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November 26, 1996

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Federal Communications Commission
Office of Secretary

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: Telecommunications Services Inside Wiring, CS Docket No. 95-184; Cable Home Wiring, Mm Docket No. 92-260; Over-the-Air Reception Devices, CS Docket No. 96-83

Yesterday, Lea Jones, Director, Regulatory Affairs, Pacific Bell Video Services, and Sarah Thomas, Senior Attorney, Pacific Telesis Legal Group, and I discussed the legal and policy arguments made in Pacific's ex parte filings of October 16, November 12, and November 21, with JoAnn Lucanik, Chief, Rick Chessen, Deputy Chief, Policy and Rules Division, and Alex Johns, Cable Services Bureau. Ms. Jones and Ms. Thomas participated by telephone. 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,

Gina Harrison/mcm

cc: R. Chessen
A. Johns
J. Lucanik

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Re: BOC Provision of "Carrier's Carrier" InterLATA Services

The Telecommunications Act of 1996 (the Act) allows a Bell Operating Company (BOC) to provide interLATA services to other carriers, including to the separate affiliate required by §272. The provision of such "carrier's carrier" services is subject to Commission approval under §271, if they originate in-region, and to the nondiscrimination safeguards of §272(e)(4), but not to the §272 separate affiliate requirement.

I. The Language of the Act Allows a BOC To Provide Carrier's Carrier Services

It is unquestioned that a BOC may provide out-of-region interLATA services both on a retail basis and to other carriers without Commission approval and without a §272 separate affiliate.[1] It is also clear that a BOC must have approval under §271, and use a §272 separate affiliate, to provide retail in-region interLATA services to the general public. The parties to CC Docket No. 96-149 disagree on whether a BOC must use a separate affiliate to provide in-region interLATA services to other carriers, including the BOC's own separate interLATA affiliate. The comments in that docket have focused on §272(e)(4). In addition to that subsection, it is also necessary to refer to the definitions in the Act and the specific provisions of §§271(b)(1) and 272(a)(2) to resolve this question. (See the attached diagram for an overview of the relationship between the §271 approval requirements and the §§272/274 structural separation requirements.)

Section 271(b)(1) of the Act requires Commission approval before a BOC may provide "interLATA services originating in any of its in-region States." Section 3(21) defines "interLATA services" as "telecommunications between a point located in a local access and transport area and a point located outside such area." Section 3(43) defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." These provisions do not draw distinction between retail and carrier's carrier offerings. Thus, a BOC must obtain Commission approval

[1] The Commission's interim *Competitive Carrier* policy allows a BOC the option of using an affiliate that complies with certain safeguards (although not all of the §272 restrictions) or being subject to dominant regulation. Report and Order, Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, FCC 96-288 (released July 1, 1996).

under §271 before it may provide in-region interLATA services originating in-region to other carriers.[2]

Section 272 uses different terminology, with a different result.

Section 272(a)(2)(B) requires a BOC to use a separate affiliate for "[o]rigination of interLATA telecommunications services."[3] Section 3(46) defines "telecommunications service" to mean "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used." Accordingly, the scope of the separate affiliate requirement only includes offerings "directly to the public." This is a much narrower class of services than those described in §271(b)(1). Congress's use of a different defined term in §272 ("telecommunications service" versus "interLATA service") leaves no doubt that the BOC itself may provide carrier's carrier services, which the BOC does not offer "directly to the public," without using a separate affiliate.

In view of the above, there is a clear resolution to the controversy in Docket 96-149 over the meaning of §272(e)(4). That section states that a BOC "may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such service 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." Because the §272 separate affiliate requirement does not apply to carrier's carrier offerings, there is no conflict between the requirement that retail services be offered through a separate affiliate. The function of §272(e)(4) in the Act, which is fully in harmony with §272(a),[4] is to clarify expressly that (1) a BOC may provide carrier's carrier services, (2) a BOC may provide facilities, as well as services, to carriers, (3) a BOC may make these offerings to its own interLATA affiliate, and (4) nondiscrimination and cost allocation apply to such offerings. Thus, §272(e)(4) is neither redundant nor is it in conflict with the overall structure of the Act.

II. BOC Provision of Carrier's Carrier Services Is in the Public Interest

Section 271(d)(3)(C) requires a BOC to satisfy the Commission that the offering of carrier's carrier services originating in-region will be consistent with the public interest before the BOC can offer such services. The BOC will make a specific public interest showing in a §271 application proceeding. However, several general public interest

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[2] Section 271 only applies where a BOC "provides" interLATA services such as to another carrier or to the general public.

[3] There are exceptions to this requirement not relevant to this discussion.

[4] Even if §272(a) could somehow be read to include carrier's carrier services, §272(e)(4) would constitute an exception because, as a matter of statutory construction, the more specific provision (§272(e)(4)) would take precedence over the general provision (§272(a)). *See* MacEvoy v. United States, 322 U.S. 102, 107 (1944). The Commission must avoid an interpretation of the Act that would make §272(e)(4) superfluous and must construe the Act to give effect to all of the words used by Congress. *See* Beisler v. Commissioner, 814 F. 2d 1304, 1307 (9th Cir. 1987).

considerations show that there is a sound policy basis for Congress's decision to allow BOC in-region interLATA carrier's carrier services.

A Bell regional holding company needs maximum flexibility to implement its network—the same flexibility that other providers of intraLATA and interLATA services enjoy—if it is to provide consumers efficient, economical, and innovative service. This includes the option of provisioning both intraLATA and interLATA services from the same underlying BOC network. Compared to using services provided by the BOC on a wholesale basis, the separate interLATA affiliate that provides retail services may not find it efficient to resell another carrier's services, acquire facilities from a third party, or construct new facilities. To optimize consumer welfare, the separate affiliate must be able to choose among all these options.

If the separate affiliate must buy from a competing interexchange carrier to provision its own interexchange services, its cost may be higher and it will be handicapped in competing on price with the existing interexchange oligopoly.[5] The ability of the BOC to offer carrier's carrier services can add an additional source of facilities-based competition at the interexchange wholesale level that will serve not only the BOC's interLATA affiliate but potentially other second tier retail interexchange carriers, who are now subject to the pricing of the big three—AT&T, MCI, and Sprint.

In addition, the BOC may provide underlying services to its own interLATA affiliate for new retail offerings not now available in the marketplace. Consumers will benefit from the introduction of these new offerings and, because the BOC must make the same underlying services available to all carriers, other retail carriers will have an opportunity to match the BOC affiliate's products.

Finally, the §272 separate affiliate requirement may apply for as few as three years after the separate interLATA affiliate enters the market.[6] Congress intended that this provision would sunset and that afterwards BOC would be able to take advantage of all possible economies of scope and scale, just as all other carriers may do today. BOC provision of carrier's carrier services to its separate affiliate would permit a quicker and more efficient transition from structural separation to integration, which promises further cost reduction and consumer pricing benefits. Forcing the interLATA affiliate to acquire duplicative facilities would prove wasteful and inefficient.

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[5] Interexchange carriers are not legally obliged to provide at cost unbundled network elements to other carriers, nor to resell their services at wholesale prices—unlike the reverse situation where incumbent interexchange carriers are guaranteed an efficient method of entering the local market. Moreover, the major facilities-based interexchange carriers are nondominant and untariffed, which gives them total control over their offerings to retail carriers. Thus, the BOC's separate affiliate may or may not be able to negotiate favorable resale terms to provision its interLATA offering. Also, as long as the option of using BOC-provided facilities and services exists (even if not exercised), it will be a factor in negotiations for resale services from the interexchange carriers that will help the affiliate reach a price that is fair.

[6] *See* §272(f)(1).

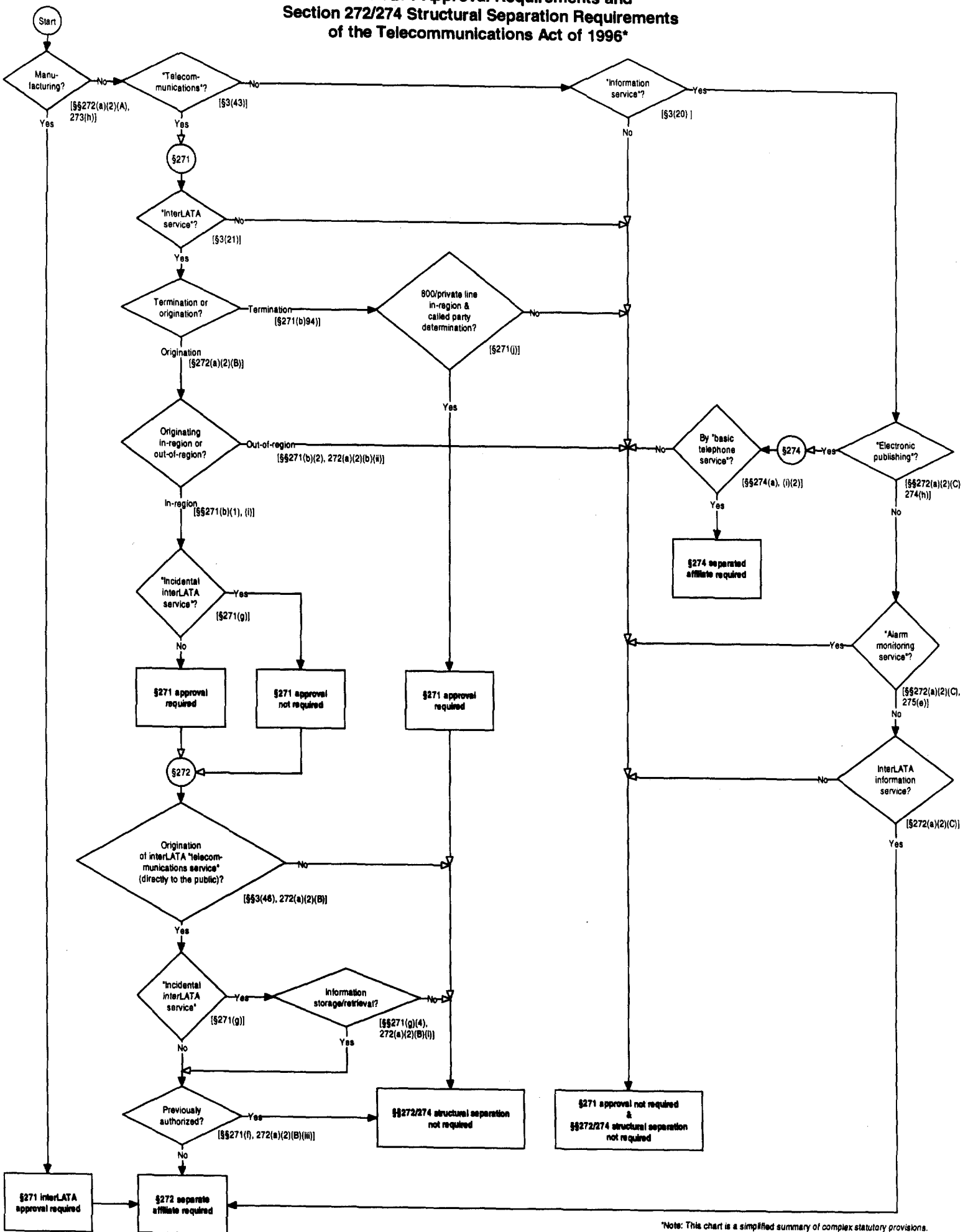
BOC provision of carrier's carrier services presents no risk of discrimination or cross-subsidy. In the first place, §271(d)(3)(B) requires the BOC to demonstrate to the Commission, before it may provide carrier's carrier services, that it will comply with §272, including the nondiscrimination provisions of §§272(c)(1) and 272(e)(4) and the accounting and affiliate transaction requirements of §272(c)(2). Second, the BOC will have an ongoing obligation under §§272(c)(1) and 272(e)(4) to offer such services on nondiscriminatory terms to all carriers. Third, the BOC will not directly engage in competition with other interLATA carriers for retail business, which is the largest and most critical part of the market. Instead, it would be acting as a supplier to interexchange carriers—sophisticated customers with many choices other than the BOC for interLATA service and facilities. These carriers can easily detect any discrimination—and easily avoid it by use of some other carrier's wholesale services.

The Commission's accounting and affiliate transaction rules, which implement §§272(c)(2) and 272(e)(4), will prevent the BOC from cross subsidizing any carrier's carrier services it provides to its interLATA affiliate. Moreover the BOC would have no incentive to set its prices at "subsidized" low rates, because the affiliate's competitors in the interexchange market would be entitled to the same prices and the BOC's affiliate would have no advantage. For the same reason, there would be no effect on competition at the retail consumer level because all carriers would have the same access to BOC services at the same prices.

* * *

In sum, the Act allows a BOC to provide in-region interLATA carrier's carrier services to its separate interLATA affiliate and to other carriers; the public will benefit from such offerings; and there is no danger of discrimination or cross subsidy.

Section 271 Approval Requirements and Section 272/274 Structural Separation Requirements of the Telecommunications Act of 1996*



*Note: This chart is a simplified summary of complex statutory provisions. It is highly advisable to consult the text of the Act (including definitions of terms).

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