DOCKET FILE COPY ORIGINAL

Before the
Federal Communications Commission
Washington, D.C. 20554

FCC MAIL SECTION
DEC 27 10 30 AM '96
DISPATCHED BY

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the	)	
Telecommunications Act of 1996	)	

REPORT AND ORDER

Adopted: December 23, 1996 **Released: December 24, 1996**

By the Commission:

TABLE OF CONTENTS

I. INTRODUCTION 1

II. BACKGROUND AND OVERALL GOALS 3
- A. Summary of the Relevant Statutory Provisions 3
- B. Goals of the Proceeding 13
- C. Scope of Commission's Authority 29
- D. Structure of this Order 47

III. SAFEGUARDS FOR INTEGRATED OPERATIONS 48
- A. General 48
- B. Specific Services 51
  - 1. Section 260 - Telemessaging Service 51
  - 2. Section 271 - InterLATA Telecommunications Services 61
    - a. Incidental InterLATA Services 62
    - b. Integrated Provision of InterLATA Services 66
    - c. Other Matters 77
  - 3. Section 275 - Alarm Monitoring Services 88
  - 4. Section 276 - Payphone Services 93

IV. SAFEGUARDS FOR SEPARATED OPERATIONS 101
A. General 101
B. Specific Services 110
1. Section 272 - Manufacturing and InterLATA Services 110
a. Statutory Language 110
b. "Arm's Length" Requirement of Section 272(b)(5) 111
i. Prevailing Company Prices 125
ii. Valuation Methods for Assets and Services. 138
iii. Fair Market Value 149
iv. Tariffed-based Valuation 155
v. Return Component for Allowable Costs 160
c. Accounting Requirements of Sections 272(b)(2) and (c)(2) 167
d. Application to InterLATA Telecommunications Affiliates 171
e. Application to Sharing of Services 179
f. Audit Requirements 184
2. Section 273 - Manufacturing by Certifying Entities 206
a. Statutory Language 206
b. Comparison of Sections 273 and 272 208
3. Section 274 - Electronic Publishing 213
a. Statutory Language 213
b. Comparison of Sections 274 and 272 214
c. Compliance Review 220
d. Section 274(f)'s Reporting Requirement 227
e. Section 274 Transactional Requirements 231
f. Miscellaneous 245
4. Separated Operations under Sections 260 and 271 through 276 248

V. OTHER MATTERS 259
A. Price Caps 259
1. General 259
2. Exogenous Costs and Part 64 260
3. Part 64 and Sharing 267
B. Section 254(k) 272

VI. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS 277

VII. FINAL PAPERWORK REDUCTION ACT ANALYSIS 284

VIII. ORDERING CLAUSES 285

I. INTRODUCTION

1. In this Report and Order ("Order") we address the accounting safeguards necessary to satisfy the requirements of sections 260 and 271 through 276 of the Communications Act of 1934, as amended by the Telecommunications Act of 1996.[1] This Order prescribes the way incumbent local exchange carriers, including the Bell Operating Companies ("BOCs"), must account for transactions with affiliates involving, and allocate costs incurred in the provision of, both regulated telecommunications services and nonregulated services, including telemessaging, interLATA telecommunications, information, manufacturing, electronic publishing, alarm monitoring and payphone services, to ensure compliance with the Act. In particular, the Order adopts the tentative conclusion in the *Notice of Proposed Rulemaking* ("*NPRM*") in this proceeding that our current cost allocation rules generally satisfy the Act's accounting safeguards requirements when incumbent local exchange carriers, including the BOCs, provide services permitted under sections 260 and 271 through 276 on an integrated basis (*i.e.*, within the telephone operating companies).[2] The Order also adopts the tentative conclusion in the *NPRM* that our current affiliate transactions rules generally satisfy the Act's accounting safeguards requirements when incumbent local exchange carriers, including the BOCs, are required to, or choose to, use an affiliate to provide services

---

[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the Act," and all citations to the sections of the Act will be to the Act as it will be codified in the United States Code.

[2] See Accounting Safeguards Under the Telecommunications Act of 1996, Notice of Proposed Rulemaking, CC Docket No. 96-112, 11 FCC Rcd 9054, 9060 para. 11, 9066 para. 27 (1996) ("NPRM"). The Commission has adopted a comprehensive system of accounting safeguards now found in Parts 32 and 64 of our rules. Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, 6 FCC Rcd 7571,7591-7605 paras. 46-74 (1991) ("Computer III Remand"). See 47 C.F.R. §§ 64.901-903. These requirements apply not only to the BOCs, but to all incumbent local exchange carriers with annual operating revenue greater than the applicable interim revenue threshold. Id. The interim revenue thresholds applicable to annual operating revenues from 1993, 1994, and 1995 are $102 million, $104 million, and $107 million, respectively. Implementation of the Telecommunications Act of 1996: Reform of Filing Requirements and Carrier Classifications, Order and Notice of Proposed Rulemaking, CC Docket No. 96-193, FCC 96-370, para. 12 (rel. Sept. 12, 1996) ("402 Order and NPRM"). Smaller incumbent local exchange carriers, other than average schedule companies, must comply with accounting rules, cost allocation standards, and affiliate transactions rules and are subject to Commission audit. Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Order on Reconsideration, CC Docket No. 86-111, 2 FCC Rcd 6283, 6300 paras. 154-157 (1987) ("Joint Cost Reconsideration Order"), further recon. 3 FCC Rcd 6701 (1988) ("Joint Cost Further Reconsideration Order"), aff'd sub nom. Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). See 47 C.F.R. §§ 64.901-903.

permitted under sections 260 and 271 through 276.[3] The Order adopts most of the *NPRM*'s proposed modifications to the affiliate transactions rules to provide greater protection against subsidization of competitive activities by subscribers to regulated telecommunications services.[4]

2. By applying our current cost allocation rules and modified affiliate transactions rules to incumbent local exchange carriers, including the BOCs, that provide services permitted under sections 260 and 271 through 276, we seek to protect regulated service ratepayers from bearing the risks and costs of carriers' nonregulated ventures. We also seek to promote competition by preventing carriers from using their market power in local exchange services to obtain an anti-competitive advantage in the markets that they seek to enter. We will monitor the development of competition to determine whether further changes to these accounting safeguards are needed to achieve the objectives of the Act.

II. BACKGROUND AND OVERALL GOALS

A. Summary of the Relevant Statutory Provisions

3. The Act permits the BOCs to engage in previously proscribed activities if the BOCs satisfy certain conditions that are intended to prevent them from recovering costs of their new ventures from subscribers to local exchange and exchange access services and from discriminating against their competitors in these new markets.[5] The Act places similar

---

[3] See NPRM, 11 FCC Rcd at 9060 para. 11, 9083-84 para. 64, 9109-10 para. 118.

[4] See id. A subsidy occurs when the reasonable costs associated with a service are not covered by the revenues generated by that service, but are instead covered by revenues generated by one or more other services.

[5] The Modified Final Judgment ("MFJ") originally prohibited the BOCs from providing information services, providing interLATA services, or manufacturing and selling telecommunications equipment or manufacturing customer premises equipment. United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983), vacated sub nom. United States v. Western Elec. Co., slip op. CA 82-0192 (D.D.C. Apr. 11, 1996). The theory behind this prohibition in the MFJ was that the BOCs could leverage their market power in the local market to impede competition in the interLATA services, manufacturing, and information services markets. The information services restriction was modified in 1987 to allow BOCs to provide voice messaging services and to transmit information services generated by others. See United States v. Western Elec. Co., 673 F.Supp. 525 (D.D.C. 1987); United States v. Western Elec. Co., 714 F.Supp. 1 (D.D.C. 1988); United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991). In 1991, the restriction on BOC ownership of content-based information services was lifted. United States v. Western Elec. Co., 767 F.Supp. 308 (D.D.C. 1991), stay vacated, United States v. Western Elec. Co., 1991-2 Trade Cases (CCH) ¶ 69,610 (D.C.Cir. 1991).

conditions on other incumbent local exchange carriers electing to enter or continue to participate in certain markets.[6]

4. The Act prescribes structural and nonstructural safeguards that are intended to protect ratepayers, consumers, and competitors against the effects of potential improper cost allocation and discrimination. These structural and nonstructural safeguards apply to activities such as payphone services that BOCs are currently permitted to provide and to activities such as alarm monitoring services that BOCs are currently permitted to provide in certain markets. In addition, these safeguards apply to other activities that incumbent local exchange carriers may now provide as a result of the Act.

5. Sections 260 and 271 through 276 outline the conditions under which incumbent local exchange carriers may offer telemessaging and alarm monitoring services and under which the BOCs may manufacture and provide telecommunications equipment, may manufacture customer premises equipment ("CPE"), and may offer interLATA telecommunications, information, electronic publishing and payphone services. While the Act requires that many of these services must be provided through separate affiliates, it also permits some to be offered on an integrated basis.[7]

6. Sections 260 and 275 generally prohibit an incumbent local exchange carrier, including the BOCs, from subsidizing its telemessaging and alarm monitoring services with revenues from regulated telecommunications services. Section 260 provides that an incumbent local exchange carrier, including a BOC, that provides telemessaging service "shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access," but does not require a separate affiliate.[8] Section 275(b)(2) bars an incumbent local exchange carrier, including a BOC, that provides alarm monitoring services from "subsidiz[ing] its alarm monitoring services either directly or indirectly from telephone exchange service operations," but does not require a separate affiliate.[9]

7. Section 271(b) authorizes the BOCs to immediately provide "out-of-region" interLATA services but requires the BOCs to obtain Commission approval before providing

---

[6] See, e.g., 47 U.S.C. §§ 260(a), 275(b).

[7] See, e.g., id. §§ 260(a), 276(a).

[8] Id. § 260(a)(1).

[9] See, e.g., id. §§ 275(b)(2), 276(a).

"in-region" interLATA services.[10] Section 271(g) lists specific "incidental interLATA services"[11] that BOCs and their affiliates may provide after February 8, 1996.[12] Section 271(h) states that "[t]he Commission shall ensure that the provision of services authorized under [section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market."[13]

8. Section 272 permits a BOC (including any affiliate) that is subject to section 251(c) to manufacture equipment (as defined in the AT&T consent decree),[14] originate in-region interLATA telecommunications services, other than incidental and previously authorized interLATA services, and provide certain interLATA information services[15] only if it does so through one or more separate affiliates. Each of the separate affiliates must "maintain [separate] books, records, and accounts in the manner prescribed by the Commission" and "shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis."[16] In its dealings with the separate affiliate, each BOC must "account for all transactions . . . in accordance with accounting principles designated or approved by the Commission."[17]

9. Section 273(d)(3) imposes separate affiliate requirements for the manufacture of telecommunications equipment and customer premises equipment upon entities that certify the same class of telecommunication equipment and customer premises equipment produced by unaffiliated entities.[18]

---

[10] Id. §§ 271(b), 271(d)(3). "In-region services" refers to the provision by "[a] Bell operating company, or any affiliate of that Bell operating company, . . . [of] interLATA services originating in any of its in-region States . . . if the Commission approves the application of such company for such State . . . ." Id. § 271(b)(1).

[11] Id. § 271(g).

[12] Id. § 271(b).

[13] Id. § 271(h).

[14] Id. § 273(h).

[15] Id. §§ 272(a)(2)(B), 272(a)(2)(C).

[16] Id. §§ 272(b)(2), 272(b)(5).

[17] Id. § 272(c)(2).

[18] Id. § 273(d)(3).

10. Section 274(a) prohibits any "Bell operating company or any affiliate [from] engag[ing] in the provision of electronic publishing that is disseminated by means of such Bell operating company's or any of its affiliates' basic telephone service," other than through "a separated affiliate or electronic publishing joint venture."[19] This separated affiliate or electronic publishing joint venture must, among other requirements, "maintain separate books, records, and accounts and prepare separate financial statements."[20]

11. Section 276(b)(1)(C) directs the Commission to prescribe rules for BOC provision of payphone service that, "at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90-623) proceeding."[21] Section 276(a)(1) states that any BOC that provides payphone service after the effective date of those rules "shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations."[22]

12. Finally, section 254(k) imposes a more general prohibition against cross-subsidization by barring telecommunications carriers from "us[ing] services that are not competitive to subsidize services that are subject to competition."[23]

---

[19] Id. § 274(a).

[20] Id. § 274(b)(1).

[21] Id. § 276(b)(1)(C). See also Amendment of section 64.702 of the Commission's Rules and Regulations (Computer III), CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) ("Phase I Order"), recon., 2 FCC Rcd 3035 (1987) ("Phase I Recon. Order"), further recon., 3 FCC Rcd 1135 (1988) ("Phase I Further Recon. Order"), second further recon., 4 FCC Rcd 5927 (1989) ("Phase I Second Further Recon."), Phase I Order and Phase I Recon. Order vacated, California v. FCC, 905 F.2d 1217 (9th Cir. 1990) ("California I"); Phase II, 2 FCC Rcd 3072 (1987) ("Phase II Order"), recon., 3 FCC Rcd 1150 (1988) ("Phase II Recon. Order"), further recon., 4 FCC Rcd 5927 (1989) ("Phase II Further Recon. Order"), Phase II Order, vacated, California I, 905 F.2d 1217 (9th Cir. 1990); Computer III Remand Proceedings, CC Docket No. 90-368, 5 FCC Rcd 7719 (1990) ("ONA Remand Order"), recon., 7 FCC Rcd 909 (1992), pets. for review denied, California v. FCC, 4 F.3d 1505 (9th Cir. 1993) ("California II"); Computer III Remand, 6 FCC Rcd 7571; BOC Safeguards Order vacated in part and remanded, California v. FCC, 39 F.3d 919 (9th Cir. 1994) ("California III"), cert. denied, 115 S.Ct. 1427 (1995).

[22] 47 U.S.C. § 276(a)(1). Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Report and Order, CC Docket No. 96-128, FCC 96-388 (rel. Sept. 20, 1996) ("Pay Telephone Reclassification Order"), recon., FCC 96-439 (rel. Nov. 8, 1996).

[23] 47 U.S.C. § 254(k).

B. Goals of the Proceeding

13. In our *NPRM*, we set forth two goals for this proceeding: (1) preserving for the benefit of interstate telephone ratepayers legitimate economies of scope that could be realized by BOCs and other incumbent local exchange carriers when entering markets from which they were previously barred or in which they continue to participate;[24] and (2) discouraging, and facilitating detection of, improper cost allocations in order to prevent incumbent local exchange carriers from imposing the costs of their competitive ventures on interstate telephone ratepayers.[25] In the *NPRM*, we asked the threshold question: to what, if any, extent should we rely on our existing accounting safeguards in Parts 32 and 64 of our rules[26] to achieve these two goals.[27] We tentatively concluded that our existing accounting safeguards, with the modifications described in the *NPRM*, would best meet the requirements and underlying goals of sections 260 and 271 through 276. We invited comment on this tentative conclusion. We also sought comment on whether less detailed accounting safeguards would suffice to achieve the objectives of the Act.[28]

14. To the extent that BOCs or other incumbent local exchange carriers maintain control over the bottleneck facility, these BOCs or other incumbent local exchange carriers could potentially engage in predatory behavior. In the *NPRM*, we also sought comment on how the extent to which a BOC or other incumbent local exchange carrier has the opportunities to engage in predatory behavior should affect our decisions in this proceeding.[29]

---

[24] Economies of scope occur when it is less costly for a single firm to produce a bundle of goods or services together, than it is for two or more firms, each specializing in distinct product lines, to produce them separately. See, e.g., John C. Panzar and Robert D. Willig, Economies of Scope, 71 AMER. ECON. REV. OF PAPERS AND PROC. 268 (1981); William J. Baumol, John C. Panzar, and Robert D. Willig, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 71-79 (1982); Daniel F. Spulber, REGULATION AND MARKETS 114-15 (1989).

[25] NPRM, 11 FCC Rcd at 9059-60 paras. 9-10.

[26] See 47 C.F.R. Parts 32 and 64.

[27] NPRM, 11 FCC Rcd at 9060 para. 11.

[28] Id. at para. 12.

[29] Id. at 9062 para. 16.

Comments:

15. Worldcom contends that the Act does not support the Commission's statement in the *NPRM* concerning the need to preserve "economies of scope" for the BOCs.[30] SBC, however, maintains that, except to the extent Congress imposed temporary separation requirements as well as other restrictions such as the nondiscrimination provisions on incumbent local exchange carriers, Congress did not deny incumbent local exchange carriers the benefits of their own efficiencies.[31]

16. Several parties, including NYNEX, contend that existing accounting safeguards are more than adequate to meet the requirements of sections 260 and 271 through 276 and no additional safeguards are required.[32] In particular, Cincinnati Bell argues that incumbent local exchange carriers will not be able to raise prices based upon improperly allocated costs given the choices that will be available to customers in a competitive market.[33] Many parties, including States, interexchange carriers, and trade associations, generally support our proposal to use current Part 32 and Part 64 accounting rules, with some modifications.[34] USTA and SBC argue that given the pro-competitive, deregulatory goals of the Act and the increase in competition since the adoption of the accounting safeguards in the *Joint Cost* and *Computer III Proceedings*, we should not impose more stringent rules.[35] Ameritech contends that we should adopt less detailed accounting rules consistent with the Act's mandate to foster a national deregulatory policy framework.[36]

17. Sprint, GSA, Puerto Rico Telephone and several BOCs argue that a new system of accounting safeguards would require the BOCs to develop new systems and retrain employees, requiring substantial investments of time and resources without any assurance that

---

[30] Worldcom Comments at 6-8.

[31] SBC Reply at 7-8.

[32] Cincinnati Bell Comments at 3; NYNEX Comments at 9-10; PacTel Comments at 5; US West Comments at 1; Coalition Reply at 1.

[33] Cincinnati Bell Comments at 4.

[34] AT&T Comments at 2; California Comments at 6; CTA Comments at 4; GSA Comments at 3; Missouri PSC Comments at 3; NYDPS Comments at 8; Puerto Rico Telephone Comments at 2; Sprint Comments at 4; TRA Comments at 5.

[35] USTA Comments at 2; SBC Comments at 2.

[36] Ameritech Comments at 12.

a new system will be more effective.[37] Ameritech adds that the substantial costs associated with the adoption of a different accounting safeguards approach would not be justified by the benefit.[38]

18. USTA maintains that where we determine that current accounting safeguards will continue to apply to incumbent local exchange carriers, we should streamline those safeguards to the extent possible to ensure fair competition and to make the rules clear and predictable.[39] USTA recommends streamlining our current rules as follows: (1) modify the shared forecast investment rules; (2) modify the affiliate transactions valuation standards; (3) simplify the Part 64 administrative process; and, (4) modify the frequency of the independent audit.[40] Ameritech and SBC recommend adoption of USTA's streamlining proposals to implement provisions under the Act related to both separated and integrated operations.[41] Several parties, including USTA, allege that competition and a number of existing safeguards, most notably price cap regulation, provide the most effective constraints on the ability of incumbent local exchange carriers to cross-subsidize.[42]

19. In contrast, APCC argues that existing safeguards have not adequately prevented cross-subsidization.[43] In particular, APCC suggests that we should make extensive changes to the cost allocation manuals, impose additional requirements to annual attestation audits, and reconsider the allocation methodology presently employed by incumbent local exchange carriers.[44] ESI recommends that we adopt rules that ensure that vertically integrated telecommunications carriers with proven market power be more strictly regulated than carriers without the potential to price squeeze.[45]

---

[37] GSA Comments at 3-4; PacTel Comments at 5; Puerto Rico Telephone Comments at 2; Sprint Comments at 4; US West Comments at 2.

[38] Ameritech Comments at 19.

[39] USTA Comments at 2. See also Ameritech Reply at 1.

[40] See USTA Comments at 14.

[41] Ameritech Comments at 13; SBC Comments at 15; Ameritech Reply at 2.

[42] PacTel Comments at 40-43; SBC Comments at 14; USTA Comments at 4.

[43] APCC Reply at 5.

[44] See APCC Comments at 11-18.

[45] ESI Reply at 2.

20. MCI maintains that the Act clearly recognizes the incentives for incumbent local exchange carriers to shift costs between their new competitive activities and their monopoly local exchange and exchange access operations.[46] Accordingly, MCI asserts that we must adopt safeguards stricter than our existing accounting safeguards to account for the increased opportunities for BOCs to enter new lines of nonregulated businesses and for the increased incentives and opportunities for incumbent local exchange carriers to shift costs following passage of the 1996 Act.[47] In particular, MCI suggests that we adopt a rule requiring carriers to maintain a complete audit trail of all cost allocations and affiliate transactions.[48]

21. GTE agrees with our contention that any commenter urging us to adopt more detailed accounting safeguards than those in our current rules or those specifically mandated by the Act bears a heavy burden of persuading us to adopt such safeguards.[49] Ameritech alleges, however, that we have not satisfied this heavy burden of persuasion test with regard to the more detailed accounting safeguards proposed in the *NPRM*.[50]

22. With respect to our concerns regarding opportunities for incumbent local exchange carriers to engage in predatory behavior, Worldcom argues that "the very act of competing head-on with the BOCs creates a heightened degree of reliance on the BOCs' bottleneck facilities that did not exist before."[51] AT&T alleges that the BOCs still control bottleneck facilities and that as long as their control continues, the BOCs will be able to engage in predatory behavior, forcing non-affiliated interexchange carriers to absorb high access charges as a real cost and allowing the BOCs and their interexchange affiliates to underprice these non-affiliated carriers.[52]

23. Ameritech and USTA, however, contend that predatory behavior is not likely to occur.[53] In particular, USTA argues that given the difference in resources between incumbent

---

[46] MCI Comments at 6.

[47] Id. at 3.

[48] Id. at 9. See also Ohio Reply at 4; TIA Reply at 25.

[49] See GTE Comments at 9.

[50] Ameritech Reply at 9; but see Worldcom Comments at 8-9.

[51] Worldcom Comments at 5.

[52] AT&T Comments at 3. See also CTA Comments at 6; MCI Comments at 4; ESI Reply at 3, 5.

[53] Ameritech Comments at 9; USTA Comments at 12.

local exchange carriers and competitors, such as AT&T and MCI in the interexchange market, it is more likely that incumbent local exchange carriers will be the victims of predatory behavior, not the perpetrators of it.[54] SBC maintains that predatory behavior concerns prices in competitive markets and has no place in an accounting safeguards proceeding.[55]

Discussion:

24. In addressing the issues in this proceeding, we adopt and follow the two fundamental goals for this proceeding articulated in the *NPRM* and discussed above. We are committed to facilitating the development of competitive telecommunications service offerings and, in particular, to giving effect to the provisions relating to incumbent local exchange carrier entry into, or expansion within, the markets covered by sections 260 and 271 through 276. We affirm that protecting ratepayers from cross-subsidizing competitive ventures is a primary goal behind all our cost allocation and affiliate transactions rules. The 1996 Act clarifies the meaning of what constitutes just and reasonable rates by adding to the Communications Act of 1934 section 254(k), which provides that incumbent local exchange carriers may "not use services that are not competitive to subsidize services that are subject to competition."[56]

25. Many commenters endorse adoption of the goals we set forth in the *NPRM*. The primary objective of this proceeding is to examine whether our existing accounting safeguards adequately respond to new competitive opportunities created by the 1996 Act. These accounting safeguards consist of cost allocation[57] and affiliate transactions rules[58] that were designed to keep incumbent local exchange carriers from imposing the costs and risks of their competitive ventures on interstate telephone ratepayers, and to ensure that interstate ratepayers share in the economies of scope realized by incumbent local exchange carriers when they expand into additional enterprises.[59] Our cost allocation and affiliate transactions rules, in

---

[54] USTA Comments at 12.

[55] SBC Comments at 11.

[56] 47 U.S.C. § 254(k).

[57] 47 C.F.R. §§ 64.901-.904.

[58] Id. § 32.27.

[59] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, Report and Order, CC Docket No. 86-111, 2 FCC Rcd 1298, 1312-14 paras. 109-117 & 1335 para. 290 (1987) ("Joint Cost Order"), recon., Joint Cost Reconsideration Order, 2 FCC Rcd 6283, further recon. Joint Cost Further Reconsideration Order, 3 FCC Rcd 6701, aff'd sub nom. Southwestern Bell Corp., 896 F.2d 1378 (D.C. Cir.

combination with audits, tariff review, and the complaint process, have proven successful at protecting regulated ratepayers from bearing the risks and costs of incumbent local exchange carriers' competitive ventures.

26. With respect to affiliate transactions, we note that the Act requires BOCs to create a separate affiliate for certain services. While the volume of affiliate transactions may increase as the result of this requirement, we do not believe that the nature and type of such transactions will raise any accounting concerns that our current rules do not already address. Similarly, the 1996 Act will also likely increase the scope of nonregulated activities in which BOCs participate because they may now provide, on an integrated basis, services that they were previously prohibited from providing. Since the inception of our Part 64 cost allocation rules, the type and level of nonregulated activities have continued to grow. We designed our cost allocation rules to accommodate the growth of these nonregulated activities and affiliate transactions. We conclude that our existing cost allocation and affiliate transactions rules, as modified herein, are appropriate for any of the new activities described in Sections 260 and 271 through 276. Where we find that our accounting safeguards should be strengthened, we do so in this Order. We therefore find that adoption of the existing cost allocation rules and the affiliate transactions rules, as modified herein, will successfully achieve our goals.

27. We noted in the *NPRM* that any commenter urging us to adopt more detailed accounting safeguards than those in our current rules or those specifically mandated by the Act bears a heavy burden in demonstrating the necessity to adopt such safeguards.[60] The imposition of this burden is consistent with the requirement of the Administrative Procedure Act that our actions be supported by the language of the Act as well as substantial evidence in the record.[61]

28. Finally, we see no need for additional accounting safeguards designed specifically to prevent predatory behavior by incumbent local exchange carriers. We believe that the accounting rules we adopt here will effectively prevent predatory behavior that might result from cross-subsidization. None of the commenters proposed any additional accounting rules to guard against predatory behavior.

1990).

[60] NPRM, 11 FCC Rcd at 9060-61 para. 12.

[61] See 5 U.S.C. § 706.

C. Scope of Commission's Authority

29. In the *NPRM*, we asked whether the Act grants the Commission authority to establish accounting safeguards for the intrastate services described in sections 260 and 271 through 276.[62] With respect to interLATA services of the types described in sections 271 and 272, we tentatively concluded, in accordance with the analysis developed and discussed in the *BOC In-Region NPRM*, that the Commission has authority to set the accounting safeguards for both interstate and intrastate interLATA services and interLATA information services governed by these sections.[63] With respect to payphone service, we tentatively concluded that the language of section 276 specifically grants the Commission jurisdiction to preempt any State regulations that may be inconsistent with the Commission's regulations.[64] With respect to manufacturing by certifying entities, we tentatively concluded that the provisions of section 273 apply to all BOC manufacturing activities, irrespective of any jurisdictional distinctions.[65]

30. We sought comment in the *NPRM* on the role the states might have in implementing the accounting safeguards provisions of sections 260 and 271 through 276.[66] We also sought comment on whether, if these sections do not specifically grant the Commission jurisdiction over intrastate services, the Commission has the authority to preempt State regulation with respect to accounting matters addressed by these sections pursuant to *Louisiana Public Service Commission v. F.C.C.* ("*Louisiana PSC*").[67] We tentatively concluded that if the Commission has the authority to preempt pursuant to *Louisiana PSC*, we should refrain

---

[62] See NPRM, 11 FCC Rcd at 9070 para.34, 9076 para. 43, 9077-78 para. 48, 9080 para. 54, 9082 para. 61, 9099 para. 94, 9101-02 paras 99-100, 9108 paras 114-115.

[63] Id. at 9076-78 paras. 43-48. Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rulemaking, CC Docket No. 96-149, FCC 96-308, para. 21 (rel. July 18, 1996) ("BOC In-Region NPRM").

[64] NPRM, 11 FCC Rcd at 9082 para. 61. 47 U.S.C. § 276(c). See also In the Matter of New England Public Communications Council Petition for Preemption Pursuant to Section 253, Memorandum Opinion and Order, CCBPol 96-11, FCC 96-470 (rel. Dec. 10, 1996). See generally Pay Telephone Reclassification Order.

[65] NPRM, 11 FCC Rcd at 9101 para. 99.

[66] Id. at 9070-71 para. 35, 9078 para. 49, 9080 para. 55, 9082 para. 61, 9101-02 para. 100, 9108-09 para. 116.

[67] Louisiana Public Service Commission v. F.C.C., 476 U.S. 355, 375, n. 4 (1986) ("Louisiana PSC").

from exercising that authority and retain our policy of not preempting States from using their own accounting safeguards for intrastate purposes.[68]

Comments:

31. Sprint asserts that the Act grants the Commission jurisdiction over section 260 telemessaging services without regard to either State or LATA boundaries.[69] Voice-Tel maintains that the inherent interstate nature of telemessaging services permits the Commission to preempt States even with respect to an individual local exchange carrier operating in a single state.[70] BellSouth, however, argues that there is no basis for the Commission to preempt State Commission actions that are consistent with section 260 and the Part 64 rules.[71]

32. In general, interexchange carriers contend that sections 271 and 272 grant the Commission authority to regulate all interLATA services including intrastate, interLATA services because sections 271 and 272 expressly address BOC provision of interLATA services, making no distinction between interstate and intrastate aspects of those services.[72] NARUC and the States generally disagree.[73] CTA and Sprint contend that the Commission should preempt the States with regard to intrastate, intraLATA telecommunications services and information services if the lack of sufficient cross-subsidization safeguards by a State will hinder the development of competition and allow the BOCs to abuse their market power in the intraLATA market.[74] California and Wisconsin PSC allege that the Commission has no authority to preempt States from using their own accounting safeguards unless individual State rules compromise the goals and intent of the Act.[75] US West argues that we should consider

---

[68] See NPRM, 11 FCC Rcd at 9071 para. 36, 9078-79 para. 50, 9080 para. 56, 9108-09 para. 116.

[69] Sprint Comments at 5.

[70] Voice-Tel Comments at 13.

[71] BellSouth Comments at 15.

[72] AT&T Comments at 4-5; CTA Comments at 11-12; MCI Comments at 40; Sprint Comments at 4; Worldcom Comments at 18.

[73] California Comments at 3-5; Florida PSC Comments at 2-3; Missouri PSC Comments at 2-3; NARUC Comments at 2-4; NYDPS Comments at 2-8; Wisconsin PSC Comments at 3-5; Ohio Reply at 4; Washington Reply at 2. See also BellSouth Reply at 16.

[74] CTA Comments at 13; Sprint Comments at 6-7.

[75] California Comments at 4; Wisconsin PSC Comments at 5.

the necessity of preemption on a case-by-case basis because there is no record to justify a blanket preemption of State accounting safeguards procedures for intrastate purposes.[76]

33. Sprint and AICC argue that the Act grants the Commission jurisdiction over alarm monitoring under section 275 without regard to either State or LATA boundaries.[77] AICC argues that even if section 275 does not, by its terms, grant the Commission jurisdiction over all alarm monitoring services, the Commission has the power to preempt State regulation in order to ensure that alarm monitoring services are not subsidized by exchange and exchange access ratepayers.[78] Florida PSC contends, however, that the Commission has no authority to preempt the States from applying their own cost allocation systems for intrastate alarm monitoring services.[79]

34. BellSouth and NYNEX contend that section 276 contains express language that, with respect to payphone service, specifically grants the Commission authority to preempt any State regulations that may be inconsistent with the Commission's regulations.[80] California and NYDPS contend that the Act does not authorize the Commission to preempt States from imposing accounting safeguards on payphone service.[81]

35. Sprint and TIA maintain that the Commission has jurisdiction over all manufacturing activities under section 273 because manufacturing cannot be segregated into interstate and intrastate portions.[82] NYDPS, however, argues that the Act does not limit States from exercising jurisdiction over manufacturing.[83]

36. All commenters that addressed the Commission's scope of authority over electronic publishing services agree that section 274 covers both interLATA and intraLATA

---

76 US West Comments at 3.

77 AICC Comments at 4-5; Sprint Comments at 5.

78 AICC Comments at 5.

79 Florida PSC Comments at 3.

80 BellSouth Comments at 20; NYNEX Comments at 18. See also Sprint Comments at 5.

81 California Comments at 9; NYDPS Comments at 6.

82 Sprint Comments at 5; TIA Reply at 28.

83 NYDPS Comments at 6.

electronic publishing.[84] YPPA contends that if Congress had intended to distinguish between interLATA and intraLATA electronic publishing, it would have done so, as it did in section 272.[85] NYDPS argues that the Act does not preclude States from exercising jurisdiction over electronic publishing.[86] NAA maintains that the requirements of section 274 apply when the electronic publishing is disseminated by means of a BOC's "basic telephone service."[87] Thus, NAA argues that the Commission's authority with respect to complaints and cease and desist orders applies to interstate and intrastate electronic publishing. NAA contends, however, that Congress has manifested no intent to preclude the States from also enforcing section 274.[88]

37. AT&T contends that the role of the States in implementing the Act's various prohibitions against cross-subsidization arises in the auditing process.[89] According to AT&T, States will also continue to have authority to use their own accounting methods for intrastate services that have not been preemptively deregulated by the Commission or for which jurisdiction has not been expressly vested in the Commission under the Act.[90]

38. With respect to the Commission's authority to preempt State accounting regulations pursuant to *Louisiana PSC*, NYDPS contends that because two sets of accounting regulations can co-exist and have co-existed in the past, the Commission's tentative conclusion to refrain from preempting States under *Louisiana PSC* is correct as a matter of law.[91] TIA contends that any State regulation with respect to BOC manufacturing that is inconsistent with the requirements of section 272 or 273 would necessarily "thwart or impede" federal policies and should therefore be preempted.[92]

---

[84] YPPA Comments at 3; NAA Comments at 4-5; BellSouth Comments at 45; NYDPS Comments at 6.

[85] YPPA Comments at 3.

[86] NYDPS Comments at 6. See also BellSouth Comments at 45.

[87] NAA Comments at 4-5.

[88] Id.

[89] AT&T Comments at 6.

[90] Id.

[91] NYDPS Comments at 7-8.

[92] TIA Reply at 28-29.

Discussion:

39. Sections 260, 271,[93] 274, 275 and 276[94] of the Communications Act of 1934 all expressly prohibit BOCs and, in some cases, other incumbent local exchange carriers from subsidizing services permitted under those sections from their "telephone exchange service"[95] or their "basic telephone service."[96] The term "telephone exchange service" as defined under section 3(47) of the Act is a primarily intrastate service.[97] Moreover, the term "basic telephone service" as defined under section 274(i)(2) is a primarily intrastate service.[98] Therefore, by barring BOCs and, in some cases, other incumbent local exchange carriers from subsidizing activities permitted pursuant to sections 260, 271, 274, 275 and 276 from their "telephone exchange service" or their "basic telephone service," these sections of the Act expressly reach intrastate services. In addition, section 273(g) states that the Commission may prescribe such additional rules and regulations as may be necessary to prevent cross-subsidization.

40. The relevant statutory references to intrastate services are extensive. Section 260(a)(1) provides that "[a]ny local exchange carrier subject to the requirements of section 251(c) that provides telemessaging service . . . (1) *shall not subsidize* its telemessaging service directly or indirectly *from its telephone exchange service* or its exchange access."[99] Section 274(a) provides that "[n]o Bell operating company or any affiliate may engage in the provision of electronic publishing that is disseminated by means of such Bell operating company's or any of its affiliates' *basic telephone service*."[100] Similarly, section 275(b)(2) provides that an incumbent local exchange carrier shall "not subsidize its alarm monitoring services either

---

[93] We note that section 271(h)'s prohibition against subsidization applies only to the incidental interLATA services authorized under subsection (g) of section 271.

[94] With regard to payphone services, section 276(c) provides that "[t]o the extent that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements." 47 U.S.C. § 276(c).

[95] Id. §§ 260(a)(1), 271(h), 275(b)(2), 276 (a)(1).

[96] Id. § 274(a).

[97] Id. § 153(47).

[98] Id. § 274(i)(2).

[99] Id. § 260(a)(1) (emphasis added).

[100] Id. § 274(a) (emphasis added).

directly or indirectly *from telephone exchange service operations*,"[101] while section 276(a)(1) prohibits any BOC that provides payphone service from subsidizing its payphone service "directly or indirectly from its *telephone exchange service operations* or its exchange access operations."[102] Further, section 271(h), pertaining to BOC entry into interLATA services, states that the "Commission shall ensure that the provision of services authorized under subsection (g) by a Bell operating company or its affiliate *will not adversely affect telephone exchange service ratepayers* or competition in any telecommunications market."[103]

41. In addition, we note that in the companion *Non-Accounting Safeguards Order*, we conclude that sections 271 and 272 give us jurisdiction over all interLATA services covered by those sections, including intrastate, interLATA services.[104] The Act defines "interLATA services" as "telecommunications between a point located in a [LATA] and a point located outside such area."[105] The definition does not distinguish between domestic and international interLATA services. Further, international telecommunications services, which originate in a LATA and terminate in a country other than the United States, or vice versa, fit within the statutory definition of interLATA services. Thus, we conclude, as we do in the Non-Accounting Safeguards Order that Congress intended the section 272 safeguards to apply to all domestic and international interLATA services.[106] Because the scope of sections 271 and 272 extends to both interstate and intrastate services, carriers must comply with the requirements of those sections for both interstate and intrastate services. We emphasize, however, that the scope of the Commission's authority under sections 271 and 272 extends only to matters covered by those sections. Those sections do not alter the jurisdictional division of authority with respect to matters falling outside their scope. For example, rates

---

[101] Id. § 275(b)(1) (emphasis added).

[102] Id. § 276(a)(1) (emphasis added).

[103] Id. § 271(h) (emphasis added).

[104] We incorporate by reference the jurisdictional analysis in Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended, Report and Order, CC Docket No. 96-149, FCC 96-489, paras. 23-24, 30-49 (rel. Dec. 24, 1996) ("Non-Accounting Safeguards Order"). Many States contain more than one LATA. The state of Texas, for example, contains sixteen BOC LATAs. See Local Exchange Routing Guide § 3, at 4. Thus, interLATA traffic may be either interstate or intrastate. For example, a call from San Francisco to Los Angeles is an intrastate interLATA call. Approximately 30 percent of interLATA traffic in 1994 was intrastate. See Industry Analysis Division, Telecommunications Industry Revenue: TRS Fund Worksheet Data, Table 6 (Com. Car. Bur. Feb. 1996).

[105] 47 U.S.C. § 153(21).

[106] Non-Accounting Safeguards Order at para. 58.

charged to end users for intrastate interLATA service have traditionally been subject to state authority, and will continue to be.

42. Based on the express statutory language prohibiting cross-subsidization, as well as our interpretation of the term "interLATA," as discussed in the *Non-Accounting Safeguards Order*, and our interpretation of the terms "telephone exchange service" and "basic telephone service," as discussed above, we conclude that the reach of sections 260, 271, 272 and 274 through 276 extends to intrastate services, and that the Commission has jurisdiction, under the cross-subsidization prohibitions contained in these sections, to adopt regulations governing intrastate services. Again, we emphasize that the scope of the Commission's authority under sections 260, 271, 272, and 274 through 276 extends only to matters covered by those sections. Those sections do not alter the jurisdictional division of authority with respect to matters falling outside their scope, including rates charged to end users for intrastate interLATA service.

43. We also find, as discussed in the *Non-Accounting Safeguards Order*, that section 2(b) of the Communications Act of 1934 does not limit the Commission's authority to establish regulations governing intrastate matters under these sections.[107] For the reasons explained below, however, we decline to impose any additional accounting rules on carriers' intrastate services. We note that the language of sections 260, 271, 272 and 274 through 276 that extends our jurisdiction to include certain intrastate activities is both more recent and more specific than section 2(b). As a result, the language of these more recent provisions is controlling.

44. As we discuss in section II.B. above, we already have an accounting safeguards system in place that prevents incumbent local exchange carriers from imposing the costs and risks of their competitive ventures on interstate telephone ratepayers and ensures that interstate ratepayers share in the economies of scope that incumbent local exchange carriers may realize upon expansion into additional enterprises. In this Order, we apply our existing accounting safeguards system, consisting of our cost allocation and modified affiliate transactions rules in Parts 32 and 64 of our rules, to the services permitted by sections 260, 271, 272 and 274 through 276. Our experience with these safeguards has demonstrated their ability to protect interstate ratepayers from improper cross-subsidization. The cross-subsidization prohibitions of sections 260, 271, 272 and 274 through 276, however, cover certain intrastate services, as noted in the previous paragraph. Neither the information contained in the record nor our experience provides us with any basis to conclude that existing state accounting systems that differ from our federal system will result in the type of subsidization of competitive activities

[107] Id. at paras. 39-45.

prohibited by sections 260, 271, 272 and 274 through 276. Therefore, we decline to impose any additional accounting rules on intrastate services.

45. Regardless of whether we or the States adopt accounting rules to prevent subsidies flowing from regulated services within our respective jurisdictions to the services permitted under sections 260, 271, 272 and 274 through 276, carriers must comply with the cross-subsidization prohibitions in those sections of the Act.[108] Any ratepayer or other person alleging a violation of these provisions by a carrier may file a complaint with the Commission pursuant to section 208 of the Communications Act.[109] In the event that a carrier or customer believes that any State has imposed accounting rules that may force a carrier to violate the cross-subsidization prohibitions of sections 260, 271, 272 and 274 through 276, then the carrier or customer may seek declaratory relief from the Commission pursuant to section 1.2 of the Commission rules on a case-by-base basis.[110]

46. With regard to the manufacturing activities covered by section 273, we conclude that States are preempted from implementing any part of that section, including its accounting safeguards provisions.[111] We base this conclusion on the fact that such manufacturing activities cannot be separated between the interstate and intrastate jurisdictions, rendering any separation between interstate and intrastate jurisdictions infeasible. As a result, we must preempt States from implementing accounting safeguards related to manufacturing activities. Moreover, while section 2(b) of the Communications Act of 1934 limits the Commission's authority over "charges, classifications, practices, services, facilities, or regulation for or in connection with intrastate communications service,"[112] we find that the manufacturing activities addressed by section 273 do not fit within any of these categories and therefore are not within the scope of section 2(b). We therefore conclude that section 2(b) does not preclude our assertion of jurisdiction over manufacturing activities, as required by section 273.

---

[108] 47 U.S.C. §§ 260, 271-72, 274-276.

[109] Id. § 208.

[110] 47 C.F.R. § 1.2 (authorized by section 554(e) of the Administrative Procedure Act, 5 U.S.C. § 554(e)).

[111] 47 U.S.C. § 273.

[112] Id. § 152(b).

D. Structure of this Order

47. Section III of this Order addresses accounting safeguards that apply when an incumbent local exchange carrier, including a BOC, provides on an integrated basis a service within the ambit of sections 260 and 271 through 276. Section IV discusses the accounting safeguards that apply when an incumbent local exchange carrier, including a BOC, uses an affiliate to provide a service within the ambit of sections 260 and 271 through 276. Within sections III and IV, we address the application of accounting safeguards to meet the individual requirements of each statutory section addressed in this Order. Section V of this Order presents our analysis as to why price cap regulation does not obviate the need for accounting safeguards to ensure against the subsidization of services permitted under sections 260 and 271 through 276 with revenues from regulated telecommunications services.

III. SAFEGUARDS FOR INTEGRATED OPERATIONS

A. General

48. In this section of the Order, we discuss the provisions in sections 260, 271, 275, and 276 relating to accounting safeguards for telemessaging, certain interLATA telecommunications and information, alarm monitoring, and payphone services that the BOCs and other incumbent local exchange carriers may provide on an integrated basis. In the *NPRM*, we tentatively concluded that our existing Part 64 cost allocation rules, developed in our *Joint Cost* and *Computer III* proceedings, satisfy the requirements of these sections of the Act that certain competitive telecommunications and information services not be subsidized by subscribers to regulated telecommunications services.[113] We invited comment on this tentative conclusion. In the *NPRM*, we asked whether the benefits of a fundamentally different approach to cost allocation would be outweighed by the costs that implementation of such a change would impose.[114] Alternatively, we asked commenters to discuss how, if necessary, we might adapt the existing cost allocation system to accommodate the services discussed in section III of the *NPRM*.

Comments:

49. Most parties, including several BOCs, support the Commission's tentative conclusion that our existing Part 64 cost allocation rules generally satisfy the requirements of the Act that certain competitive and information services not be subsidized by subscribers to

[113] NPRM, 11 FCC Rcd at 9066 para. 27.

[114] Id. at para. 28.

regulated telecommunications services.[115] In particular, Puerto Rico Telephone contends that we need not modify our cost allocation rules because competition in the local exchange and exchange access markets will ensure that local exchange carriers do not shift costs of nonregulated services to regulated ratepayers.[116] In contrast, MCI maintains that additional safeguards for integrated operations are necessary to protect the public interest.[117] Ameritech argues that our current cost allocation rules exceed the statutory requirements of the Act.[118]

Discussion:

50. We developed our cost allocation rules in the *Joint Cost* and *Computer III Proceedings* to help ensure that interstate ratepayers do not bear the costs and risks of the telephone companies' nonregulated activities.[119] These rules prescribe how subject carriers must separate the costs of activities regulated under Title II from the costs of nonregulated activities when the nonregulated activities are performed directly by the carrier rather than through an affiliate.[120] Under these rules, incumbent local exchange carriers may not apportion the costs of nonregulated activities to regulated products and services. We adopt our tentative conclusion that our existing Part 64 cost allocation rules satisfy the requirements of sections 260, 271, 275, and 276 that certain competitive telecommunications and information services not be subsidized by subscribers to regulated telecommunications services. Incumbent local exchange carriers have implemented internal cost allocation systems to help ensure their compliance with these rules. No commenter has presented a plan for redesigning these internal systems to accommodate a fundamentally different cost allocation approach. We

---

[115] CTA Comments at 8; PacTel Comments at 9; Sprint Comments at 7; US West Comments at 3. See also BellSouth Comments at 12; NYNEX Comments at 11.

[116] Puerto Rico Telephone Comments at 2.

[117] MCI Comments at 11. See also Sprint Comments at 4; Worldcom Comments at 10; Worldcom Reply at 3.

[118] Ameritech Comments at 3.

[119] These rules, along with the affiliate transactions requirements in section 32.27 of the Commission's rules, represent the nonstructural accounting safeguards adopted in the Computer III proceedings (CC Docket No. 90-623). See 47 U.S.C. § 276(b)(1)(C).

[120] By nonregulated activities, we mean activities not regulated under Title II of the Act or equivalent state statutes. This category generally consists of activities that have never been subject to regulation under Title II; activities subject to Title II regulation that we have preemptively deregulated; and activities subject to Title II regulation that have been deregulated at the interstate level, but not preemptively deregulated, that we conclude should be classified as nonregulated activities for Title II accounting purposes. See 47 C.F.R. § 32.23(a).

discuss below the application of our cost allocation rules to services permitted under sections 260, 271, 275, and 276.

B. Specific Services

1. Section 260 - Telemessaging Service

51. Section 260(a)(1) provides that each "local exchange carrier subject to the requirements of section 251(c) that provides telemessaging service . . . shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access."[121] Section 251(c), in turn, applies to every "incumbent local exchange carrier."[122] Section 260(c) defines "telemessaging service" as "voice mail and voice storage and retrieval services, any live operator services used to record, transcribe, or relay messages (other than telecommunications relay services), and any ancillary services offered in combination with these services."[123]

52. In the *NPRM*, we tentatively concluded that applying our Part 64 rules to telemessaging will safeguard against the cross-subsidies prohibited by section 260(a)(1).[124] We also tentatively concluded, as we did in a companion NPRM, the *BOC In-Region NPRM*, that telemessaging is an information service and that our authority under sections 271 and 272 over interLATA information services extends to intrastate, interLATA information services

---

[121] 47 U.S.C. § 260(a)(1).

[122] Id. § 251(c). Section 251(h)(1) defines "an incumbent local exchange carrier" as: the local exchange carrier, with respect to an area, that--

> (A) on the date of enactment of the Telecommunications Act of 1996, provided telephone exchange service in such area; and
>
> (B)(i) on such date of enactment, was deemed to be a member of the exchange carrier association pursuant to section 69.601(b) of the Commission's regulations (47 C.F.R. 69.601(b)); or
>
> (ii) is a person or entity that, on or after such date of enactment, became a successor or assign of a member described in clause (i).

Id. § 251(h)(1).

[123] Id. § 260(c).

[124] NPRM, 11 FCC Rcd at 9070 para. 33.

provided by BOCs or their affiliates.[125] Therefore, BOC provision of telemessaging service on an interLATA basis would be subject to the separate affiliate requirements of section 272.[126] We invited comment on these tentative conclusions.

Comments:

53. In general, incumbent local exchange carriers assert that the existing Part 64 rules will effectively prevent cross-subsidization of telemessaging services.[127] ATSI contends that existing rules applicable to telemessaging are not sufficient to safeguard against the subsidies prohibited by section 260 because they fall short of equalizing cost attributions.[128]

54. Voice-Tel maintains that existing accounting safeguards in Parts 32 and 64 cannot ensure that telemessaging services that are marketed and provided by incumbent local exchange carriers on an in-house basis will not be subsidized by ratepayers.[129] Voice-Tel argues that because telemessaging is part of basic service offered by a local exchange carrier and is marketed by customer service representatives at the same time that other basic service options are presented, there are no easily identifiable separate marketing activities that can be isolated and separately costed.[130] Telemessaging often uses the same facilities that are used for other basic and optional services provided by the local exchange carrier, and the switch is not necessarily partitioned in a manner that permits direct allocation.[131] Voice-Tel contends that even if the switch can be partitioned, it is questionable whether the use of lines and trunks can be properly allocated because most telemessaging services permit access to a mailbox by dialing either a special number or by dialing one's own number.[132] In both cases, there is no separate trunk or line cost to allocate. Accordingly, Voice-Tel's advocates that we should

---

[125] BOC In-Region NPRM at para. 21.

[126] Id. at para. 54. For a more complete discussion of this issue, see section IV.B.4., infra.

[127] Ameritech Comments at 19; BellSouth Comments at 14; PacTel Comments at 9; USTA Comments at 19; US West Comments at 4.

[128] ATSI Comments at 5.

[129] Voice-Tel Comments at 5.

[130] Id.

[131] Id. at 7.

[132] Id. at 8.