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Federal Communications Commission
Office of Secretary

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: Non-Accounting Safeguards, CC Docket No.96-149; CPNI, CC Docket No. 96-115; CC Docket No. 96-150, Accounting Safeguards

Today, Pat Mahoney, Senior Attorney, Pacific Telesis, Manuela McCall, Executive Director, Business Development & Strategy, Pacific Bell Communications, Michael Yourshaw of Wiley, Rein & Fielding and I met with Daniel Gonzales, Legal Advisor to Commissioner Chong, Elliot E. Maxwell, Deputy Chief, Office of Plans and Policy, A. Richard Metzger, Jr., Deputy Chief, Common Carrier Bureau, and with Radhika Karmarkar and Sarah E. Whitesell, of the Policy Division, Common Carrier Bureau, to discuss issues summarized in the attachments. We are submitting two copies of this notice, in accordance with Section 1.206(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.

Sincerely yours,

Attachments

cc: Daniel Gonzales
Radhika Karmarkar
Elliot E. Maxwell
A. Richard Metzger
Sarah E. Whitesell

No. of Copies rec'd 0+1
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Policy for BOC Joint Marketing of InterLATA Services and Provision of Shared Administrative Services

Legal requirements

Section 272 requires that Bell Operating Companies ("BOCs") provide in-region interLATA services through a separate affiliate and allows, under certain conditions, the BOC and the interLATA affiliate to market or sell each others' services. In addition, section 272 implicitly permits the holding company (or a services affiliate) to provide administrative services to both the BOC and the interLATA affiliate.[1] This section establishes detailed safeguards which are more than sufficient to prevent discrimination and cross-subsidy of competitive interLATA services by the BOC in connection with joint marketing or shared administrative services.[2]

Section 251(g) continues in effect the equal access obligation imposed under the MFJ.

Section 222, relating to the confidentiality of customer proprietary information (CPNI), also will affect joint marketing activities. It requires customer approval for a carrier to use CPNI obtained from one service, e.g., local, to market or sell another service, e.g., long distance.

Authorized activities

In order to enter the interLATA market efficiently and on an equal footing with other competitors, it is essential that the BOC have the ability to offer "one-stop shopping" and integrated packaging ("bundling") of local and interLATA services. This is expressly authorized by the Act: section 272(g)(2) allows a BOC to market or sell an affiliate's interLATA services once it is authorized under section 271. Similarly, the Act contemplates that the interLATA affiliate may also offer one-stop shopping by providing local service as a competitive local exchange carrier (CLEC) with its own facilities or those obtained from the BOC under section 251. Accordingly, section 272(g)(1) allows the interLATA affiliate to market or sell the BOC's telephone exchange services and section 272(e)(4) lets the interLATA affiliate obtain intraLATA facilities and services from the BOC.

Joint marketing and selling, as authorized by these sections, is not limited in any way by the Act, and necessarily includes (without limitation) advertising both services

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[1] Furthermore, the Act does not prohibit the BOC itself from providing administrative services to the separate affiliate, as the Commission allowed under *Computer II*.

[2] The requirements imposed by section 272 are more stringent than those currently required by the Commission under either *Computer III* or *Competitive Carrier*.

together, telemarketing (inbound and outbound), making services available from a single source, and/or offering packages and bundles of services at single or discounted prices.[3]

To compete successfully, the Bell company should have the same flexibility of corporate organization as its competitors and be able to take advantage of economies of scope and scale, subject only to the restrictions required in the Act. In particular, the holding company, or a services affiliate, should be able to provide shared administrative services[4] to both the BOC and the interLATA affiliate. Nothing in section 272 applies to the holding company or restricts what it may provide to the BOC or interLATA affiliate.

The Commission's existing rules, as well as the detailed provisions of the Act, are more than adequate to assure that joint marketing and shared administrative services—which clearly are permitted under the Act—pose no risk of cross-subsidy or discrimination that would call for additional rules beyond a restatement of the Act itself. Nor is there any threat of a violation of consumer's privacy expectations from authorized joint marketing.

Discrimination

Other provision of the Act, notably section 201, 202, 251, and 252, are a bulwark preventing BOC discrimination against competing carriers. Section 272 supplements these sections with non-discrimination provisions in subsections 272(c)(1) and 272(e), which specifically prohibit the BOC from discriminating between the interLATA affiliate and other carriers.

Not all intracorporate dealings are governed by nondiscrimination requirements, nor should they be so restricted. In the first place, the provision by the holding company or another affiliate of non-telecommunication administrative services is not regulated. For example, section 272(c)(1) applies only to the BOC, not the holding company. Second, section 272(g)(3) expressly exempts joint marketing activities between the BOC and the interLATA affiliate from the nondiscrimination provisions of section 272(c).

Section 251 requires the BOC to provide nondiscriminatory interconnection, access to unbundled network elements, resale services, and collocation to competing carriers. This section, and detailed implementing regulations, make it inconceivable that

[3] It would be helpful if the Commission were to define authorized marketing and selling activities. For example: "The term 'market or sell' as used in this subpart includes (without limitation) any of the following: advertising the availability of combined local exchange and interLATA services, inbound or outbound joint telemarketing of local exchange and interLATA services, making combined local exchange and interLATA services available from a single source, and/or providing bundling discounts for the purchase of combined local exchange and interLATA services."

[4] Examples of shared administrative services include 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, and business placement.

the BOC could discriminate in favor of the interLATA affiliate with respect to any service or facility of any competitive significance.

In addition, section 251(g) carries forward the equal access and nondiscriminatory interconnection restrictions and obligation applied to the BOCs by the MFJ. This assures that the provision of exchange access to interLATA carriers that compete with the interLATA affiliate will be on nondiscriminatory terms. The BOC will inform customers that they have a choice of interLATA carriers and take the customer's order for the interLATA carrier the customer selects. Thus, it will meet its equal access obligations and also be able to market and sell the services of its interLATA affiliate on inbound calls.

Section 272(c)(1) imposes nondiscrimination obligations on the BOC vis-à-vis the interLATA affiliate with respect to the provision or procurement of goods, services, facilities, and information, or in the establishment of standards during the 3-year period when structural separation is required.

In the joint marketing context, section 272(g)(1) imposes a nondiscrimination obligation on a BOC that allows its interLATA affiliate to market or sell the BOC's telephone exchange services. The BOC must offer competitors the same marketing opportunities.

Finally, section 272(e) enacts a list of specific non-discrimination obligations that survive the sunset of section 272(c)(1), including nondiscriminatory provisioning of telephone exchange service and exchange access, nondiscriminatory provision of facilities, services, or information concerning provision of exchange access, and nondiscriminatory pricing. Subsection 272(e)(4) specifically allows the BOC to provide any interLATA or intraLATA facilities or services to the interLATA affiliate if it makes the same offering to all carriers. Thus, if the BOC were to provide facilities to be used by the affiliate for either local or long distance services, all other carriers would be given the same opportunity.

Competing interexchange carriers can detect and report any discrimination they may experience. Indeed, any discrimination having a competitive impact in the marketplace would have to be obvious to customers, as well. In addition, existing reports under the Commission's CEI/ONA and ARMIS requirements give more than sufficient information about provisioning/installation and maintenance/repair for all service elements that would be relevant for section 272 purposes.[5] Therefore, no new reports are needed.

[5] The CEI/ONA report could be modified to show service the BOC provides to its interLATA affiliate compared to all other customers.

Reports at a greater level of detail may be appropriate as a business matter in connection with provision of service and facilities under interconnection agreements. The BOC can arrive at mutually satisfactory reporting requirements with its interconnection customers without a universal, detailed, publicly available reporting requirement imposed by the Commission.

Cross-subsidy

Section 272(b)(2) requires that the interLATA affiliate maintain books, records, and accounts that are separate from those of the BOC. Section 272(b)(5) requires the BOC and interLATA affiliate to conduct transactions on an arm's length basis. Section 272(c)(2) requires the BOC to account for all transactions with a separate affiliate in accordance with the Commission's accounting principles.

Application of the Commission's existing affiliate transaction rules[6] will satisfy these statutory requirements and are more than sufficient to address cross-subsidy concerns. For carriers subject to price caps, the effect of cost shifting on price is largely eliminated, thus adding an additional layer of protection against any adverse effect on consumers or competition due to cost shifting. The affiliate transaction rules are intended to protect against cross subsidy from a regulated entity to its nonregulated affiliate. These rules, as now in effect, could apply to any provision or receipt by the BOC of marketing or administrative services of the interLATA affiliate. The Commission need only order that the interLATA affiliate be deemed to be nonregulated for Title II accounting purposes only.

If the BOC were to provide marketing or administrative services to the affiliate, §32.27(d) of the rules requires that the interLATA affiliate pay the established prevailing price for those services (if such a price is available) or the fully distributed cost. This satisfies the Act's arm's length requirement as well as assuring that no cross-subsidy flows between the BOC and the affiliate, because the BOC will be fully compensated.[7]

The Commission's existing record-keeping requirements satisfy the Act by ensuring that these transactions will be auditable.

The Commission's rules require each BOC to file a cost allocation manual (CAM) with the Commission. This meets the Act's requirements because the BOC must describe all transactions with the interLATA affiliate and must make the CAM publicly available.

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[6] 47 C.F.R. §§32.27, 64.902.

[7] Minor changes to the affiliate transaction rules would be appropriate to permit rates appearing in publicly filed agreements submitted to a state commission and in statements of generally available terms (SGAT) pursuant to §252(f) to be another acceptable valuation basis and to use a uniform rate of return for affiliate transactions.

Section 272(d) requires a biennial federal/state audit of a BOC's compliance with section 272. This audit, along with the annual CAM audit required by the Commission, will give ample assurance that the accounting safeguards are being met.

In sum, the Act's requirements, as fully implemented by the Commission's existing cost allocation and affiliate transaction rules, together with price caps, assure that joint marketing or shared administrative services cannot harm consumers or competition by cross-subsidy.

Use of CPNI for joint marketing

The Commission's implementation of the privacy requirements regarding CPNI under section 222 should not preclude one-stop shopping. The BOC can market jointly the interLATA affiliate's interLATA services to those customers who have given permission for such use by whatever means are permitted as a result of CC Docket No. 96-115. The BOC may seek oral approval to use CPNI to market its affiliate's services. In addition, nothing in Section 222 limits the BOC's right to share CPNI with the interLATA affiliate if it has the customer's approval to do so. When the BOC obtains CPNI approval for such use, it is not obliged at the same time to seek such approval on behalf of other carriers, nor to share the CPNI with them. Instead, section 222(c)(2) contains specific procedures for supplying CPNI to others upon affirmative written request.

This balanced approach to use of CPNI fully protects customer's privacy expectations, while according the BOC necessary flexibility to market new services competitively.

Conclusion

Section 272 of the Act allows the BOC and its interLATA affiliate to market jointly local and long distance services. It also allows the holding company or a services affiliate to provide administrative services to the BOC and the interLATA affiliate. Section 272, along with other provisions of the Act and the Commission's existing rules, is adequate to prevent joint marketing or shared services from causing discrimination or cross-subsidy. Section 222 can be implemented consistently with customer privacy requirements and joint marketing needs. The Commission need only adopt rules mirroring the requirements of section 272, with a provision defining joint marketing, in order to protect consumers and foster competition.

APPENDIX _
AMENDMENTS TO THE CODE OF FEDERAL REGULATIONS

1. Part 64, Subpart S of Title 47 of the Code of Federal Regulations (C.F.R.) is added to read as follows:

Subpart S—Separate Affiliate; Safeguards.

§ 64.1901 Basis and purpose.

(a) *Basis*. These rules are issued pursuant to the Communications Act of 1934, as amended.

(b) *Purpose*. The purpose of these rules is to implement section 272 of the Communications Act of 1934, as amended, 47 U.S.C. 272.

§ 64.1903 Separate Affiliate Required for Competitive Activities.

(a) A Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c) of the Communications Act of 1934, as amended, 47 U.S.C. 251(c), may not provide any service described in paragraph (b) unless it provides that service through one or more affiliates that—

(1) are separate from any operating company entity that is subject to the requirements of section 251(c) of the Communications Act of 1934, as amended, 47 U.S.C. 251(c); and

(2) meet the requirements of § 64.1905.

(b) The services for which a separate affiliate is required by § 64.1903(a) are:

(1) Manufacturing activities (as defined in section 273(h) of the Communications Act of 1934, as amended, 47 U.S.C. 273(h)).

(2) Origination of interLATA telecommunications services, other than—

(i) incidental interLATA services described in paragraphs (1), (2), (3), (5), and (6) of section 271(g) of the Communications Act of 1934, as amended, 47 U.S.C. 271(g);

(ii) out-of-region services described in section 271(b)(2) of the Communications Act of 1934, as amended, 47 U.S.C. 271(b)(2); or

(iii) previously authorized activities described in section 271(f) of the Communications Act of 1934, as amended, 47 U.S.C. 271(f).

(3) InterLATA information services, other than electronic publishing (as defined in section 274(h) of the Communications Act of 1934, as amended, 47 U.S.C. 274(h)) and alarm monitoring services (as defined in section 275(e) of the Communications Act of 1934, as amended, 47 U.S.C. 275(e)).

§ 64.1905 Structural and Transactional Requirements.

The separate affiliate required by this section—

(a) shall operate independently from the Bell operating company;

(b) shall maintain its own books, records, and accounts which shall be separate from the books, records, and accounts maintained by the Bell operating company of which it is an affiliate;

(c) shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate;

(d) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and

(e) shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection.

§ 64.1907 Nondiscrimination Safeguards.

In its dealings with its affiliate described in § 64.1903, a Bell operating company—

(a) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards; and

(b) shall account for all transactions with an affiliate described in § 64.1903 in accordance with § 32.27 of this chapter.

§ 64.1909 Biennial Audit.

(a) A company required to operate a separate affiliate under this subpart shall obtain and pay for a joint Federal/ State audit every 2 years conducted by an independent auditor to determine whether such company has complied with this section 272 of the Communications Act of 1934, as amended, 47 U.S.C. 272, and this subpart, and the accounting requirements under § 32.27 of this chapter.

(b) The auditor described in paragraph (1) 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. Any party may submit comments on the final audit report.

(c) For purposes of conducting audits and reviews under this section—

(1) the independent auditor and the Commission shall have access to the financial accounts and records of each company and of its affiliates necessary to verify transactions conducted with that company that are relevant to the specific activities permitted under this subpart and that are necessary for the regulation of rates;

(2) the Commission shall have access to the working papers and supporting materials of any auditor who performs an audit under this section; and

§ 64.1911 Fulfillment of Certain Requests.

A Bell operating company and an affiliate that is subject to the requirements of section 251(c) of the Communications Act of 1934, as amended, 47 U.S.C. 251(c)—

(a) shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access 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;

(b) shall not provide any facilities, services, or information concerning its provision of exchange access to the affiliate described in § 64.1903 unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;

(c) shall charge the affiliate described in § 64.1903, or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and

(d) 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.

§ 64.1913 Sunset.

(a) The provisions of this subpart (other than § 64.1911) shall cease to apply with respect to the manufacturing activities or the interLATA telecommunications services of a Bell operating company 3 years after the date such Bell operating company or any Bell operating company affiliate is authorized to provide interLATA telecommunications services under section 271(d) of the Communications Act of 1934, as amended, 47 U.S.C. 271(d).

(b) The provisions of this subpart (other than § 64.1911) shall cease to apply with respect to the interLATA information services of a Bell operating company on February 8, 2000.

§ 64.1915 Joint Marketing.

(a) The term "market or sell" as used in this subpart includes (without limitation) any of the following: advertising the availability of combined local exchange and interLATA services, inbound or outbound joint telemarketing of local exchange and interLATA services, making combined local exchange and interLATA services available from a single source, and/or providing bundling discounts for the purchase of combined local exchange and interLATA services.

(b) A Bell operating company affiliate required by this section may not market or sell telephone exchange services provided by the Bell operating company unless that company permits other entities offering the same or similar service to market and sell its telephone exchange services.

(c) A Bell operating company may not market or sell interLATA service provided by an affiliate required by this subpart within any of its in-region States until such company is authorized to provide interLATA services in such State under section 271(d) of the Communications Act of 1934, as amended, 47 U.S.C. 271(d).

(d) The joint marketing and sale of services permitted under this section shall not be considered to violate the nondiscrimination provisions of § 64.1907.

§ 64.1917 Transition.

With respect to any activity in which a Bell operating company is engaged on February 8, 1996, such company shall have until February 8, 1997, to comply with the requirements of this subpart.

CC Docket No. 96-149 Ex Parte

- Joint Marketing
- Centralized Administrative Services
- Nondominant Status

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 Permit:

- Pacific Bell and PBCOM to offer "one-stop shopping" and integrated packaging
- Pacific Telesis or its services subsidiary to provide centralized administrative services to all of its affiliates

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 and PBCOM can offer "one-stop shopping" and integrated packaging
- PBCOM will fairly compensate Pacific Bell for all joint marketing efforts

PBCOM Plans

- Sales
  - Pacific Bell/Nevada Bell joint marketing will be an important channel for PBCOM
  - PBCOM will also have its own sales channels and will utilize third party retail channels
- Services Provisioning: IntraLATA
  - PBCOM's state fillings for authority in California and Nevada include requests for CLEC authority. The extent to which PBCOM will utilize that authority will depend importantly on Pacific Bell's and Nevada Bell's ability to market and sell "integrated packages" to meet the competition from major IECs
- Services Provisioning: InterLATA
  - PBCOM currently plans to provide interLATA services through a combination of the use of its own facilities (e.g., switches) and third party facilities of other carriers. We expect to use Sprint for nationwide and international carriage. In-region, we will consider options, including Sprint and Pacific Bell facilities pursuant to section 272(e)(4).

Pacific Bell Will 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's services
- Marketing and sales include, for example:
  - advertising
  - outbound calling to customers
  - offering both types of services on the same call
  - integrating packages of services
  - customer referrals and transfers

Pacific Bell's Joint Marketing Should Be Broadly Interpreted

- In order to provide best service to customers Pacific Bell must be able to do everything competitors can do to market and sell PBCOM's and Pacific Bell's services together
- Pacific Bell should be able to sell *all* services offered by PBCOM

Pacific Bell and PBCOM Can Offer One-Stop Shopping and Integrated Packaging

- 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

Pacific Bell Looks Forward to Joint Marketing PBCOM's Services with Pacific Bell's Services

- Value to Pacific Bell's customers
  - "One-stop shopping"
  - Responsive to customer requests
  - Less confusing for customers
- Value to Pacific Bell
  - Promotes customer satisfaction
  - Retains customers on Pacific Bell's services
  - Allows Pacific Bell to compete effectively

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 services 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 BOC
- 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*, the BOC was permitted to provide certain "administrative services" to 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 Should Be Regulated As a Nondominant Carrier

- PBCOM will have zero initial market share and no market power
- Substitutable supply capacity exists -- customers can easily change providers if PBCOM's prices are not competitive
- Dominant regulation will harm competition
- The U.S. Department of Justice recommends: *"The Commission should not apply its dominant carrier regulations to BOC affiliates."*