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

Re: *Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149*

Dear Mr. Caton:

In accordance with the Commission's rules governing ex parte presentations, enclosed is a letter from SBC Communications Inc. ("SBC") to Regina M. Keeney, Chief of the Common Carrier Bureau, which we request be included in the official record in this docket. The letter responds to Commission staff requests to address and discuss the term "operate independently," which is found at Section 272(b)(1) of the Telecommunications Act of 1996.

Pursuant to the Commission's rules, an original and two copies of this letter and the attachment are provided. Please stamp and return the copy provided for that purpose. Should you have any questions concerning this filing, do not hesitate to contact me at (202) 326-8888.

Very truly yours,

Todd F. Silbergeld

Attachment

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November 14, 1996

Ms. Regina Keeney
Chief, Common Carrier Bureau
Federal Communications Commission
1919 M Street N.W., Room 500
Washington, D.C. 20554

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

Dear Ms. Keeney:

Per requests from your staff, SBC Communications Inc. ("SBC") provides the following information to supplement the record in CC Docket No. 96-149, implementing certain aspects of the Telecommunications Act of 1996 (the "1996 Act"). This letter is intended to set forth the attributes of a Bell operating company ("BOC") Section 272 affiliate that "operates independently" from the BOC. Although SBC does not consider rules defining the parameters of the phrase "operate independently" to be necessary, in the event that the Commission determines rules to be necessary, a proposed draft of suitable rules implementing Section 272, and particularly subsections 272(b) and (g), is attached.

The phrase "operate independently" does not have universal meaning. As is set forth below, operational independence has one meaning in the enhanced services regulatory context, another meaning in the commercial mobile radio service regulatory context, and yet different meanings in the context of Sections 272 and 274 of the 1996 Act. Congress evidently gave little or no consideration to the Commission's prior use of the phrase "operate independently" in historical regulatory contexts. Section 272(b)(1) of the 1996 Act evolved from a unique legislative process that established boundaries for its meaning without reference in the legislative history to outdated regulatory regimes. The Commission, therefore, should ascribe a meaning supported by the express terms of the 1996 Act and its legislative history and one that is consistent with the intent of Congress.

I. THE CONTEXT: EFFECTIVE JOINT MARKETING

It is imperative that the Commission ultimately applies to the phrase "operate independently" a definition that does not undermine the express right of a BOC or its Section 272 affiliate to jointly market telephone exchange services and interLATA services, among others. The operational independence requirement cannot be construed in any way to limit the joint marketing freedoms because joint marketing in parity with competitors is broadly authorized under Section 272(g) notwithstanding the other limitations upon the relationship between the BOC and its

interLATA affiliate set forth in Section 272(c) (see Sections 271(e)(1) and 272(g) and Senate Report at 23, 43). To undercut this premise would fail to enable additional, robust competition in the telecommunications industry, which should be the Commission's paramount goal in this docket.

Ultimately, Congressional intent requires that the Commission's determination of the meaning of "operate independently" permit the same kinds of back-office coordination that allows the competitors of the BOCs and their Section 272 affiliates to offer effective "one-stop shopping."¹ Certainly, at least for the time being, BOCs will continue to be subject to cost allocation and other regulatory requirements. However, whatever action the Commission takes, it must permit the BOCs and their affiliates to jointly market local and interexchange service so that they can effectively compete with carriers that are not restricted under Section 272. To do anything less is to interpret the explicit words and intent of Congress as an empty gesture.

The most compelling evidence of why the Commission's implementation of operational independence must grant the BOCs flexible joint marketing freedom is the reality of how "one-stop" marketing efforts are put together. Carriers providing a "one-stop shop" will package local, long distance, wireless, paging, Internet access, voice mail, home security, and fee-based television in their marketing efforts. The consumer will be able to contact such a carrier and, with one call, make a decision as to whether to establish service for all the desired telecommunications services. Services will be billed on one bill, and the customer will use one phone number for all service and repair needs. This ability to acquire, pay for, and ask questions about service--all in one stop--is the sort of innovation Congress intended under the 1996 Act. Complex behind-the-scenes operational coordination will be needed to provide such one-stop service, and an overly restrictive interpretation of independent operations would eliminate a new competitive option for consumers at its inception.

II. PARAMETERS FOR THE PHRASE "OPERATE INDEPENDENTLY"

A. BASIC STANDARDS

1. A "Piercing The Corporate Veil" Definition Of "Operate Independently" Is Appropriate

One straightforward approach to defining independent operations is to look to the distinctions between companies necessary to preserve the existence of a "corporate veil." Specifically, under a "piercing-the-corporate veil" standard, in order to be deemed as operating independently, neither the BOC nor its Section 272 affiliate could be an "instrument" or "alter ego" of the other, such

¹"One-stop shopping," as defined by the Commission, includes "a single point of contact for all service, repair and billing needs." In the Matter of Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services. Implementation of Section 601(d) of the Telecommunications Act of 1996, and Sections 222 and 251(c)(5) of the Communications Act of 1934, Notice of Proposed Rulemaking, Order On Remand, And Waiver Order, WT Docket No. 96-162 (released August 13, 1996) at ¶51.

that one entity conducted its business solely to serve the other.

In the same manner that Congress permitted a Section 272 entity to jointly market with and obtain services and facilities from its affiliated BOC, no one would suggest that any other corporate entity would endanger its corporate protections by participating in such activities with another corporation.

2. **The Phrase “Operate Independently” Implies A Straightforward Operational Structure**

Aside from the qualitative “piercing the corporate veil” standard, certain operational or organizational characteristics should be present to effectuate the meaning of the term “operate independently.” In addition to the other express requirements of Section 272(b), a Section 272 separate affiliate that operates independently must:

- a. have a separate board of directors that does not include BOC officers, directors, or employees;
- b. have a chief executive officer who is responsible for the operation and results of the affiliate(s), is responsible for overall execution of the business plan, and is not an officer, director, or employee of the affiliated BOC;
- c. have a chief financial officer who is responsible for the separate budget, financial, and operational planning of the affiliate(s) and is not an officer, director, or employee of the affiliated BOC; and
- d. have operating personnel who are responsible for the planning and execution of the affiliate’s business plans and who are not officers, directors, or employees of the affiliated BOC.

Additional general propositions relating to the independent operations of the BOC and the BOC affiliate are applicable. For instance, the separate affiliate operates independently while still purchasing products and services based on publicly-disclosed contractual agreements with the BOC pursuant to Section 272(b)(5) and in accordance with the applicable nondiscrimination safeguards defined in Sections 272(c) and (e). The separate affiliate also operates independently while purchasing products and services from affiliated companies other than the BOC (from whom the BOC may also currently or in the future purchase products and services).

B. HISTORICALLY RESTRICTED ACTIVITIES ARE NOT PRECLUDED BY SECTION 272’s INDEPENDENT OPERATIONS REQUIREMENT

Fundamentally, it is inappropriate to look to historical regulations to determine what Congress intended in the 1996 Act. As an initial matter, the Commission’s regulations themselves ascribe inconsistent meanings to the concept of operational independence. Moreover, the historical

meanings are themselves inconsistent with the 1996 Act.

- First, to construe the use of the phrase “operate independently” as used in Section 272 coextensively with the Computer II rules would essentially read out of the 1996 Act Section 272 (b)(5), (c), and (e)’s express contemplation that such transactions, including provision of interLATA and intraLATA facilities, would be permitted. Although facilities-oriented prohibitions may have been appropriate in the very different enhanced services industry and during very different times, Congress did not impose through Section 272 the Computer II requirements that the BOC and its affiliate use separate computer, network, and transmission facilities.
- Second, while in the context of its BOC-affiliate cellular provision rules, 47 C.F.R. §22.903, BOC-affiliated cellular providers are required to utilize separate computer and transmission facilities in the provision of cellular services, comparable language is conspicuously absent from Section 272. The absence of such language in Section 272 requires the inference that Congress did not intend to require separate computer and transmission facilities between the BOC and the required separate affiliate. Accordingly, to construe the phrase “operate independently” as requiring such separation as was mandated by Section 22.903 is to render a nullity Congress’ intent.

C. SECTION 274 IS OF LITTLE USE IN INTERPRETING SECTION 272

In addition, the phrase “operate independently” is used differently in different contexts within the 1996 Act. Subsection (b) of Section 274, for instance, relating to electronic publishing, requires that a BOC and its electronic publishing affiliate be “operated independently.” Subsections (b)(1) through (9) next enumerate the elements of independent operations, some of which are common to Section 272, and some of which are not. Common to both Section 274 operational independence elements and Section 272(b) are requirements for separate books and accounts; separate officers, directors, and employees; separate credit; and arm’s length, written, and public transactions.

Moreover, the separate Section 274 affiliate may not “own” any “property” in common with the BOC, presumably including switching, transmission, or other computer facilities. While this language reaches only the ownership of property, it nonetheless is absent from Section 272, again requiring the inference that such activities are permitted under Section 272.

Finally, the requirement that the Section 274 affiliate operate more independently from the BOC than the Section 272 affiliate is underscored by the joint marketing permitted to each. Rather than being able to engage in the types of joint marketing activities permitted directly for the Section 272 affiliate, a Section 274 affiliate may obtain joint marketing only by means of non-discriminatory inbound telemarketing from the BOC or through participation in teaming arrangements or joint ventures.

Unquestionably, the concept of operational independence is more restrictive in the Section 274 environment.

D. OPERATIONAL INDEPENDENCE HAS NOT BEEN GIVEN UNIVERSAL MEANING

Operational independence is not a universal concept, and the term “operate independently” has not been given a single, universal definition. Instead, the concept of operational independence has different meaning depending on the statutory, regulatory, or industrial context in which it is used. Accordingly, in the context of Section 272, the Commission should ascribe to it a contemporary meaning drawn from the context and legislative history of Section 272 and based upon the particulars of the industry in which it is to be applied.

III. THE STATUTORY EVOLUTION OF THE 1996 ACT INDICATES THAT CONGRESS ENVISIONED SUBSTANTIAL ACTIVITY BETWEEN THE BOC AND THE BOC AFFILIATE WITHOUT ENDANGERING INDEPENDENT OPERATIONS

A. BOTH H.R. 1555 AND THE 1996 ACT REQUIRE INDEPENDENT OPERATIONS, BUT THE 1996 ACT DOES NOT PROHIBIT JOINT VENTURES OR PARTNERSHIPS, THE JOINT OWNERSHIP OR USE OF SWITCHING OR TRANSMISSION EQUIPMENT, OR THE JOINT OWNERSHIP OR USE OF OTHER PROPERTY

In addition to participating in joint marketing activities, the BOC affiliate can operate independently from the BOC within the bounds of Section 272, and yet:

- (1) participate in joint venture activities or partnerships with the BOC;
- (2) own or use telecommunications transmission or switching facilities in common with the BOC;² or
- (3) jointly own or share the use of other types of property with the BOC.

The legislative history of the 1996 Act states that the unenacted H.R. 1555 Section 246(c), the legislative House companion provision to Section 272 of the 1996 Act, required “fully separate operations and property.” However, while H.R. 1555 Section 246 required “Separate Operations and Property,” Section 272 of the 1996 Act has specified “Structural and Transactional Requirements.” This is more than a semantic difference. From the subtitles to the text, Section

²Although SBC contends that the correct reading of Section 272 in light of its legislative history permits joint ownership of transmission and switching facilities, it has no current plans for its BOC and its Section 272 affiliate to own such facilities jointly. See Notice of Proposed Rulemaking (“NRPM”) at n.106.

272 of the 1996 Act is in many respects indisputably less restrictive on integrated operations than H.R. 1555. The conclusion that must be drawn is that, by abrogating certain aspects of Section 246 in lieu of Section 272, Congress intended that substantial transactions among BOCs and their affiliates would be permitted, and in particular, that the phrase "operate independently" would have a limited scope.

The structure of Section 246(c) of H.R. 1555 is comparable to that of Section 272 of the 1996 Act, in that its first proviso is a basic requirement that the separate subsidiary "operate independently from the Bell operating company or any affiliate thereof . . ." In Section 246(c), the requirement of independent operations is followed by four additional attributes, one of which is common to both Section 272 and Section 246(c) (the requirement that the BOC and the BOC affiliate have separate officers, directors, employees). However, H.R. 1555 Section 246(c) specifically prohibited joint venture activities and partnerships among BOCs and their interLATA affiliates, prohibited common ownership of telecommunications transmission or switching facilities, and prohibited the joint ownership or shared use of any other property among BOCs and their interexchange affiliates. None of these prohibitions is contained in Section 272, and a logical conclusion that can be drawn is that Congress intended that these activities not constitute attributes of the phrase "operate independently" as ultimately enacted.

B. THE PHRASE "OPERATE INDEPENDENTLY" ALSO SHOULD NOT BE USED TO PROHIBIT THE USE OF SHARED ADMINISTRATIVE SERVICES OR OTHER SERVICES PROVIDED BY THE PARENT CORPORATION OR A MUTUAL AFFILIATE

While Section 272 requires that the separated affiliate "operate independently from the [the BOC]," H.R. 1555 required that the separate affiliate "operate independently from the Bell operating company or any affiliate thereof."³ Similarly, while Section 272 requires that the separate affiliate maintain officers, directors, and employees separate from the BOC, it does not require, as did H.R. 1555, that the affiliate "have separate officers, directors, and employees who may not also serve as officers, directors, or employees of the Bell operating company or any affiliate thereof."⁴ H.R. 1555 also required that the BOC interLATA affiliate:

- (3) not enter into any joint venture activities or partnership with a Bell operating company or any affiliate thereof,
- (4) not own any telecommunications transmission or switching facilities in common with the Bell operating company or any affiliate thereof, and

³House Report on H.R. 1555 (Report No. 104-204) ("House Report") at 10 (emphasis added). Section (4) of the Communications Act as amended defines the term "Bell operating company" to mean and include specific entities, including Southwestern Bell Telephone Company and its successors and assigns, but "does not include an affiliate of any such company . . ." The 1996 Act also defines "affiliate" to mean "a person that (directly or indirectly) owns or controls, is owned or controlled by, or is under common ownership or control with, another person." "Affiliates" of the BOC, therefore, include the parent of the BOC, as well as subsidiaries and horizontal affiliates of the BOC.

⁴House Report at 10 (emphasis added).

- (5) not jointly own or share the use of any other property with the Bell operating company or any affiliate thereof.⁵

As the Commission pointed out in the NPRM, each of these requirements was omitted from Section 272 of the 1996 Act as ultimately enacted. Perhaps more significantly, however, virtually every safeguard--structural or non-structural--set forth in Section 246 of H.R. 1555 applied not only to the relationship between the BOC and its in-region, interLATA affiliate, but also to the relationship between non-Section 246/non-Section 272 BOC affiliates and the in-region, interLATA affiliate.

A comparison of H.R. 1555 with the 1996 Act leads to the inescapable conclusion that the Section 272 requirements are materially less restrictive than those that would have been imposed under H.R. 1555 and permit a corporate parent or common affiliate to perform services for the BOC and the BOC Section 272 affiliate.

While vertical or horizontal integration may arguably have been prohibited under H.R. 1555, Congress could not both have omitted the "[BOC] or any affiliate thereof" language in lieu of simply "the [BOC]" and yet intended that integration be prohibited. The structural separation requirements of Section 272 are, therefore, inapplicable to the relationship between the BOC and non-Section 272 affiliates, and are likewise inapplicable to the relationship between the Section-272 affiliate and its non-BOC parent or any of its non-BOC affiliates.

The clear evolution of the language of H.R. 1555 Section 246 to that of 1996 Act Section 272, as enacted, therefore, supports the proposition that Congress intended that the Section 272 separate affiliate not be prohibited from obtaining services even on a discriminatory basis from the BOC parent holding company or any other BOC affiliate. Services-affiliate corporate structures--in which shared administrative services, marketing services, network planning services, etc., are supplied to both the BOC and the BOC Section 272 affiliate--cannot be deemed to violate Section 272's independent operations requirement.

IV. THE REQUIREMENT OF INDEPENDENT OPERATIONS SHOULD NOT BE USED TO DENY TO A BOC SECTION 272 AFFILIATE WHAT IS AVAILABLE TO OTHER REQUESTING TELECOMMUNICATIONS CARRIERS

To the extent that BOCs offer switching, transmission, or computer facilities or operational interfaces for use or access by unaffiliated providers of interexchange or local exchange services (e.g., via resold services, the use of unbundled network elements, or through the use of computer interfaces necessary to give access to operations support systems), the same access must be granted to BOC Section 272 affiliates. In summary, Sections 272(b)(5), (c), and (e) permit the BOC to provide goods, services, and facilities to a BOC Section 272 affiliate on terms that are arms-length, in writing, publicly available, and nondiscriminatory, without violating the principle

⁵House Report at 10 (emphasis added).

of operational independence.⁶ If the Commission interprets Section 272(b)(1) to exclude from BOC affiliates the same access to such systems as is offered to unaffiliated entities (as a Computer-II or Section-22.903-type construction of operational independence arguably could), the Commission will turn on its head the express statutory language of Section 272.

Ultimately, as long as the BOC affiliate's joint use or sharing of switching, transmission, or computer facilities is nondiscriminatory and otherwise complies with the terms of Section 272, (b)(5), (c), and (e), such use is not an impediment to independent operations, and the Commission cannot and should not impose regulations to the contrary.



David F. Brown
Attorney

cc: **The Hon. Reed E. Hundt**
 The Hon. James H. Quello
 The Hon. Susan Ness
 The Hon. Rachelle B. Chong
 Mr. Metzger
 Mr. Atlas
 Ms. Matthey
 Ms. Karmarkar
 Ms. Kinney
 Ms. Leanza
 Ms. Whitesell
 Ms. Scinto
 Mr. Caton, Acting Secretary

⁶In addition, pursuant to the provisions of Section 272(g), the BOC and the BOC Section 272 affiliate may provide joint marketing services on a discriminatory basis.