



MCI Communications Corporation

1801 Pennsylvania Avenue, NW
Washington, DC 20006
202 887 2375

Kimberly M. Kirby
Senior Manager
FCC Affairs

EX PARTE OR LATE FILED

December 13, 1996

EX PARTE

Mr. William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, NW Room 222
Washington, DC 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 Mr. Caton:

On Friday, December 13, 1996, Mary Brown, Frank Krogh and I of MCI met with Debra Weiner, Linda Kinney, and Blaise Scinto. The purpose of the meeting was to review MCI's position in this proceeding as stated in MCI's comments. The meeting focused on the joint marketing issues addressed in this docket and the attached documents outline the topics discussed.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Kimberly M. Kirby

Attachments

cc: Linda Kinney
Debra Weiner
Blaise Scinto

No. of Copies rec'd 021
List ABCDE



**MCI Telecommunications
Corporation**

1801 Pennsylvania Ave., N.W.
Washington, D.C. 20006
202 887 2372
FAX: 202 887 3175

Frank W. Krogh
Appellate Counsel
Regulatory Law

December 13, 1996

EX PARTE

Mr. Christopher Wright
Deputy General Counsel
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 96-149; Section 271(e)(1) of the
Communications Act

Dear Mr. Wright:

This addresses the questions you raised with Anthony C. Epstein, Kim Kirby and I during our telephone conference on December 11 and your request for a response to the December 9 letter to you from Michael K. Kellogg and the December 6 letter to you from Mr. Robert L. Pettit on behalf of the Bell Operating Companies (BOCs). Essentially, the BOCs' interpretation of Section 271(e)(1) would delay the advent of meaningful local service competition and the consumer benefits that such competition will bring. Messrs. Kellogg and Pettit admit that their interpretation would require separation of resold local and interLATA services operations of the larger interexchange carriers (IXCs). Congress, however, plainly decided to impose such a separation requirement only on the BOCs. A de facto separation requirement on the larger IXCs would therefore frustrate Congress' intent to permit the larger IXCs to jointly provision interLATA and resold local services. Moreover, the draconian advertising restrictions proposed by Messrs. Kellogg and Pettit would sweep within their ambit the advertising of concededly lawful activities, thus raising serious First Amendment issues.

In order to fully understand the perverse effects that would result from the BOCs' reading of Section 271(e)(1), some misconceptions about resale in their letters must be corrected. Mr. Kellogg states that having to provide local services at a wholesale discount to IXCs "means that consumers of the Bell companies' other services must bear part of the cost of the resold services." The wholesale discount, however, simply reflects the costs that the BOCs avoid by having IXCs resell their local services, leaving the wholesale rates as profitable for the BOCs as their "retail" rates. Every dollar of resold



Letter to Christopher J. Wright
December 13, 1996
Page 2

local services is therefore as profitable for the BOCs as the local services they provide directly, while the IXCs take on the risks of competing with the BOCs' local business. Moreover, even in those cases where a retail rate or its corresponding wholesale rate is arguably below economic cost, the BOCs receive enormous subsidies from above-cost pricing of other services -- a system that Congress has required to be revised. Explicit, cost-based, competitively-neutral subsidy flows will compensate the BOCs for any below-cost pricing of basic services offered over their networks.

In light of the various resale and universal service provisions that work to keep the BOCs whole, the BOCs' efforts to force duplicative sales and provisioning organizations on the larger IXCs thus can only be viewed as a transparent attempt to significantly raise the cost of entry into the local service market through resale, thereby delaying the advent of meaningful local competition. As Congress and the Commission have recognized, resale is a critical first step in developing a local service customer base while new entrants install switches and construct networks. Permitting the BOCs' strategy to succeed thus would impair the development of facilities-based local competition.

The BOC letters candidly assert that their reading of Section 271(e)(1) would require a separate sales organization with separate personnel and separate points of contact for the larger IXCs' own interLATA and resold local services, as well as separate advertising. Such duplication would effectively double the larger IXCs' additional costs of providing resold local services (the costs over and above the wholesale rates paid to the BOCs), foreclosing them from that market. Such a result would frustrate one of the primary purposes of the 1996 Act, which was to open up the BOCs' local service monopoly to meaningful competition, and, more specifically, would effectively deny the larger IXCs the right to resell BOC local services recognized and guaranteed by Section 251(c)(4) of the Act.

A proper interpretation of Section 271(e)(1), on the other hand, under which only resold local service and interLATA service tie-ins and cross-product discounting would be prohibited, would still impose a significant constraint on the larger IXCs while not crippling their ability to enter the local service market. At the same time, such an interpretation would give the BOCs a fair opportunity to compete with the larger IXCs during the period while they cannot satisfy the requirements of Section 271. With the prohibition of tying and cross-product discounting, any BOC can match, dollar for dollar, any offering by a larger IXC of resold local services. The BOCs thus would have a full and fair opportunity to protect their existing local customer base.

Letter to Christopher J. Wright
December 13, 1996
Page 3

Not only do the purposes of the 1996 Act militate against the BOCs' interpretation of Section 271(e)(1) -- and support MCI's construction -- but the structure and relevant language of the Act also compel the same result. Unlike the BOCs, the IXCs are not subject to a separation requirement in their provision of local and interLATA services and are authorized to provide both types of services right now. Thus, Section 271(e)(1) cannot be read to prohibit the larger IXCs from (a) providing resold local service and their own interLATA services through one organization, (b) using the same customer service group to support both kinds of services, or (c) including both kinds of services on the same bill. Nor does Section 271(e)(1) prohibit the larger IXCs from accurately informing customers -- through telemarketing, sales calls, or print or electronic advertising -- of the lawful means by which the larger IXCs provide these services or of the resulting benefits to consumers.

The other provisions in the 1996 Act containing the word "marketing" and precedents cited in the BOC letters do not support the BOCs' reading of Section 271(e)(1), because those provisions and precedents involve situations where a separation requirement is, or was, imposed on dominant carriers.¹ Moreover, the prohibitions in Sections 272(g)(2) and 271(e)(1) are hardly parallel or equivalent. Section 272(g)(2) broadly states that a BOC "may not market or sell [in-region] interLATA service provided by an affiliate" until it obtains in-region authority, while Section 271(e)(1) states that the larger IXCs may not "jointly market" resold local services with their interLATA services for a specified time.

In light of all of these factors -- statutory structure, context, intent and language -- Section 271(e)(1) must not be interpreted in a way that effectively negates Congress' decision to permit IXCs to resell BOC local services. Nor should interpretation of Section 271(e)(1) ignore the basic difference between IXCs and the BOCs: the BOCs retain enormous market power, and the IXCs have none. Because IXCs lack the monopoly power that the BOCs can leverage, the regulatory constraints applied to the BOCs should not blindly be applied to the IXCs. The duplication that would be required by the approach advocated by the BOCs would, as they acknowledge, impose a de facto

¹ Since there are no separation requirements for IXC local and interLATA services, the other uses of the term "joint marketing" cited in the BOC letters arise in a different "regulatory context" (see Kellogg letter at 3) from the situation addressed by Section 271(e)(1) and thus cannot be imported into that provision as Messrs. Kellogg and Pettit argue.

Letter to Christopher J. Wright
December 13, 1996
Page 4

separation requirement on the larger IXCs. Similarly, a prohibition against combined advertising or telemarketing of both resold local and interLATA services would impose a duplication akin to a separation requirement.

Moreover, there is no constitutional way to impose a prohibition on the combined advertising of local service generally and interLATA service. Such advertising would, on its face, describe entirely lawful activities -- e.g., the combined provision of facilities-based local service and interLATA service. The BOC letters do not adequately deal with this problem, although Mr. Kellogg does concede that any such regulation of combined advertising would raise "line-drawing problems." Mr. Pettit's letter takes their approach to its logical extreme, thereby revealing its constitutional infirmities, by proposing a rule whereby a larger IXC may not advertise the availability of its interLATA services combined with any type of local service through media or channels that may reasonably be expected to reach a substantial number of customers to whom the IXC is able to provide local service only by reselling BOC local service. As both letters concede, such an advertisement on its face would be announcing an entirely legal activity -- e.g., combining facilities-based local service and interLATA services -- and thus could not be prohibited. The censorship Mr. Pettit suggests based on the services available to likely targets of such advertising would draw the Commission into a constitutional quagmire.²

At the very least, attempting to enforce the vague and ephemeral line proposed by the BOCs would require a substantial commitment of the Commission's resources, contrary to the goal of the 1996 Act to let competition replace regulation where possible. The kind of regulation proposed by Mr. Pettit would

² The difficulties inherent in such a vague restriction on advertising, based on the services available to its likely targets, distinguish this situation from cases cited in the BOC letters in which restrictions on advertising or other speech were clear and no more extensive than necessary to serve a substantial governmental interest. For example, in United States v. Edge Broadcasting Co., 113 S. Ct. 2696 (1993), the Court upheld restrictions on the broadcasting of lottery advertisements by radio stations that only prohibit such advertising by stations licensed to locations in states in which lotteries are illegal. The regulations in question permit stations licensed to locations in states that sponsor lotteries to broadcast such advertisements, irrespective of whether a large portion of such a station's audience is located in a state in which lotteries are illegal. *Id.* at 2704.

Letter to Christopher J. Wright
December 13, 1996
Page 5

invite endless fights about the wording, or likely targets, of individual advertisements or the wording of statements by individual sales representatives. Policing such a prohibition would generate such anomalies as a telemarketer having to refuse to answer questions about local service, for example, after having discussed interLATA service with a prospect, hanging up and then redialing the same prospect to discuss local service "because FCC regulations require it." The BOCs' approach would, at a minimum, call into question the ability of an IXC sales representative to accurately inform a prospective local customer that she can have one point of contact for customer service, and one bill if she subscribes to other services provided by the IXC as well. Similarly, under the rules proposed by Mr. Pettit, an advertisement for MCI's local service could not identify MCI as a long distance carrier.

In these circumstances, the most compelling reading of Section 271(e)(1) would bar only the tying of interLATA and resold local services and cross-product discounting. That is the only interpretation of "joint marketing" in this context that does not impose a de facto separation requirement, negate Section 251(c)(4), or raise constitutional problems. Other than such tie-ins or cross-product discounts, there is nothing about the combined provision or advertising of resold local and interLATA services that reduces the BOCs' ability to hold onto local service customers through non-discriminatory pricing.

This interpretation gives substance to the congressional prohibition. It imposes a significant constraint on the marketing efforts of larger IXCs, putting them at a significant competitive disadvantage compared to smaller, but aggressive and successful, IXCs. The ability to offer a package of local and long distance services at a single discounted price would likely be attractive to a significant number of consumers. For example, intrastate, interLATA calling in California is a tremendous market, and Section 271(e)(1) denies one subset of IXCs the opportunity to offer statewide local and long distance calling for a flat monthly rate.

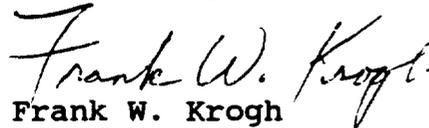
The BOCs' discussions of legislative history are off base. Contrary to Mr. Kellogg's suggestion, there is nothing in the final Conference Report to the 1996 Act about Section 271(e)(1) preventing "one-stop shopping" for IXC local and interLATA services, and the fact that joint provision of such services by the larger IXCs is not prohibited negates any such implication. Thus, there is nothing to suggest that Congress intended to deprive the larger IXCs of the efficiencies of joint provision and combined advertising of local and interLATA services. As long as the larger IXCs do not tie the two types of services together or offer cross-product discounting, the BOCs will be at

Letter to Christopher J. Wright
December 13, 1996
Page 6

"parity" with the larger IXC's in the offering of the services that both are now authorized to provide, namely local services.

Thank you for taking the time to discuss this issue with us. Attached as further background is a relevant excerpt from a previous ex parte submission. If you have any questions about our views, please let me or Kim Kirby know.

Yours truly,


Frank W. Krogh

cc: Chairman Hundt
Commissioner Quello
Commissioner Chong
Commissioner Ness
John Nakahata
Lauren J. Belvin
Jane Mago
James L. Casserly
William E. Kennard
Marjorie S. Bertman
Debra A. Weiner
Regina Keeney
Richard Metzger, Jr.
Carol Matthey
Radhika Karmarkar
Linda Kinney
William F. Caton

6. What are the justifications for MCI's narrow construction of the joint marketing restriction in Section 271(e)(1) on the largest IXCs? Why should joint marketing marketing for purposes

of Section 271(e)(1) be interpreted differently from joint marketing for purposes of Section 272(g)?

The focus of this rulemaking is on the interpretation and implementation of Section 272 by the BOCs, not on the right of other carriers, including all interexchange carriers, to resell BOC local services. The joint marketing provisions of Sections 272(e)(1) and 272(g)(2) serve different purposes, as will be explained. The Commission need not decide in the context of this rulemaking the parameters of Section 272(e)(1), and that provision may be most usefully addressed if and when any BOC challenges the marketing practices of a carrier that resells its services. Nevertheless, MCI will address the question posed by the staff.

In interpreting the joint marketing restrictions of Sections 271(e)(1) and 272(g)(2) applicable to the large IXC and BOCs prior to BOC in-region authority in a given state, the Commission needs to consider the nature of the interLATA market and the focus and purposes of Section 272 and the other provisions of the 1996 Act. An academic interpretation of Sections 271(e)(1) and 272(g)(2) in isolation from the overall context in which those provisions are to be applied will undermine, rather than facilitate, the vibrant competition that now characterizes the interLATA market as well as the development of local service competition. As the Commission has repeatedly found in recent

years, the interLATA market is "substantially competitive" (1990)⁸ and characterized by "aggressive price competition" (1995),⁹ and "[c]ompetition for long-distance customers has become increasingly intense" (1996).¹⁰ Last year, AT&T was found to be non-dominant under the Commission's Competitive Carrier criteria,¹¹ which means that no interLATA carrier has market power.¹²

⁸ Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880, 5887 (1991); Order 6 FCC Rcd 7255; Memorandum Opinion and Order, 6 FCC Rcd 7569 (1991); Memorandum Opinion and Order, 7 FCC Rcd 2677 (1992); Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 2659 (1993); Second Report and Order, 8 FCC Rcd 3668 (1993); Memorandum Opinion and Order, 8 FCC Rcd 5046 (1993); Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 4562 (1995).

⁹ Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, FCC 95-427 (released Oct. 23, 1995) (AT&T Non-Dominance Order), at ¶ 64.

¹⁰ Federal Communications Commission, Common Carrier Bureau, "Common Carrier Competition, Spring 1996," Report No. CC 96-9 (April 10, 1996).

¹¹ Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Therefor, CC Docket No. 79-252, Notice of Inquiry and Proposed Rulemaking (Notice), 77 FCC 2d 308 (1979); First Report and Order (First Report), 85 FCC 2d 1 (1980); Further Notice of Proposed Rulemaking, 84 FCC 2d 445 (1981); Second Further Notice of Proposed Rulemaking, 47 Fed. Reg. 17308 (1982); Second Report and Order (Second Report), 91 FCC 2d 59 (1982), recon. denied, 93 FCC 2d 54 (1983); Third Report and Order (Third Report), 48 Fed. Reg. 46791 (1983); Fourth Report and Order (Fourth Report), 95 FCC 2d 554 (1983), vacated, AT&T v. FCC, 978 F.2d 727 (D.C. Cir. 1992), cert. denied, MCI Telecommunications Corp. v. AT&T, 113 S. Ct. 3020 (1993); Fourth Further Notice of Proposed Rulemaking, 96 FCC 2d 1191 (1984); Fifth Report and Order (Fifth Report), 98 FCC 2d 1191 (1984); Sixth Report and Order (Sixth Report), 99 FCC 2d 1020 (1985), vacated sub nom., MCI Telecommunications Corp. v. FCC, 765 F.2d 1186 (D.C. Cir. 1985).

¹² AT&T Non-Dominance Order at ¶¶ 138-42.

By contrast, the Commission recently reconfirmed, months after enactment of the 1996 Act, that BOCs still have "market power in ... the local exchange and exchange access market[s],"¹³ which are "noncompetitive,"¹⁴ giving the BOCs "bottleneck control over inputs into the interexchange market."¹⁵ The 1996 Act recognizes the BOCs' continuing local market dominance in a myriad of ways, including the stringent conditions that must be satisfied before a BOC can secure authorization to provide in-region interLATA service and the separation requirements imposed by Section 272 on BOC interLATA affiliates. In effect, the separation and other requirements imposed on the BOCs, but not on IXCs, constitute a legislative recognition that the marketplace already restricts the IXCs', but not the BOCs', pricing and other behaviors. The BOCs' unconstrained local market power requires a greater degree of legislative and regulatory restrictions on joint marketing and other activities to create a level playing field between BOCs and the large IXCs.

In this context, it is inconceivable that Congress intended in Sections 271(e)(1) and 272(g)(2) to ignore the vast differences between the BOCs' local service dominance and the vigorously competitive interLATA market that it recognized in Section 272 generally and throughout the 1996 Act. The focus of

¹³ Bell Operating Company Provision of Out-of-Region Interstate, Interexchange Services, CC Docket No. 96-21, FCC 96-288 (released July 1, 1996) at ¶ 17.

¹⁴ Id. at ¶ 39.

¹⁵ Id. at ¶ 34.

Section 272 (as well as this docket) is the separation requirements and other safeguards necessary to ensure that the BOCs do not abuse their market power. The focus of Section 271(e)(1) -- which is unrelated to the issues of BOC safeguards -- is to prevent, for a limited time, one category of interLATA carriers from certain marketing practices relating to BOC local services that they have always had a right to resell on an unseparated basis. The two provisions thus serve very different purposes and should not be interpreted as interchangeable or parallel provisions.

It follows that those two provisions were not intended to restrict the BOCs and large IXCs in exactly the same way. In fact, the different purposes of Sections 271(e)(1) and 272(g)(2) are reflected in the relevant statutory language. Section 271(e)(1) states that the large IXCs may not "jointly market" certain local services with their interLATA services in a given state until a BOC has in-region authority in that state, while Section 272(g)(2) states more broadly that a BOC "may not market or sell [in-region] interLATA service provided by an affiliate" until it gets in-region authority. "Jointly market" in 271(e)(1) must have been intended to mean something different from the broader "market or sell" in 272(g)(2). Since Sections 271(a) and 272(a) already prohibit a BOC from providing in-region interLATA services prior to in-region authority, Section 272(g)(2) would be superfluous if it merely repeated that prohibition. Moreover, Congress could have used "jointly market" in both 271(e)(1) and

272(g)(2).

MCI submits that this difference in statutory language, in light of the different purposes of the two provisions, was intended to convey different degrees of restrictiveness, especially given the separation requirements on the BOCs, the specific purposes those requirements are intended to serve and the other competitive factors and statutory goals discussed above. For example, one aspect of the BOCs' local exchange dominance is that the BOCs have inherited a relationship with virtually every customer in their respective service regions that goes back longer than almost any telephone subscriber in America has been alive. The BOCs, moreover, enjoy name recognition at least equal to the IXCs, thanks to advertising paid for by captive ratepayers, including IXCs. If the BOCs were to exploit that monopoly hold on their local service customers in marketing their affiliates' interLATA services before satisfying the conditions for in-region authority, the competition that has developed in interLATA services would be severely harmed. That is why they may not "market or sell" their affiliates' interLATA services until they gain in-region authority.

IXCs, on the other hand, have no such hold on their customers and thus are permitted to provide both local and interLATA services now and are not subject to any separation requirements. It follows that the prohibition on IXC joint marketing in Section 271(e)(1) cannot be interpreted to require, for example, that an IXC provide resold local service and its own

interLATA service out of separate entities, since that would impose a separate affiliate requirement on a carrier that has no market power in either service, something that the 1996 Act does not do. Similarly, since IXCs are not subject to any separation requirements, they may use the same sales channels and the same personnel to market local and interLATA services.

The issue thus becomes whether an IXC telemarketer, to take a specific illustration, may mention both local and interLATA services in the same call or whether he or she must hang up after discussing one service and call back to discuss the other. MCI submits that, in light of the IXCs' lack of power in either market and the absence of any separation requirements on IXC activities, it would be irrational and arbitrary to force the IXC telemarketer in this hypothetical to make two different calls and never mention the two types of service in the same call. Such an artificial constraint would effectively impose a de facto separation requirement on the large IXCs, which is not authorized by the 1996 Act or any Commission regulation. The marketplace will constrain the large IXCs enough. Such an unnecessary, artificial, extra-legal regulatory separation constraint on IXC marketing would thwart the development of local service competition that the 1996 Act was intended to promote.

For example, MCI will start off its local service marketing efforts with almost a zero market share and less than a 20 percent interLATA market share, and that interLATA share is constantly in contention. If it cannot mention both types of

service in the same marketing call or in the same advertisement, especially with regard to the over 80 percent of the market that it does not serve at all, it will never be in a position to compete with the BOCs.

The Commission should interpret the statutorily undefined phrase "joint marketing" in Section 271(e)(1) in light of the different market positions of the large IXCs and the BOCs and the purposes of the 1996 Act. That provision should therefore be interpreted to allow an IXC telemarketer or advertisement to refer to both types of services but to prohibit an IXC, as explained in MCI's comments, from offering both for a bundled price. That is the only meaning in the context of the 1996 Act as a whole that can reasonably be given to the requirement that the large IXCs not "jointly market" resold local and interLATA services. Any greater degree of restrictiveness will sabotage the main goal of the 1996 Act, which is to facilitate the development of local competition, and it would also facilitate the clear purpose of the Act to permit MCI and the other two IXCs covered by Section 271(e)(1) to resell BOC local services and to do so efficiently on an unseparated basis.

After a BOC obtains in-region authority, of course, IXCs may jointly market interLATA services and resold BOC local services, and Section 272(g)(3) permits the "joint marketing and sale" of interLATA and local services by the BOC. At that point, there will still be significant restrictions on the BOCs' activities, stemming from the separation restrictions. Thus, a BOC still

should not be allowed to bundle local and interLATA services in a single price that effectively forces the customer to buy both, and the joint marketing activity must be performed either by the BOC or its affiliate under written contract on a fully compensated basis, not together.