2).

[125] Id at § 272(b)(5).

[126] Id. at § 272(c)(2).

[127] Id.

[128] Affiliate Transactions Notice, 8 FCC Rcd at 8090-91, para. 51.

[129] 47 U.S.C. § 272(b)(5).

c. "Arm's Length" Requirement of Section 272(b)(5)

70. Section 272(b)(5) of the 1996 Act requires that transactions between the BOC and its affiliates engaged in the manufacturing activities, origination of interLATA telecommunications services, and interLATA information services described in Section 272(a)(2) be conducted on "an arm's length basis."[130] In the *Computer II Final Decision,*[131] we required AT&T to provide enhanced services and customer premises equipment only through a "separate corporate entity" that would "deal with any affiliated manufacturing entity only on an *'arm's length'*" basis.[132] We stated that "the transfer of any products" between this separate corporate entity and "any affiliated equipment manufacturer must be done at a price that is compensatory."[133] We also stated that, "[t]o police this requirement, we [would] require that any transaction between the enhanced services subsidiary and any other affiliate which involves the transfer (either directly or by accounting or other record entries) of money, personnel, resources or other assets be recorded in auditable form."[134] We invite comment on whether we should adopt similar requirements to implement Section 272(b)(5). We also invite comment on whether a requirement that prices be compensatory would be consistent with the Congressional intent behind Section 272(b)(5) and, in particular, any intent that ratepayers of regulated services benefit from the economies of scope from BOC manufacturing, origination of interLATA telecommunications services, and interLATA information services activities.

71. In *Computer III*, we reexamined our regulatory regime for the provision of enhanced services and replaced the *Computer II* requirements with a series of nonstructural safeguards. These safeguards included the Part 64 cost allocation rules and the affiliate transactions rules that we developed in the *Joint Cost Order*. The latter prescribe how incumbent local exchange carriers other than average schedule companies[135] must value their

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130 Id.

131 Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry), Final Decision, 77 FCC 2d 384 (1980) ("Computer II Final Decision"), recon., 84 FCC 2d 50 (1980), further recon., 88 FCC 2d 512 (1981), aff'd sub nom. Computer and Communications Industry Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

132 Computer II Final Decision, 77 FCC 2d at 498 (emphasis added)(adopting Section 64.702(c)(3) of the Commission's rules); see also id. at 482.

133 Id. at 482.

134 Id. at 483.

135 Many incumbent local exchange carriers receive compensation from the pools administered by the National Exchange Carrier Association, Inc. as either "cost companies" or "average schedule companies." Cost companies receive compensation for the use of their facilities in originating and terminating interstate common carrier

affiliate transactions for Title II accounting purposes.[136] These rules direct subject carriers to use different methods for valuing assets transferred and services provided. For asset transfers, the rules require that they use one of four methods: (1) tariffed rates;[137] (2) prevailing company prices;[138] (3) net book cost;[139] and (4) estimated fair market value.[140] Carriers must record each asset transferred to an affiliate pursuant to tariff at the tariffed rate. If an affiliate that sells a non-tariffed asset to its regulated carrier also sells the same kind of asset to third parties at a generally available price, the carrier must record the asset transfer at that prevailing company price. All other asset transfers must be recorded at the higher of net book cost and estimated fair market value when it is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the buyer (*i.e.*, from the affiliate).[141] The United States Court of Appeals for the District of Columbia Circuit affirmed the valuation methods for asset transfers, finding them "reasonably designed to prevent systematic abuse of ratepayers."[142]

72. The affiliate transactions rules authorize three valuation methods for determining the amounts carriers should record in their Part 32 accounts for services they provide to or obtain from affiliates: (1) tariffed rates;[143] (2) prevailing company prices;[144] and (3) fully distributed costs.[145] Carriers must record services provided to an affiliate pursuant to tariff at the

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communications services on the basis of their actual interstate costs of performing those functions. Cost companies perform studies of their total costs in accordance with Parts 32, 36, and 64 of the Commission's rules to determine their actual interstate costs. See 47 C.F.R. Parts 32, 36, and 64. Average schedule companies receive compensation for their interstate common carrier services on the basis of formulas that are designed to "simulate the disbursements that would be received...by a [cost study] company that is representative of average schedule companies." 47 C.F.R. § 69.606(a).

[136] See, e.g., Southwestern Bell Telephone Co., Order to Show Cause, 10 FCC Rcd 4407, 4407, para. 3 (1995).

[137] 47 C.F.R. § 32.27(c).

[138] Id. at § 32.27(b) & (c).

[139] Net book cost refers to costs less all applicable valuation reserves.

[140] 47 C.F.R. § 32.27(b) & (c).

[141] Id.

[142] Southwestern Bell Corp. v. FCC, 896 F.2d 1378, 1378 (D.C.Cir. 1990).

[143] 47 C.F.R. § 32.27(c).

[144] Id. at § 32.27(b) & (c).

tariffed rate. If an affiliate provides a non-tariffed service to its regulated carrier that it also provides to third parties, the carrier must record the transaction at the prevailing company price. All other affiliate services must be recorded at the service provider's fully distributed costs.[146]

73. As stated above, the Commission has released an *Affiliate Transactions Notice* that proposes certain rule changes to provide greater protection against subsidization.[147] We discuss certain of these proposed changes below. We solicit comment concerning whether our affiliate transactions rules, with the proposed changes, would be necessary or sufficient to ensure compliance with the "arm's length" requirement of Section 272(b)(5).

74. We also seek comment on whether and, if so, how we should amend our rules to address Section 272(b)(5)'s requirement that all transactions be "reduced to writing and available for public inspection."[148] We ask the commenters to address in particular whether Internet access to information about these transactions would be sufficient to comply with this requirement "for public inspection." We also invite commenters to suggest any other methods we could implement to comply with Section 272(b)(5). We seek further comment about whether we need to adopt safeguards to protect any sensitive or confidential information that these publicly available documents may contain.

75. We note that Section 272(e)(1) requires a "Bell operating company and an affiliate that is subject to the requirements of section 251(c)" to "fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access service within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates."[149] We interpret "transactions" under Section 272(b)(5) to include requests by an affiliate to its BOC for telephone exchange service or exchange access. We seek comment on this interpretation. We also seek comment on whether we should require information about such transactions to be made publicly available and, if so, whether we need to adopt safeguards to protect any sensitive or confidential information related to such transactions.

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[145] Id. at § 32.27(d).

[146] Id.

[147] See Affiliate Transactions Notice, 8 FCC Rcd 8071.

[148] 47 U.S.C. § 272(b)(5).

[149] Id. at § 272(e)(1).

i. Identical Valuation Methods for Assets and Services.

76. In the *Joint Cost Order*, we did not prescribe uniform valuation methods for all affiliate transactions.[150] In particular, if an asset transfer was neither tariffed nor subject to prevailing company prices, we required carriers to record the transfer at the higher of net book cost and estimated fair market value when it is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the purchaser. In contrast, the Commission required carriers to record all non-tariffed services other than those having prevailing company prices at the providers' fully distributed costs.[151]

77. If we apply our affiliate transactions rules, with the changes proposed in this Notice, to transactions between the BOC and its affiliates engaged in the manufacturing, origination of interLATA telecommunications services and interLATA information services described in Section 272(a)(2) of the 1996 Act, we believe we should consider prescribing uniform valuation methods for all affiliate transactions. In the *Affiliate Transactions Notice*, we tentatively concluded that our treatment of the provision of services that are neither tariffed nor subject to prevailing company prices[152] may reward a carrier's imprudent acts of buying services for more than, and selling services for less than, fair market value.[153] By requiring carriers to record services they sell to nonregulated affiliates at the carriers' fully distributed costs even when those costs are less than what non-affiliates would pay the carriers, the rules motivate carriers to sell services for less than fair market value. Similarly, by permitting carriers to record services purchased from nonregulated affiliates at the affiliates' fully distributed costs, even when those costs exceed what the carriers would pay non-affiliates, the rules motivate carriers to pay more than fair market value for services.[154] If these increased costs are reflected in rates for regulated telecommunications services, ratepayers may be harmed. Ratepayers and service

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[150] See Joint Cost Order, 2 FCC Rcd at 1336-37, paras. 294-301.

[151] Id.

[152] We discuss the prevailing price method in Section III.B.1.c.(ii), infra.

[153] See Joint Cost Order, 2 FCC Rcd at 1336-37, paras. 294-301.

[154] One way this can occur is through chain transactions. Chain transactions involve a series of transfers of an asset or a service, or a product created by one affiliate with assets or services transferred from another member of the affiliate group. We believe that our current valuation methods for services may enable a BOC affiliate to use chain transactions to pass assets or services to the BOC at inflated charges. For example, nonregulated affiliate A could buy a product from a third party. A could then sell the product to nonregulated affiliate B at any price (*e.g.*, with a 50 percent profit). B could then sell the product to the BOC at a price that includes not only its authorized profit, but also the profit earned by A. Because BOCs generally value and record such transactions based on the affiliate transactions rules governing service transfers, the transaction would be recorded at fully distributed costs.

providers not affiliated with carriers may also be harmed if the valuation methods for affiliate transactions induce carriers and their affiliates to "use services that are not competitive to subsidize services that are subject to competition,"[155] thereby putting service providers not affiliated with the carrier at a competitive disadvantage.

78. Because of the concerns identified in the preceding paragraph, we believe that the current rules regarding the valuation of affiliate services may not be consistent with the requirement of Section 272(b)(5) for "transactions . . . on an arm's length basis."[156] Requiring that affiliate transactions that do not involve tariffed assets or services be recorded at the higher of cost and estimated fair market value when the carrier is the seller or transferor, and at the lower of cost and estimated fair market value when the carrier is the buyer or transferee appears more likely to achieve these statutory objectives. We propose to continue to define the applicable cost benchmarks as net book cost for asset transfers and fully distributed costs for service transfers.[157] Our proposed rule, viewed in light of other changes detailed below, would form part of a rational and streamlined approach to affiliate transactions. This proposed rule would also reduce the incentive to record an affiliate transaction as a provision of a service, rather than an asset transfer, especially in the context of procurement activities.[158] We seek comment on whether these modifications would better meet the objectives of Section 272. We also ask commenters to discuss whether, and under what circumstances, we should allow carriers and their affiliates to use any alternative valuation methods. We also seek comment on how the elimination of a sharing obligation from our price cap rules would affect the validity of our tentative conclusion in the *Affiliate Transactions Notice* that our treatment of the provision of services that are neither tariffed nor subject to prevailing company prices may reward a carrier's imprudent acts of buying services for more than, and selling services for less than, fair market value.[159]

79. Section 272(e)(3) requires that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . shall charge the affiliate described in subsection (a) or impute to itself (if using the access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated

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[155] 47 U.S.C. § 254(k).

[156] Id. at § 272(b)(5).

[157] We note that the services we are discussing here are not tariffed.

[158] New York Telephone Co. and New England Telephone and Telegraph Co., Order to Show Cause and Notice of Apparent Liability for Forfeitures, 5 FCC Rcd 866 (1990) (alleging that a procurement subsidiary earned excess profits by overcharging its telephone affiliates for goods and services).

[159] See Joint Cost Order, 2 FCC Rcd at 1336-37, paras. 294-301.

interexchange carriers for such service."[160] Section 272(e)(4) states that "[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) . . . may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated."[161] We invite comment on how these requirements should affect our rules for implementing the "arm's length" requirement of Section 272(b)(5). We also invite comment on whether we should adopt specific accounting procedures to address the difference, if any, between the rates charged by BOCs when they provide interLATA or intraLATA facilities or services on a separated basis and "the costs [that would be] appropriately allocated" for the underlying facilities or services.

ii. Prevailing Company Prices

80. The prevailing price method describes the use of the price at which a company offers an asset or service to the general public to establish the value of the affiliate transaction.[162] Generally, when a carrier transfers assets or provides services to an affiliate or the affiliate transfers assets or provides services to the carrier and either the carrier or affiliate conducts similar transactions with the non-affiliates, the transfer or service price with non-affiliates should become the benchmark price for defining the value of the transaction. Although the prevailing price appears to represent the price that would be paid in an arm's length transaction, prevailing price in affiliate transactions may not reflect fair market value primarily because of the different nature of affiliate and non-affiliate transactions. In competitive markets, companies devote significant resources to retaining and attracting customers including sales presentations, advertising campaigns, discounts for volume purchases, or long-term commitments. Most affiliate transactions, however, take place in an entirely different environment. Sales between affiliates generally do not require extensive marketing efforts and involve lower transactional costs than sales to non-affiliates. We invite comment on whether affiliate transactions conducted "on an arm's length basis" will necessarily entail the same marketing efforts and transactional costs as sales to non-affiliates. We also invite comment on what, if any, effect any differences in those efforts and costs should have on our decision regarding the use of the prevailing price method for recording affiliate transactions between BOCs and their affiliates engaged in manufacturing, interLATA telecommunications origination and interLATA information services as described in Section 272(a)(2).

81. Our experience with the prevailing price method has revealed the

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[160] 47 U.S.C. § 272(e)(3).

[161] Id. at § 272(e)(4).

[162] See Affiliate Transactions Notice, 8 FCC Rcd at 8077-80, paras. 15-22.

difficulty of defining what constitutes a prevailing price.[163] When a nonregulated affiliate transfers assets or provides services to the carrier and non-affiliates, the question becomes what percentage of an affiliate's overall business must be provided to non-affiliates in order to establish a prevailing company price. If the percentage of third-party business is small, there may not be enough participants in the market to ensure that the price equals the price the carrier and the affiliate would have negotiated "on an arm's length basis."[164] In such situations, using prevailing prices to value asset transfers could permit affiliates to charge inflated prices to the BOC. This would allow nonregulated affiliates to receive added revenue that could permit the nonregulated affiliate to price other competitive assets and services lower to the detriment of fair competition. An additional problem in determining a prevailing price arises because of the nature of the products and services that an affiliate may transfer. "[R]egulatory requirements that [BOCs] buy equipment competitively crumble quickly when the product being purchased is technically complex and readily differentiated."[165]

82. We, therefore, seek comment on the benefits of our proposal to amend our affiliate transactions rules to eliminate the valuation of affiliate transactions based on prevailing prices for transactions between a BOC and its affiliates engaged in the manufacturing, interLATA telecommunications origination and interLATA information services described in Section 272(a)(2). Under this proposal, transactions from the carrier to the nonregulated affiliate would be recorded at tariffed rates, if applicable, or at the higher of fair market value or fully distributed cost. Transactions from the nonregulated affiliate to the carrier would be recorded at the lower of fully distributed cost or fair market value.

iii. Estimates of Fair Market Value

83. In prior portions of this Notice,[166] we propose to adopt identical valuation methodologies for assets and services which would require the carrier to record most affiliate transactions at the higher of net book cost and estimated fair market value when the carrier is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the buyer.[167] These proposals implicitly assume that there is an observable fair market value for any

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[163] Id.

[164] 47 U.S.C. § 272(b)(5).

[165] United States v. Western Elec. Co., 673 F.Supp. 525, 571 (D.D.C. 1987) (quoting Huber Report at 14.13).

[166] See Sections III.B.1.c.i & ii. supra.

[167] As an example of a definition of "fair market value," United States Treasury regulations define it as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." 26 C.F.R.

assets and services that a carrier and its nonregulated affiliates might provide each other, and that reasonable efforts will enable the carrier to discover that value. We believe that the procedures carriers use in estimating fair market value should vary with the circumstances of the transaction and consequently that we should not specify the methodologies that carriers must follow to estimate fair market value. We instead propose to require carriers to make good faith determinations of the fair market value, where such a valuation is required under the affiliate transactions rules. While this methodology will limit appraisals to transactions, such as building sales and other transfers of major assets, for which nonregulated companies obtain appraisals in the normal course of business, we believe a more stringent approach would impose unnecessary burdens and costs on the BOCs and other incumbent local exchange carriers. We believe that a good faith requirement would help ensure that affiliates covered by Section 272 "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis."[168]

84. While we propose not to prescribe methodologies for estimating fair market value, we seek comment on whether we should set criteria for determining what constitutes a good faith estimate of fair market value. For example, if a transaction is subject to reasonable independent valuation methods, we believe that carriers should continue to ascertain fair market value by applying these methods to demonstrate their good faith. If companies making certain purchases routinely solicit competitive bids, survey potential suppliers, or obtain independent appraisals, companies should continue to employ these methods to determine fair market value. Thus, carriers could support affiliate transactions involving real estate transfers by means of independent appraisals.

85. In situations involving transactions that are not easily valued, we seek comment on whether we should still require carriers to support their valuations by reasonable and appropriate methods. For example, for some assets or services, a carrier might determine that an independent appraisal would be difficult, if not impossible, to obtain or be prohibitively expensive. In this case, a good faith attempt to ascertain fair market value might include supporting the transaction with computations or studies that utilize methods and principles that an independent appraiser would apply. This could mean, if possible, obtaining comparable sales information, computing values by applying a reasonable capitalization rate on cash flow, or determining replacement value. We note that nothing discussed in this Notice would exempt carriers from their statutory obligation under Section 220(c) to justify their accounting entries.[169] We invite comment on our proposal to allow good faith attempts to determine fair market value in affiliate transactions.

§ 1.170-1.

[168] 47 U.S.C. § 272(b)(5).

[169] Id. at § 220(c).

iv. Tariffed-based Valuation

86. Finally, we seek comment about the status of tariff-based valuation if incumbent local exchange carriers are not required to provide interconnection and collocation services and network elements pursuant to tariffs. Under Section 252, it may be that the BOC would submit agreements adopted by negotiations or arbitration to State commissions for approval or rejection without ever filing a tariff.[170] Alternatively, the BOCs may file statements of generally available terms pursuant to Section 252(f) that would state the terms on which these LECs would provide services to all customers who desire them.[171] We seek comment on whether, and the extent to which, our affiliate transactions rules should be amended to substitute rates appearing in such publicly filed agreements and statements for tariffed rates where affiliates could subscribe to services under such generally available terms. We also seek comment on whether such amendments would be consistent with, or required by, Sections 272(e)(3) and 272(e)(4).

v. Return Component for Allowable Costs

87. In the *Joint Cost Proceeding*, the Commission determined that fully distributed costs should include a return on investment, but no "profit" in excess of the return then prescribed for the carrier's interstate regulated activities.[172] Consequently, carriers that utilize fully distributed cost to value affiliate transactions include in their cost computations a component for rate of return. We believe we should consider allowing all carriers providing directly, or indirectly through an affiliate, the services that are the subject of Section 272 to use a uniform rate of return to value affiliate transactions. Adopting numerous rates of return would impose a significant compliance burden on the industry. In addition, the use of various rates of return could favor certain telecommunications service providers and disadvantage others. Moreover, allowing carriers to determine their own rate of return would increase the likelihood that an affiliate will fail to "conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis[,]" as required by Section 272(b)(5).[173] From a regulatory standpoint, the Commission would have a difficult, if not impossible, burden if it had to engage in numerous prescription proceedings and then monitor compliance with each.

88. The Commission has prescribed a unitary, overall rate of return for those

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[170] Id. at § 252(e).

[171] Id. at § 252(f)(1).

[172] Joint Cost Reconsideration Order, 2 FCC Rcd at 6296, para. 119, 6298, para. 133, & 6315, n. 203.

[173] 47 U.S.C. § 272(b)(5).

incumbent local exchange carriers still subject to rate-of-return regulation to use in computing interstate revenue requirements, unless a carrier can show that such use would be confiscatory.[174] The current prescribed rate of return on interstate services is 11.25 percent.[175] Because the rate-of-return represcription will not affect either the price cap indices or the sharing zones for carriers subject to price cap regulation,[176] the impact of any represcription of this rate of return on price cap LECs would be limited. In addition to affecting cost calculations for affiliate transactions, as we propose above, a represcription may change the amounts that price cap LECs receive from the universal service fund or pay for long-term support of NECA's common line pool[177] and the amounts those LECs pay the telecommunications relay services fund to give persons with hearing or speech impairments full access to the voice communications network.[178] We seek comment on whether we should require the BOCs to use the prescribed interstate rate of return for valuing their transactions with their affiliates engaged in the manufacturing activities, in-region telecommunications services origination and interLATA information services described in Section 272(a)(2).

d. Application to InterLATA Telecommunications Affiliates

89. We propose to apply our affiliate transactions rules to transactions between a BOC and any affiliates it establishes under Section 272(a). Under that provision, a BOC, including any affiliate, "which is a local exchange carrier that is subject to the requirements of section 251(c)" may not provide in-region interLATA telecommunications services, interLATA information services, or manufacturing unless it provides those services through one or more affiliate.[179] Any transactions between a BOC and its interLATA information services or manufacturing affiliates would be subject to our existing affiliate transactions rules, because neither interLATA information services nor manufacturing are

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[174] Amendment of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes, Report and Order, 10 FCC Rcd 6788 (1995) ("Rate of Return Order").

[175] The Bureau has released a Public Notice seeking comment on whether the Commission should commence a represcription proceeding. Common Carrier Bureau Sets Pleading Schedule for Preliminary Rate of Return Inquiry, Public Notice, DA 96-139, 61 Fed Reg. 6641 (February 21, 1996).

[176] See Rate of Return Order, 10 FCC Rcd at 6818, paras. 63-64. See Section III.B.1.c.v., infra.

[177] Id. Both of these programs distribute revenue based on the prescribed interstate rate of return. See 47 C.F.R. §§ 36.601-36.631, 69.607-69612. See also Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Docket No. 96-45, FCC 96-93 (March 8, 1996),

[178] See Rate of Return Order, 10 FCC Rcd at 6818, paras. 63-64. See 47 C.F.R. § 64.604.

[179] 47 U.S.C. § 272(a)(1).

regulated activities under Title II.[180] InterLATA telecommunications services, however, are regulated under Title II, and, absent a Commission requirement to the contrary, the affiliates that offer those services would therefore classify interLATA telecommunications services as regulated for Title II accounting purposes. Our existing affiliate transactions rules are solely designed for transactions between regulated carriers and their nonregulated affiliates.[181] To help protect against improper subsidization, we have already determined that out-of-region interstate, interexchange services provided by BOC affiliates should be treated as nonregulated for accounting purposes.[182] Thus, our affiliate transactions rules apply to transactions between the BOCs and those affiliates. Because BOC in-region interLATA telecommunications services also present a potential for improper subsidization, we tentatively conclude that we should apply our affiliate transactions rules to transactions between each BOC and any interLATA telecommunications services affiliate it establishes under Section 272(a). We invite comment on this tentative conclusion. We also invite comment on whether and how we should adapt our affiliate transactions rules if applied to such transactions and, in particular, whether we should adopt special valuation methodologies for these transactions to recognize the regulated status of the affiliates on both sides of the transactions.

90. Section 272 does not prohibit a BOC from providing manufacturing and interLATA information services described in Section 272(a)(2) through the same affiliate by which it provides origination of interLATA telecommunications services described in the same section. It also does not prohibit that affiliate from engaging in other activities not regulated under Title II. We seek comment on whether in this context we should apply our cost allocation rules to prevent subsidization of nonregulated activities, including manufacturing and interLATA information services, by subscribers to interLATA telecommunication services. In particular, we seek comment on what, if any, authority Section 254(k) extends to our application of our cost allocation rules to affiliates engaged in regulated and nonregulated activities.

e. Application to Joint Marketing

91. Although Section 272(b)(3) requires [the affiliate] to "have separate officers, directors, and employees from the Bell operating company of which it is an affiliate,"[183] Section 272(g)(2) allows the BOC to "market or sell interLATA service provided by an affiliate required by [Section 272] . . . [after] such company is authorized to provide interLATA services

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180 See Joint Cost Reconsideration Order, 2 FCC Rcd at 6297, para. 122.

181 Id.

182 BOC Out-of-Region Order at paras. 38-40.

183 47 U.S.C. § 272(b)(3).

in such State under section 271(d)."[184] In our companion *BOC In-Region NPRM*, we seek comment on whether an affiliate may share marketing personnel with a BOC, and if so, what corporate and financial arrangements are necessary to comply with sections 272(b)(3), 272(b)(5) and 272(g)(2).[185] If an affiliate may share marketing personnel with a BOC, we tentatively conclude that we should apply our cost allocation and affiliate transactions rules, as we propose to modify them in this Notice, to any joint marketing of interLATA and local exchange services. We seek comment whether and the extent to which any additional accounting safeguards may be necessary.

f. Audit Requirements

92. Section 272(d) states that companies required to maintain a separate affiliate under Section 272 "shall obtain and pay for a Federal/State audit every 2 years conducted by an independent auditor to determine whether such company complied with this section and the regulations promulgated under this section, and particularly whether such company has complied with the separate accounting requirements under [Section 272(b)]."[186] The independent auditor "shall submit the results of the audit to the Commission and to the State commission of each State in which the company audited provides service, which shall make such results available for public inspection."[187] Interested persons may then submit comment on the final audit report.[188]

93. We tentatively conclude that the independent auditor's report should be filed with the Commission and each relevant State commission and should include a discussion of: (1) the scope of the work conducted, with a description of how the affiliate's or joint venture's books were examined and the extent of the examination; (2) the auditor's conclusion whether examination of the books has revealed compliance or non-compliance with the affiliate transactions rules and any non-discrimination requirements in the Commission rules; (3) any limitations imposed on the auditor in the course of its review by the affiliate or joint venture or other circumstances that might affect the auditor's opinion; and (4) a statement by the auditor that the carrier's cost allocation methodologies conform to the Communications Act of 1934, as amended, and the Commission's rules and that the carrier has accurately applied the methodologies described in those rules. We seek comment on the necessity or desirability of

[184] Id. at § 272(g)(2).

[185] See BOC In-Region NPRM at para. 62.

[186] 47 U.S.C. § 272(d)(1).

[187] Id. at § 272(d)(2).

[188] Id. at § 272(d)(3).

using such an approach to satisfy the requirements of Section 272(d). We also seek comment on whether the independent auditor's report should address whether the carrier has complied with Sections 272(e)(3) and 272(e)(4).

g. Scope of Commission's Authority

94. Section 272 of the 1996 Act, by its terms, covers transactions between a BOC and its affiliates engaged in the manufacturing activities, origination of interLATA telecommunications services, and interLATA information services described in Section 272(a)(2). As we have done in the *BOC In-Region NPRM*, we believe that each of these activities requires a different analysis.[189] We state elsewhere in this Notice our tentative conclusions and analysis regarding telemessaging, interLATA telecommunications services, and manufacturing activities.[190] We also tentatively conclude that we should apply our analysis for telemessaging to other interLATA information services covered by Section 272.[191] We seek comment on this tentative conclusion.

2. Section 273 - Manufacturing by Certifying Entities

a. Statutory Language

95. Section 273(d) of the 1996 Act requires certain standard-setting organizations to maintain separate affiliates in order to engage in certain types of manufacturing.[192] Under Section 273(d)(3), when such a standard-setting organization certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity, the certifying entity "shall only manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity . . . through a separate affiliate."[193] "[N]otwithstanding [Section 273(d)(3)]," Section 273(d)(1)(B) prohibits "Bell Communications Research, Inc., or any successor entity or affiliate" from "engag[ing] in manufacturing telecommunications equipment or customer premises equipment as long as it is an affiliate of

[189] BOC In-Region NPRM at para. 31.

[190] See discussions in Sections II.B.1., III.B.1. and III.B.2. of this Notice.

[191] See discussion in Sections II B.1., supra.

[192] 47 U.S.C. § 273(d).

[193] Id. at § 273(d)(3).

more than 1 otherwise unaffiliated [BOC] or successor or assign of any such company."[194]

96. Section 273(d)(3)(B) requires the separate affiliate to "maintain books, records, and accounts separate from those of the entity that certifies such equipment, consistent with generally acceptable accounting principles[,]"[195] and to "have segregated facilities and separate employees" from the certifying entity.[196] Section 273(g) permits "[t]he Commission [to] prescribe such additional rules and regulations as the Commission determines necessary to carry out the provisions of this section, and otherwise to prevent discrimination and cross-subsidization in a [BOC's] dealings with its affiliates and with third parties."[197]

b. Comparison of Sections 273 and 272

97. Both Sections 272 and 273 require the use of a separate affiliate to engage in different specified activities. We have already proposed accounting safeguards to govern transactions between a BOC and its affiliate engaged in the manufacturing, origination of interLATA telecommunications services and interLATA information services described in Section 272(a)(2). Section 273 requires a standard-setting organization that certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity to "only manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity . . through a separate affiliate."[198] Section 273(d)(3)(B) requires that the separate affiliate of the standard-setting organization "maintain books, records, and accounts separate from those of the entity that certifies such equipment, consistent with generally acceptable accounting principles[,]"[199] and to "have segregated facilities and separate employees" from the certifying entity.[200] As a threshold question, we seek comment on whether and, if so, how Section 273's different statutory language requires or permits different accounting treatment from that required or permitted for BOCs under Section 272. Specifically, we seek comment whether we should apply our affiliate transactions rules, as we propose to modify them, to

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194 Id. at § 273(d)(1)(B).

195 Id. at § 273(d)(3)(B)(i).

196 Id. at § 273(d)(3)(B)(iii).

197 Id. at § 273(g).

198 Id. at § 273(d)(3).

199 Id. at § 273(d)(3)(B)(i).

200 Id. at § 273(d)(3)(B)(iii).

transactions between a certifying entity and the affiliate it must maintain under Section 273(d). We note that our existing rules would not cover transactions between a certifying entity and its affiliate where that certifying entity is not also a regulated carrier. We, therefore, seek comment on whether, and to what extent, we should modify our affiliate transactions rules to govern such transactions.

98. In addition to the accounting safeguards for BOC entry into manufacturing set forth in Section 272 as discussed above, we note that Section 273(g) specifically authorizes "[t]he Commission [to] prescribe such additional rules and regulations as the Commission determines necessary . . . to prevent cross-subsidization in a [BOC's] dealings with its affiliates and with third parties."[201] We tentatively conclude that application of our affiliate transactions rules, as we propose to modify them, to BOCs engaged in activities under Section 273 would be sufficient to satisfy this provision of the 1996 Act. We seek comment on this tentative conclusion.

c. Scope of Commission's Authority

99. Section 273 provides that a BOC may manufacture and provide telecommunications equipment and customer premises equipment if the Commission authorizes that BOC to provide interLATA services under Section 271(d). Section 273 also sets out safeguards for BOC manufacturing activities. We tentatively conclude that the provisions of this section apply to all BOC manufacturing activities, irrespective of any jurisdictional distinctions. First, much like Sections 271 and 272, Section 273 sets the conditions for BOC entry into manufacturing. Thus, as with Sections 271 and 272, we believe that Section 273 was meant to supersede the MFJ, and to replace it for both interstate and intrastate activities, to the extent that such a jurisdictional division makes sense in the context of manufacturing.[202] Section 273 conditions entry into manufacturing on the BOC's obtaining Commission approval for interLATA entry under Section 272. This relationship between Sections 272 and 273 further suggests that they should both be read to have the same jurisdictional reach.

100. Moreover, we tentatively conclude that although 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,"[203] we tentatively conclude the manufacturing activities addressed by Section 273 are not within the scope of Section 2(b). Even if Section 2(b) applies with respect to BOC manufacturing under

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[201] Id. at § 273(g).

[202] See discussion in Section II.B.2.d., supra.

[203] 47 U.S.C. § 152(b).

Section 273, we tentatively find that such manufacturing activities plainly cannot be segregated into interstate and intrastate portions. We invite comment on what role States might have in implementing Section 273's accounting safeguards provisions, assuming the correctness of these beliefs, and, in particular, whether in enacting Section 273, Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures in their regulation of "charges . . . for or in connection with intrastate communications service[s]."[204] We ask the commenters also to address whether preemption in this area would be necessary to achieve the intent behind Section 273 or whether less intrusive measures would be sufficient.

3. Section 274 - Electronic Publishing

101. Section 274 of the 1996 Act prescribes the terms under which a BOC may offer electronic publishing. Section 274(a) permits a BOC or its affiliate to provide electronic publishing over its or its affiliate's basic telephone service only through a "separated affiliate" or an "electronic publishing joint venture."[205] Section 274(i)(9) defines "separated affiliate" as "a corporation under common ownership or control with a Bell operating company that does not own or control a Bell operating company and is not owned or controlled by a Bell operating company and that engages in the provision of electronic publishing which is disseminated by means of such Bell operating company's or any of its affiliate's basic telephone service."[206] Section 274(i)(8), in turn defines "own" as having "a direct or indirect equity interest (or the equivalent thereof) of more than 10 percent of an entity, or the right to more than 10 percent of the gross revenues of an entity under a revenue sharing or royalty agreement."[207] Section 274(i)(4) states that "control" has the meaning that it has in 17 C.F.R. 240.12b-2, the regulations promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or any successor provision to such section."[208] Section 274(i)(5) defines an "electronic publishing joint venture" as "a joint venture owned by a Bell operating company or affiliate that engages in the provision of electronic publishing which is disseminated by means of such Bell operating company's or any of its affiliates' basic telephone service."[209]

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[204] Id.

[205] Id. at § 274(a).

[206] Id. at § 274(i)(9).

[207] Id. at § 274(i)(8).

[208] Id. at § 274(i)(4).

[209] Id. at § 274(i)(5).

102. Under Section 274(b), the "separated affiliate" or joint venture[210] "shall be operated independently from the [BOC]."[211] The "separated affiliate" or joint venture and the BOC with which it is affiliated must "carry out transactions (i) in a manner consistent with such independence, (ii) pursuant to written contracts or tariffs that are filed with the Commission and made publicly available, and (iii) in a manner that is auditable in accordance with generally accepted auditing standards."[212] The "separated affiliate" or joint venture must also "value any assets that are transferred directly or indirectly from the [BOC] to a separated affiliate or joint venture, and record any transactions by which such assets are transferred, in accordance with such regulations as may be prescribed by the Commission or a State commission to prevent improper cross-subsidies."[213]

103. Section 274(c)(2) discusses the joint activities permitted under Section 274.[214] Section 274(c)(2)(A) provides that "[a] Bell operating company may provide inbound telemarketing or referral services related to the provision of electronic publishing for a separated affiliate, electronic publishing joint venture, affiliate, or unaffiliated electronic publisher, provided that if such services are provided to a separated affiliate, electronic publishing joint venture, or affiliate, such services shall be made available to all electronic publishers on request, on nondiscriminatory terms."[215] Section 274(c)(2)(B) states that "[a] Bell operating company may engage in nondiscriminatory teaming or business arrangements to engage in electronic publishing with any separated affiliate or with any other electronic publisher if (i) the Bell operating company only provides facilities, services, and basic telephone service information as authorized by [Section 274], and (ii) the Bell operating company does not own such teaming or business arrangement."[216] Lastly, Section 274(c)(2)(C) permits "[a] Bell operating company or affiliate [to] participat[e] on a nonexclusive basis in electronic publishing joint ventures with

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[210] "Joint venture" is not defined in Section 274 or in other sections of the 1996 Act. Black's Law Dictionary defines "joint venture" as "a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit" or "a one-time grouping of two or more persons in a business undertaking." Unlike a partnership, a joint venture does not require a continuing relationship among the parties. Black's Law Dictionary 584 (abridged 6th ed. 1991). A joint venture is treated like a partnership for federal income tax purposes. See 26 U.S.C. § 7701(a).

[211] 47 U.S.C. § 274(b).

[212] Id. at § 274(b)(3).

[213] Id. at § 274(b)(4).

[214] Id. at § 274(c)(2).

[215] Id. at § 274(c)(2)(A).

[216] Id. at § 274(c)(2)(B).