

establishment of prevailing company prices is as easy and cost-effective as the BOCs suggest, such prices can still be used, along with other relevant benchmarks, in determining the fair market value of assets and services provided to the BOCs by their separate affiliates.<sup>53</sup> More importantly, using prevailing company prices in this manner, i.e., as one factor in estimating fair market value, will avoid the substantial risks associated with their use as an independent valuation method.<sup>54</sup>

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<sup>53</sup> In addition, as the comments submitted by the American Public Communications Council ("APCC") suggest, prices which the BOCs charge for goods and services provided to non-affiliates can be used as a benchmark to ensure that a BOC's separate affiliate does not receive preferential treatment. APCC Comments at 28-29.

<sup>54</sup> Should the Commission decide to retain the use of prevailing company pricing as a valuation method, TIA supports the imposition of a more objective standard for determining when reliance on this method is appropriate, i.e., a standard which limits the use of this method to situations in which the separate affiliate can demonstrate that it has made substantial sales of the same product to purchasers other than its affiliated BOCs. In this regard, MCI has suggested that the Commission adopt the 75% standard advanced in its 1993 Notice, applied on a product-by-product basis. See MCI Comments at 24 (citing Affiliate Transactions Notice, supra n.21, at ¶ 22).

If this approach is adopted, however, the Commission would need to ensure that the third-party transactions used in determining the prevailing company price are in fact appropriate benchmarks for the valuation of a BOC's purchases from its affiliate. As the Commission's Notice recognizes, establishment of a reliable prevailing company price is particularly difficult in the area of equipment sales, given the technically complex and often customized nature of many products purchased by the BOCs. See Notice at ¶ 81, citing United States v. Western Electric Co., 673 F.Supp 525, 571 (D.D.C. 1987) (quoting Huber Report at 14.13). Accordingly, TIA believes that the better approach  
(... continued)

**C. ESTIMATES OF FAIR MARKET VALUE [NPRM Section  
III.B.1.c.iii.; ¶¶ 83-85]**

While TIA believes that the BOCs should be accorded a reasonable degree of flexibility in determining fair market value, TIA urges the Commission to reject the suggestion that there is no need to impose a requirement that such determinations be made in good faith,<sup>55</sup> as the Commission proposes.<sup>56</sup>

In addition, as TIA has indicated in its comments in response to the Commission's Non-Accounting Safeguards Notice, all BOCs should be required to establish procedures designed to ensure non-discrimination in their procurement of goods and services from affiliated and non-affiliated suppliers.<sup>57</sup> To the extent that appropriate non-discriminatory procurement standards and procedures are adopted, implemented, and enforced, concerns with regard to potential abuses in the valuation of affiliate transactions will be reduced.

Accordingly, TIA again urges the Commission to require that appropriate, comprehensive procedures be established which ensure that products manufactured by BOC affiliates and non-affiliates

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(... continued)

is to simply eliminate the use of prevailing company pricing as an independent valuation method.

<sup>55</sup> See U S West Comments at 18.

<sup>56</sup> NPRM at ¶ 83.

<sup>57</sup> See TIA's August 15, 1996 Comments in CC Docket No. 96-149, at 41-42.

are accorded non-discriminatory treatment throughout the procurement process.<sup>58</sup> Such procedures should describe the specific steps which will be taken (e.g., supplier surveys, RFP, RFQs) in order to ensure that the BOCs give appropriate consideration to all would-be suppliers, that their procurement decisions are made on a truly non-discriminatory basis, and that the costs for products procured by a BOC are properly allocated and accounted for.<sup>59</sup> While it may be appropriate to allow the BOCs some degree of flexibility in the procedures to be used in particular circumstances (e.g., a more rigorous procedure for larger-scale procurements than is employed for smaller purchases), the Commission should make every effort to ensure that all BOC procurement procedures are transparent, auditable, and are applied in a non-discriminatory manner.

BOC procedures also should provide for appropriate documentation and retention of records relating to the application of the BOC's established procedures to particular purchases.<sup>60</sup> If properly implemented, such procedures will help

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<sup>58</sup> Id. See also New York State Department of Public Service Comments at 9.

<sup>59</sup> TIA notes that consolidated BOC procurement of different types of equipment from affiliated or non-affiliated suppliers creates potential risks of cross-subsidization and discrimination, in the absence of rules which ensure an appropriate allocation of total procurement costs among the various categories of products being purchased.

<sup>60</sup> See TIA's August 15, 1996 Comments in CC Docket No. 96-149, at 48-49.

to ensure that if, at the end of the procurement process, a BOC makes a decision to purchase from its affiliate, sufficient information exists to accurately determine the fair market value of the transaction and to verify that the procurement decision was made in a non-discriminatory manner.

**VI. AUDIT REQUIREMENTS [NPRM SECTION III.B.1.f.; ¶¶ 92-93]**

TIA joins those commenters who urge the Commission to make it clear that the biennial audit requirement established in Section 272(d) supplements, rather than replaces, the annual audit required under the Commission's existing rules.<sup>61</sup> TIA also supports the Commission's tentative conclusions regarding the required contents of the audit report.<sup>62</sup>

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<sup>61</sup> See e.g., MCI Comments at 37.

<sup>62</sup> Consistent with the Notice, the independent auditor's report should include, at a minimum, 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, as well as 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 (including the affiliate transactions rules) and that the carrier has accurately applied the methodologies described in those rules. Notice at ¶ 93. The Commission also should reserve the right to impose additional requirements in the future, as appropriate.

Moreover, auditors' work papers should be made available to regulators<sup>63</sup> and to other interested parties upon request, with appropriate protection for proprietary information. TIA also supports MCI's suggestion that the Commission adopt a rule requiring carriers to maintain a complete audit trail of all cost allocations and affiliate transactions.<sup>64</sup>

**VII. SECTION 273(d) - MANUFACTURING BY CERTIFYING ENTITIES [NPRM Section III.B.2; ¶¶ 95-98]**

The only significant comments received with respect to the accounting rules to be applied under Section 273(d) of the Communications Act were submitted by Bell Communications Research, Inc. ("Bellcore"). As an initial matter, TIA believes that Bellcore's suggestion that "it can choose between placing manufacturing or certification activities in the separate affiliate"<sup>65</sup> ignores the fundamental purpose of the relevant provisions, which is to protect competition and consumer interests by ensuring appropriate separation between Bellcore manufacturing activities, on the one hand, and Bellcore's

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<sup>63</sup> See New York Department of Public Service Comments at 10.

<sup>64</sup> See MCI Comments at 9. While the Commission's Joint Cost Order stated that all carriers would be expected to maintain a complete audit trail of all cost allocations and affiliate transactions, the Commission did not adopt a rule requiring that such an audit trail be maintained. Joint Cost Order, 2 F.C.C.R. 1298, at ¶ 242 (1987). The Commission subsequently proposed such a rule in its Affiliate Transactions Notice, supra n.21, at ¶ 99.

<sup>65</sup> See Bellcore Comments at 3, n.2.

certification and other ratepayer-funded activities, on the other.<sup>66</sup>

Section 273(d)(3)(A) of the Communications Act, as amended, clearly states that the certifying entity (i.e. Bellcore) "shall only **manufacture** a particular class of telecommunications equipment or [CPE] for which it has undertaken, during the previous 18 months, certification activity for such class of equipment **through a separate affiliate.**"<sup>67</sup> Moreover, Section 272(d)(3)(B) explicitly provides that the "separate affiliate" required under Section 272(d)(3)(A) shall "maintain books, records, and accounts **separate from those of the entity that certifies such equipment,** consistent with generally acceptable accounting principles."<sup>68</sup> Finally, the language used in Section 273(d)(3)(C), barring discrimination by the certifying entity in favor "of its **manufacturing affiliate**"<sup>69</sup> or disclosure of other manufacturers' proprietary information "to the **manufacturing affiliate,**"<sup>70</sup> also makes it clear that it is **manufacturing**

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<sup>66</sup> TIA does not object to the placement of Bellcore's certification activities in a separate affiliate, so long as the necessary separation between manufacturing activities and Bellcore's certification and other ratepayer-funded activities is maintained.

<sup>67</sup> 47 U.S.C. § 273(d)(3)(A) (emphasis added).

<sup>68</sup> 47 U.S.C. § 273(d)(3)(B)(i) (emphasis added).

<sup>69</sup> 47 U.S.C. § 273(d)(3)(C)(i) (emphasis added).

<sup>70</sup> 47 U.S.C. § 273(d)(3)(C)(ii) (emphasis added).

activities that Bellcore must conduct through a separate affiliate.

TIA also opposes Bellcore's contention that the Commission's affiliate transactions rules cannot or should not be applied to transactions between Bellcore and any manufacturing affiliate which it may create.<sup>71</sup> While TIA agrees that the affiliate transactions rules are designed to address the potential for cross-subsidization of competitive activities "by subscribers to regulated telecommunications services," Bellcore currently is owned by the seven Regional Bell Operating Companies and may remain affiliated with regulated carriers (including one RBOC) even after it is permitted to manufacture, pursuant to Section 273(d)(1)(B). Thus, until all carrier affiliations are eliminated, Bellcore's stated rationale for arguing that the Commission should not apply the affiliate transactions rules is inapplicable.<sup>72</sup> To ensure that Bellcore's ratepayer-funded activities are not used as a vehicle for cross-subsidization of competitive manufacturing activities, the Commission should apply

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<sup>71</sup> See Bellcore Comments at 3-4; USTA Comments at 26. See also BellSouth Comments at 40 (endorsing, without further explanation, Bellcore's comments).

<sup>72</sup> So long as such affiliations remain, the Commission may exercise its specific authority under Section 273(g) and/or its more general authority under Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), to impose additional accounting requirements designed to address potential cross-subsidization of Bellcore manufacturing activities with regulated revenues.

its affiliate transactions rules, as modified, to transactions between Bellcore and any manufacturing affiliate which it establishes, once it is free to engage in such activities.

**VIII. SCOPE OF COMMISSION AUTHORITY [NPRM Section III.B.2.c.; ¶¶ 99-100]**

TIA supports the Commission's tentative conclusion that the manufacturing-related provisions of Section 272 and 273 "apply to all BOC manufacturing activities, irrespective of any jurisdictional distinctions,"<sup>73</sup> and its conclusion that such activities "are not within the scope of Section 2(b)."<sup>74</sup> TIA also concurs in the Commission's alternative conclusion that even if Section 2(b) were applicable, BOC manufacturing activities "plainly cannot be segregated into interstate and intrastate portions."<sup>75</sup> Accordingly, TIA agrees that any state regulation

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73 NPRM at ¶ 99.

74 Id. at ¶ 100.

75 Id. By its nature, the manufacture of telecommunications equipment or CPE is never solely an intrastate activity. Manufacturers of such products increasingly require access to potential customers throughout the United States and in overseas markets, in order to succeed in a global economy. Moreover, the costs of manufacturing equipment for customers in particular states cannot practically be segregated, given the use of common facilities and personnel. Finally, even where a manufacturer's product (e.g., an end office switch) is installed for use in the "local loop," such equipment is generally used to complete both interstate and intrastate calls. See e.g., North Carolina Utilities Commission v. FCC, 537 F.2d 787, 791 (4th Cir.), cert. denied, 429 U.S. 1027 (1976) ("NCUC I"); North Carolina Utilities Commission v. FCC, 552 F.2d 1036, 1043 (4th Cir.), cert. denied, 434 U.S. 874 (1977) ("NCUC II"); Computer and Communications

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with respect to BOC manufacturing that is inconsistent with the requirements of Section 272 or 273 or the Commission's implementing regulations would necessarily thwart and impede federal policies, and should therefore be preempted.

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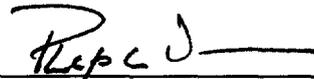
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Industry Association v. FCC, 693 F.2d 198, 205-206, 215 (D.C. Cir. 1982), cert. denied, 461 U.S. 938 (1983).

**IX. CONCLUSION**

TIA respectfully urges the Commission to take action to preserve the benefits of the vigorously competitive domestic telecommunications equipment marketplace which exists today, by adopting strong, comprehensive accounting safeguards, including strengthened affiliate transactions rules, consistent with the foregoing comments.

Respectfully submitted,



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