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**SEP 30 1996**

FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

September 30, 1996

**EX PARTE**

William F. Caton  
Acting Secretary  
Federal Communications Commission  
Mail Stop 1170  
1919 M Street, N.W., Room 222  
Washington, D.C. 20554

Dear Mr. Caton:

Re: CC Docket No. 96-149, *Nonstructural Safeguards* - Section 272 of the  
*Communications Act*

On Friday, September 27, 1996, Patricia Mahoney and Stan Moore, Senior Attorneys, Pacific Telesis, Cheryl Peters, Regulatory Manager, Pacific Bell, Jerry A. Hausman, MacDonald Professor Economics at the Massachusetts Institute of Technology, Michael J. Yourshaw, Wiley, Rein & Fielding, and I met with A. Richard Metzger, Deputy Chief, Common Carrier Bureau, Tim Peterson, Counsel to the Chief, Common Carrier Bureau, Donald K. Stockdale, Deputy Chief, Policy Division, Patrick DeGraba, Susan McMaster, Brent Olson, Staci Pies, Cindy Jackson, Craig Brown, and Radihika V. Karmarkar of the Common Carrier Bureau, to discuss the matters summarized in the attached. Please associate this material with the above-referenced docket.

We are submitting two copies of this notice in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me should you have any questions or require additional information concerning this matter.

Sincerely,



Attachment

cc: Craig Brown  
Patrick DeGraba  
Cindy Jackson  
Radihika V. Karmarkar  
Susan McMaster  
A. Richard Metzger  
Brent Olson  
Tim Peterson  
Staci Pies  
Donald K. Stockdale

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# CC Docket No. 96-149 Ex Parte

- Joint Marketing
- Centralized Administrative Services
- Nondominant Regulation

# Intent of Congress in Passing the Telecommunications Act of 1996

*“... 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.”*

# To Meet Congress' "Pro-Competitive, De-Regulatory" Goals the Commission Should Not Handicap PBCOM

- Pacific Bell and PBCOM can offer one-stop shopping
- Pacific Telesis can provide administrative services for PBCOM
- PBCOM must be regulated as a nondominant carrier

# JOINT MARKETING — SECTION 272(g)(1)&(2)

- The Act permits PBCOM to market intraLATA and interLATA services
- The Act permits Pacific Bell to serve as a sales channel for its interLATA affiliate, PBCOM
- Pacific Bell will meet its equal access obligations for all interexchange carriers
- Pacific Bell and PBCOM can offer one-stop shopping
- PBCOM will fairly compensate Pacific Bell for all joint marketing efforts

# PBCOM Plans To Market IntraLATA and InterLATA Services

- PBCOM currently plans to resell local services of its affiliates, Pacific Bell and Nevada Bell, as well as of selected other incumbent LECs
- PBCOM currently plans to resell Sprint interLATA service when Section 271 authorization is received
- Will sell through a variety of channels
  - its own marketing force
  - third party retail channels
  - Pacific Bell/Nevada Bell joint marketing

# The Act Permits Pacific Bell To Serve As a Sales Channel for Its InterLATA Affiliate, PBCOM

- Includes all marketing and sales-related activities
- Pacific Bell will comply with all CPNI requirements in marketing PBCOM services
- Marketing and sales include, for example:
  - advertising
  - outbound calling to customers
  - offering both types of services on the same call
  - packaging and bundling services together

# Pacific Bell Will Meet Its Equal Access Obligations for All Interexchange Carriers

- On “inbound” customer inquiries about a new service connection or change in local exchange access service, Pacific Bell will
  - inform customers that they have a choice of many interexchange carriers for long distance services
  - offer to read from a “revolving” list of available IECs
  - describe PBCOM’s services, prices, terms and conditions
  - place the order for PBCOM or other IEC’s service

# Pacific Bell Marketing of PBCOM Services

- On “inbound” calls where a customer requests or inquires about PBCOM service, Pacific Bell will discuss PBCOM’s services with the customer and may place the order
- On “outbound” calls (where Pacific Bell contacts a customer) Pacific Bell will actively solicit orders for PBCOM’s services

# Pacific Bell and PBCOM Can Offer One-Stop Shopping

- This is essential to compete with other IECs that offer bundled services
- Promotes competition — as the Act intends
- Minimizes customer confusion from multiple contacts
- Increases economic efficiency — permits economies of scope

# PBCOM Will Fairly Compensate Pacific Bell for All Joint Marketing Efforts

- Terms of compensation will be consistent with federal and state affiliate transaction rules
  - Must be publicly filed and will be closely scrutinized by interested parties
- Subject to various audits — Commission(s), company auditors, and external auditors
- Requirement to maintain separate books will enable detection of inequities

# PROVISION OF ADMINISTRATIVE SERVICES BY THE HOLDING COMPANY

- Consolidation of administrative services can benefit consumers
- Section 272(b) does not apply to the holding company
- The provisions of the 1996 Act are sufficient to preclude cross-subsidy and discrimination

# Consolidation of Administrative Services Can Benefit Consumers

The holding company or a service subsidiary can perform certain functions for all of its subsidiaries, including the BOC and a section 272 separate affiliate

- Finance and Accounting
- Legal Services
- Human Resources
- Marketing Communications
- Research and Development
- New Product Development
- Certain Procurement
- Management Information and Marketing Support Systems
- Real Estate Management
- Business Placement

***By consolidating administrative services the corporation can realize economies of scope and scale and benefit consumers***

# Section 272(b) Does Not Apply to the Holding Company

- The four structural separation provisions of section 272(b) expressly relate only to the relationship between the separate affiliate (PBCOM) and the Bell Operating Company
- If Congress had intended to separate the Holding Company, it would have been specific
- The central provision of administrative services is essential to efficient operations
- PBCOM's competitors, such as AT&T and MCI, are permitted to provide centralized administrative services
- Under *Computer Inquiry II*, even the BOC was permitted to provide certain "administrative services" for the separate affiliate

# **The Provisions of the 1996 Act Are Sufficient To Preclude Cross-Subsidy and Discrimination**

- Pacific Bell's books, records, and accounts are separate from PBCOM's
- Pacific Bell and PBCOM will have separate personnel
  - Obtaining services from the same company does not create shared employees
- Pacific Bell's assets will not guarantee PBCOM's credit
  - Any holding company guarantee of the affiliate's debt must be without recourse to the BOC's assets
- Transactions between Pacific Bell and PBCOM must be at arm's length and will be subject to the Commission's affiliate transactions accounting rules

# PBCOM MUST BE REGULATED AS A NONDOMINANT CARRIER

- PBCOM has no market power
- Dominant regulation will harm competition
- The U.S. Department of Justice recommends: *“The Commission should not apply its dominant carrier regulations to BOC affiliates.”*

# PBCOM Has No Market Power To Raise Prices by Restricting Its Own Output

- PBCOM has zero initial market share for interstate, domestic (or international) interLATA telecommunications services
  - It cannot quickly increase its market share to the point where it could raise prices by restricting output because it will be competing with large, established carriers like AT&T and MCI
- Substitutable supply capacity exists — customers can easily change providers if PBCOM's prices are not competitive
- PBCOM would not have market power under any narrower market definition

# PBCOM Has No Market Power To Raise Prices by Raising Rivals' Costs

- Pacific Bell cannot exercise any “bottleneck” control
  - The Commission has determined that the Act allows competitors to provide exchange access using unbundled network elements, shattering the “bottleneck” and any competitive advantage
  - Pacific Bell must provide exactly the same treatment to CLECs that it provides to itself
- Pacific Bell’s local exchange services and facilities are price controlled, precluding exercise of market power
  - Exchange access is subject to price caps
  - Unbundled elements must be priced at TELRIC

# Cost Misallocation, Predation, or Discrimination Cannot Be Used To Gain Market Power

- The Act's structural and accounting safeguards prevent cost misallocation and cross-subsidies
- Predation cannot be successful
  - The low marginal cost of interLATA traffic would lead to huge financial losses by a would-be predator
  - Because of the substantial sunk cost in competitors' existing networks, there is no barrier to market re-entry
- Competition cannot be distorted by discrimination
  - Discrimination cannot be effective and undetectable at the same time
  - The Act's specific nondiscrimination safeguards will be effective

# Dominant Regulation Will Harm Competition

- Tariffs filed on 1 day's notice — like PBCOM's competitors
  - Enables PBCOM to match price changes of its competitors identical time period
  - Speeds new services to customers
  - Longer notice periods could harm consumers by reducing price discounts and other forms of price competition among incumbent long distance carriers
- No cost support — like PBCOM's competitors
  - PBCOM will compete in markets the Commission has already declared competitive — PBCOM should not be required to subsidize its costs to its competitors

**Pacific Telesis Group**

# Dominant Regulation Will Harm Competition

- **No 214 approval process — like PBCOM's competitors**
  - The streamlined 214 process allows rapid introduction of new services
- **No price cap regulation — like PBCOM's competitors**
  - Price cap regulation of PBCOM would interfere with market pricing and result in less efficient investment and service decisions

# SUMMARY

- Pacific Bell and PBCOM can offer one-stop shopping
- Pacific Telesis can provide administrative services for PBCOM
- PBCOM must be regulated as a nondominant carrier