the competitors reduce their interLATA rates to match the BOC interLATA affiliate's reductions, the BOC would receive increased access revenues. In the extreme, such a situation could drive the affiliate's rivals from the market. MCI claims that, even if such a predatory strategy is not successful, the rivals would be weakened by the cost increases they absorb, thereby reducing their output and their ability to compete effectively.[372]

128. We conclude that imposing advance tariffing and cost support data requirements on the BOC interLATA affiliates would not be an efficient means of preventing the BOCs from engaging in such a predatory price squeeze strategy.[373] As previously discussed, advance notice periods for tariff filings could reduce the BOC interLATA affiliates' incentives to reduce their interLATA rates. Furthermore, requiring the BOC interLATA affiliates to file cost support data could discourage them from introducing innovative new service offerings.[374] We also conclude that imposing advance tariff filing and cost support data requirements on the BOC interLATA affiliates would not address LDDS' concern that the BOC interLATA affiliates could effectively evade imputation requirements by passing on their access cost advantage in reduced prices for services not subject to the Commission's jurisdiction, such as local exchange and information services. In addition, we believe that, if the predatory behavior described above were to occur, it could be adequately addressed through our complaint process and enforcement of the antitrust laws, coupled with the biennial audits required by section 272(d),[375] such that the benefits of any protections offered by advance tariffing and cost support data requirements would be outweighed by the enormous administrative burden those requirements would impose on the Commission.[376] A BOC interLATA affiliate that charges a rate for its interLATA services below its incremental cost to provide service would be in violation of sections 201 and 202 of the Communications

structure, regardless of any affiliation with the BOC); Bell Atlantic Aug. 30, 1996 Reply at 22 (asserting that MFS' illustration ignores section 272(e)(3), which requires that an interLATA affiliate pay the same for access that unaffiliated carriers do and the potential that the competitor could provide exchange and exchange access service).

[372] MCI Aug. 30, 1996 Reply at 36-37.

[373] See AT&T Aug. 15, 1996 Comments at 66; MCI Aug. 15, 1996 Comments at 64-65.

[374] See supra ¶¶ 88-90.

[375] 47 U.S.C. § 272(d). See Bell Atlantic Aug. 30, 1996 Reply at 20; NYNEX Aug. 30, 1996 Reply at 33; PacTel Aug. 30, 1996 Reply at 32.

[376] See Non-Accounting Safeguards Order at ¶ 258.

Act, if such a rate were sustained for an extended period.[377]

129. We also note that other factors constrain the ability of a BOC or BOC interLATA affiliate to engage in a predatory price squeeze. For example, a BOC interLATA affiliate's apparent cost advantage resulting from its avoidance of access charges may be offset by other costs it must incur, such as the cost of interLATA transport, which, at least initially, may be greater than the true marginal cost of interLATA transport for facilities-based interLATA carriers.[378] In addition, a BOC interLATA affiliate will have to pay terminating access charges to LECs other than its BOC parent for calls terminating outside the BOC's region and to competing LECs in the BOC's in-region states. Having to pay such access charges reduces the cost disparity between the BOC interLATA affiliate and competing interexchange carriers. Finally, we note that a price squeeze strategy would give a BOC interLATA affiliate the ability to raise price by restricting its own output only if it is able to drive competitors from the market. As discussed previously, the existence of four nationwide, or near-nationwide, network facilities makes it unlikely that a BOC interLATA affiliate could successfully engage in a predatory strategy.[379] As a result, we conclude that the BOCs or BOC interLATA affiliates will not be able to engage in a price squeeze to such an extent that the BOC interLATA affiliates will have the ability, upon entry or soon thereafter, to raise price by restricting their own output. Thus we do not believe that classifying a BOC's interLATA affiliate as a dominant carrier is necessary or appropriate to constrain the BOC and its affiliate from attempting to execute a predatory price squeeze.

130. We agree with commenters that assert that the risk of the BOCs engaging in a price squeeze will be greatly reduced when interLATA competitors gain the ability to purchase access to the BOCs' networks at or near cost, and as competition develops in the provision of exchange access services.[380] As noted, we believe that the ability of competing carriers to acquire access through the purchase of unbundled elements enables them to avoid originating access charges and thus partially protect themselves against a price squeeze.

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[377] Non-Accounting Safeguards Order at ¶ 258. See also AT&T Communications Tariff F.C.C. No. 1; PRO America Optional Calling Plan; Alascom, Inc. Tariff F.C.C. No. 1; Block-of-Time Call America, Memorandum Opinion and Order, 103 FCC 2d 134, 136, ¶ 3 (1985) (finding that AT&T's calling plan would violate sections 201(b) and 202(a) because AT&T had failed to demonstrate that the plan's revenues would cover its costs).

[378] Ameritech Aug. 15, 1996 Comments at 31.

[379] See supra ¶ 107.

[380] See, e.g., MFS Aug. 15, 1996 Comments at 5; MCI Aug. 15, 1996 Comments at 64. See also PacTel Aug. 15, 1996 Comments at 62 (if price cap regulation is not working, Commission should revise it, not impose dominant regulation on BOC interLATA affiliates).

Moreover, to the extent that access charges are reformed to more closely reflect economic cost, as is being considered in the access charge reform proceeding, the potential for a price squeeze should be further mitigated.[381]

f. Mergers or Joint Ventures Between Two or More BOCs

i. Background and Comments

131. In the Non-Accounting Safeguards NPRM, we sought comment on what effect, if any, a merger of or joint venture between two or more BOCs should have on our determination whether to classify the interLATA affiliate of one of those BOCs as dominant or non-dominant.[382] Bell Atlantic, contends that the prospect of mergers between BOCs should not have any impact on whether the BOCs are treated as dominant because both parties to such a merger would be entering the long distance market with zero market share and in competition with well established competitors and because the merged company's access business would remain subject to all the same market and regulatory constraints as nonmerged BOCs.[383] Sprint and the New York State Department of Public Service (NYPDS) contend that mergers, acquisitions, and similar combinations by BOCs may require consideration of geographic markets more expansive than a particular BOC's region.[384]

ii. Discussion

132. We conclude that a merger of or joint venture between two or more BOCs should have no direct effect on our determination of whether to classify the interLATA affiliates of one of those BOCs as dominant or non-dominant. Bell Atlantic notes that, even though a merged company's territory would grow, it would continue to be subject to the same regulation currently imposed on the individual companies prior to the merger or joint venture. In the Non-Accounting Safeguards Order, we concluded that, upon completion of a merger between or among BOCs, the in-region states of a merged entity shall include all of the in-region states of each of the BOCs involved in the merger.[385] Thus, the merged entity

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[381] See Access Charge Reform NPRM at ¶ 14.

[382] Non-Accounting Safeguards NPRM at ¶ 148.

[383] Bell Atlantic Aug. 15, 1996 Comments at 20.

[384] Sprint Aug. 15, 1996 Comments at 62-63; NYPDS Aug. 15, 1996 Comments at 7.

[385] Non-Accounting Safeguards Order at ¶ 69. We declined, however, to adopt a general rule that would treat the regions of merging BOCs as combined prior to completion of the merger, for the purposes of applying the section 272 separate affiliate and nondiscrimination safeguards. We found that adequate protections against

would be required to satisfy the requirements of sections 271 and 272 in providing interLATA services originating in those in-region states. We also note that DOJ is currently considering the implications of such mergers and joint ventures from an antitrust perspective.[386]

g. Conclusion

133. Based on the preceding analysis, we conclude that the BOCs' interLATA affiliates will not have the ability, upon entry or soon thereafter, to raise the price of in-region, interstate, domestic, interLATA services by restricting their own output, and, therefore, that the BOC interLATA affiliates should be classified as non-dominant in the provision of those services. We note, however, that we retain the ability to impose some or all of the dominant carrier regulations on one or more of the BOC interLATA affiliates if this proves necessary in the future.[387] As discussed in the Notice, our experience with regulating the independent LECs' provision of interstate, domestic, interexchange services and the BOCs' provision of enhanced services suggests that our existing safeguards have worked reasonably well and generally have been effective, in conjunction with our regular audits, in deterring the improper allocation of costs and unlawful discrimination.[388] We are not persuaded by MCI's argument that the Ninth Circuit's decision in California III[389] leads

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discriminatory and anticompetitive conduct already applied to mergers, acquisitions, and joint ventures among BOCs. Id.

[386] See Justice Clears 2 Mergers Involving Phone Firms, Wash. Post, Nov. 6, 1996, at C11.

[387] See DOJ Aug. 30, 1996 Reply at 17.

[388] Non-Accounting Safeguards NPRM at ¶ 146; PacTel Aug. 15, 1996 Comments at 65-66 (noting that PacTel has lost significant market share in intraLATA toll services and that Bell Atlantic and NYNEX have not gained significant market share in the provision of interLATA corridor services). We acknowledge, however, that there have been instances in which individual BOCs may have not complied with our non-structural safeguards in providing non-regulated services. See id. n. 284. See also MCI Aug. 15, 1996 Comments at 67 (referring to the MemoryCall case).

[389] California v. FCC, 39 F.3d 919, 923 (9th Cir. 1994) (California III). In its Computer III decisions, the Commission removed the separate affiliate requirements applicable to AT&T and the BOCs, provided that they complied with certain nonstructural safeguards intended to guarantee that they offered their regulated network services to competing enhanced service providers on an equal and nondiscriminatory basis. The U.S. Court of Appeals for the Ninth Circuit vacated portions of the Commission's Computer III decisions in three separate decisions. Amendment of Section 64.702 of the Commission's Rules and Regulations, CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) (Phase I Order), recon., 2 FCC Rcd 3035 (1987) (Phase I Reconsideration Order), further recon., 3 FCC Rcd 1135 (1988), second further recon., 4 FCC Rcd 5927 (1989); Phase I Order and Phase I Reconsideration Order vacated, California v. FCC, 905 F.2d 1217 (9th Cir. 1990) (California I); Phase II, 2 FCC Rcd 3072 (1987) (Computer III Phase II Order), recon., 3 FCC Rcd 1150

to the conclusion that we should impose dominant carrier regulation on the BOC interLATA affiliates.[390] As discussed above, section 272 requires the BOCs to provide in-region, interLATA services through structurally separate affiliates. Since section 272's structural separation requirements are akin to those in Computer II, the Ninth Circuit's discussion of whether the Commission had adequately justified its elimination of the Computer II structural separation requirements for BOC enhanced services is not relevant here.

134. We believe that the entry of the BOC interLATA affiliates into the provision of in-region, interLATA services has the potential to increase price competition and lead to innovative new services and market efficiencies. We recognize that, as long as the BOCs retain control of local bottleneck facilities, they could potentially engage in improper cost allocation, discrimination, and other anticompetitive conduct to favor their affiliates' in-region, interLATA services. We conclude, however, that, to the extent dominant carrier regulation addresses such anticompetitive conduct, the burdens imposed by such regulation outweighs its benefits. We therefore see no reason to impose dominant carrier regulation on the BOC interLATA affiliates, given that section 272 contains numerous safeguards designed to prevent the BOCs from engaging in improper cost allocation, discrimination, and other anticompetitive conduct.[391] We emphasize that our decision to accord non-dominant treatment to the BOCs' provision of in-region, interLATA services is predicated upon their full compliance with the structural, transactional, and nondiscrimination requirements of section 272 and our implementing rules. We believe that these safeguards, coupled with other statutory and regulatory safeguards, are sufficient to prevent the BOC interLATA affiliates from gaining the ability, upon entry or shortly thereafter, to raise prices by restricting their output.

(1988), further recon., 4 FCC Rcd 5927 (1989); Phase II Order vacated, California I, 905 F.2d 1217 (9th Cir. 1990); Computer III Remand Proceeding, 5 FCC Rcd 7719 (1990), recon., 7 FCC Rcd 909 (1992), pets. for review denied, California v. FCC, 4 F.3d 1505 (9th Cir. 1993); BOC Safeguards Order, 6 FCC Rcd 7571 (1991), vacated in part and remanded, California III, 39 F.3d 919 (9th Cir. 1994), cert. denied, 115 S. Ct. 1427 (1995).

[390] See MCI Aug. 15, 1996 Comments at 67.

[391] Section 272(f)(1) of the Communications Act provides that the BOC safeguards set out in section 272, other than those prescribed in section 272(e), shall sunset three years after the date that the BOC affiliate is authorized to provide interLATA telecommunications services unless the Commission extends such three-year period by rule or order. We cannot now predict how competition will develop in local exchange markets nor can we determine at this time what accounting and non-accounting safeguards, if any, will be needed at that time. Accordingly, we recognize that it will be necessary for the Commission to determine what accounting and non-accounting safeguards, if any, are necessary and appropriate upon expiration of those section 272 safeguards subject to sunset, and whether BOC interLATA affiliates should be classified as dominant or non-dominant in the provision of in-region, interstate, domestic, interLATA services.

3. Classification of BOC InterLATA Affiliates in the Provision of In-Region, International Services

a. Background

135. In the Non-Accounting Safeguards NPRM, we tentatively concluded that we should apply the same regulatory treatment to a BOC interLATA affiliate's provision of in-region, international services as we apply to its provision of in-region, interstate, domestic, interLATA services, assuming the BOC or BOC interLATA affiliate does not have an affiliation with a foreign carrier that has the ability to discriminate against the rivals of the BOC or its affiliate through control of bottleneck facilities in a foreign destination market.[392] Under this proposal, our current framework for addressing issues raised by foreign carrier affiliations would apply to the BOCs' provision of U.S. international services.[393]

b. Comments

136. Most commenters support the Commission's proposal to apply the same regulatory treatment to the BOC interLATA affiliates' provision of in-region, international services as it applies to in-region, interstate, domestic interLATA services.[394] PacTel and U S West agree that if the BOC interLATA affiliates should be non-dominant for in-region domestic services, they should be non-dominant for in-region international services, but they further claim that differences in the domestic and international markets suggest that BOC interLATA affiliates should be classified as nondominant for international interLATA services regardless of their classification for domestic services.[395] PacTel agrees that the existing rules governing dominance based on foreign market affiliations should apply to BOC interLATA affiliates as they do to all other international carriers. PacTel suggests, however,

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[392] Non-Accounting Safeguards NPRM at ¶ 150; see also Market Entry and Regulation of Foreign-affiliated Entities, IB Docket No. 95-22, Report and Order, 11 FCC Rcd 3873, 3917-20 (1995) (Foreign Carrier Entry Order), recon. pending.

[393] Non-Accounting Safeguards NPRM at ¶ 151.

[394] See, e.g., AT&T Aug. 15, 1996 Comments at 66-67, n.59; BellSouth Aug. 15, 1996 Comments at 56; NYNEX Aug. 15, 1996 Comments at 61; Excel Aug. 15, 1996 Comments at 8-9.

[395] PacTel Aug. 15, 1996 Comments at 68; U S West Aug. 30, 1996 Reply at 31 n.85. According to PacTel, the international market is different from the domestic market in three respects: (1) the U.S. international telecommunications market is far more concentrated than the domestic market, with only a small number of facilities-based carriers; (2) while access costs are the major expense for domestic interLATA calls, access to satellite or fiber facilities are the largest single expense for international services; and (3) BOCs are likely to procure most of their international facilities from consortiums led by AT&T. PacTel Aug. 15, 1996 Comments at 68-69.

that the Commission should ensure that route-by-route dominance filings, based on foreign affiliations, be concluded no later than the grant of a section 271 entry petition.[396]

137. MCI generally agrees with the Commission that a BOC's in-region international service should be treated in a manner similar to its in-region domestic interLATA service.[397] It contends, however, that the BOCs have unique advantages in the international services market as a result of their "regional focus." MCI expresses concern that the BOCs will enter into special arrangements with foreign carriers under which return traffic would be "groomed" -- i.e., the foreign carrier would give the BOC's interLATA affiliate the return traffic that terminates in the BOC's region.[398] MCI contends that, by contrast, non-BOC interexchange carriers would be required to take return traffic to destinations all over the United States and thereby incur higher costs in terminating such traffic. MCI notes that a disproportionate amount of international traffic terminates in the NYNEX and Pacific Bell regions and argues that these BOCs would have an especially lucrative opportunity to obtain groomed traffic.[399] MCI notes that such arrangements may result in lower costs for terminating U.S. inbound traffic, but characterizes these arrangements as "anticompetitive." It urges the Commission, at a minimum, to impose on the BOC interLATA affiliates the same safeguards that it imposed on MCI in the order approving British Telecom's (BT's) initial 20 percent investment in MCI.[400] A number of the BOCs respond that such additional requirements are unnecessary and inappropriate.[401]

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[396] PacTel Aug. 15, 1996 Comments at 69. PacTel states that this could be accomplished by beginning the process before section 271 applications are filed or by streamlining any required parallel section 214 filings of BOC interLATA affiliates. PacTel Aug. 15, 1996 Comments at 69.

[397] MCI Aug. 15, 1996 Comments at 68.

[398] Id.

[399] Id. at 68-69.

[400] Id. at 69-71. See MCI Communications Corp. British Telecommunications plc: Joint Petition for Declaratory Ruling Concerning Section 310(b)(4) and (d) of the Communications Act of 1934, as amended, File No. I-S-P-93-013, Declaratory Ruling and Order, 9 FCC Rcd 3960 (rel. July 25, 1994) (approving initial 20 percent investment).

[401] PacTel Aug. 30, 1996 Reply at 35 (claiming that MCI's objection to regionally-sorted traffic is contrary to efficiency and thus flatly anticompetitive); SBC Aug. 30, 1996 Reply at 28-29 (contending that there is no evidence to suggest that existing rules adopted to handle the regulatory treatment of U.S. carriers on international routes are insufficient, and that such situations should, instead, be handled on a case-by-case basis); NYNEX Aug. 30, 1996 Reply at 34-35 (asserting that additional conditions imposed on MCI were based on unique circumstances).

c. Discussion

138. We adopt our tentative conclusion that we should apply the same regulatory treatment to a BOC interLATA affiliate's provision of in-region, international services as we apply to its provision of in-region, interstate, domestic, interLATA services. As discussed in the Notice, the relevant issue in both contexts is whether the BOC interLATA affiliate can exploit its market power in local exchange and exchange access services to raise prices by restricting its own output in another market (the domestic interLATA or international market). We also note that the section 272 safeguards apply equally to the BOCs' in-region, domestic, interLATA and in-region, international services.[402] We find no practical distinctions between a BOC's ability and incentive to use its market power in the provision of local exchange and access services to improperly allocate costs, discriminate against, or otherwise disadvantage unaffiliated domestic interexchange competitors as opposed to international service competitors.[403]

139. In light of our classification of the BOC interLATA affiliates as non-dominant in the provision in-region, interstate, domestic, interLATA services, we accordingly will classify each BOC interLATA affiliate as non-dominant in the provision of in-region, international services, unless it is affiliated, within the meaning of section 63.18(h)(1)(i) of our rules, with a foreign carrier that has the ability to discriminate against the rivals of the BOC or its affiliate through control of bottleneck services or facilities in a foreign destination market. We will apply section 63.10(a) of our rules to determine whether to regulate a BOC interLATA affiliate as dominant on those U.S. international routes where an affiliated foreign carrier has the ability to discriminate against unaffiliated U.S. international carriers through control of bottleneck services or facilities in the foreign destination market.[404] The safeguards that we apply to carriers that we classify as dominant based on a foreign carrier affiliation are contained in Section 63.10(c) of our rules and are designed to address the incentive and ability of the foreign carrier to discriminate against the rivals of its U.S. affiliate in the provision of services or facilities necessary to terminate U.S. international

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[402] Non-Accounting Safeguards Order at ¶ 58.

[403] See AT&T Aug. 15, 1996 Comments at 66-67, n.59 (the ability and incentive of a BOC to use its market power for the purpose of raising its rivals' costs in the long-distance market does not depend on whether its competitors are domestic or international); BellSouth Aug. 15, 1996 Comments at 56; NYNEX Aug. 15, 1996 Comments at 61.

[404] See Foreign Carrier Entry Order, 11 FCC Rcd at 3917-20.

traffic.[405] This framework for addressing issues raised by foreign carrier affiliations will apply to the BOCs' provision of U.S. international services as an additional component of our regulation of the U.S. international services market.

140. We reject MCI's suggestion that we should impose additional safeguards on the BOC's in-region, international services.[406] We observe, as an initial matter, that all U.S. international carriers are subject to the same prohibition against accepting "special concessions" from foreign carriers that we imposed on MCI in the order approving BT's initial 20 percent investment in MCI. The grooming described by MCI would constitute a special concession prohibited by the terms of Section 63.14 of the Commission's rules to the extent the U.S. carrier entered into a grooming arrangement that the foreign carrier did not offer to similarly situated U.S. carriers.[407] A U.S. carrier that negotiates a grooming arrangement with a foreign carrier on a particular route would be required to submit the arrangement to the Commission for public comment and review in circumstances where the arrangement deviates from existing arrangements with other U.S. carriers for the routing and/or settlement of traffic on that route.[408]

141. We are not prepared to rule on this record, however, that the grooming of return traffic (i.e., giving a U.S. carrier the return traffic that terminates in a particular region) in a manner that may ultimately reduce U.S. carrier costs and rates is anticompetitive per se. We recently adopted guidelines for permitting in certain circumstances flexible settlement arrangements between U.S. and foreign carriers that do not comply with the

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[405] Section 63.10(a) of the Commission's rules provides that: (1) carriers having no affiliation with a foreign carrier in the destination market are presumptively non-dominant for that route; (2) carriers affiliated with a foreign carrier that is a monopoly in the destination market are presumptively dominant for that route; (3) carriers affiliated with a foreign carrier that is not a monopoly on that route receive closer scrutiny by the Commission; and (4) carriers that serve an affiliated destination market solely through the resale of an unaffiliated U.S. facilities-based carrier's switched services are presumptively nondominant for that route. See also Regulation of International Common Carrier Services, CC Docket No. 91-360, Report and Order, 7 FCC Rcd 7331, 7334, ¶¶ 19-24 (1992).

[406] See MCI Aug. 15, 1996 Comments at 68-71.

[407] See 47 C.F.R. Section 63.14 ("[a]ny carrier authorized to provide international communications service . . . shall be prohibited from agreeing to accept special concessions directly or indirectly from any foreign carrier or administration with respect to traffic or revenue flows between the United States and any foreign country served . . . and from agreeing to enter into such agreements in the future. . . .").

[408] See 47 C.F.R. § 43.51(d) (to be renumbered 47 C.F.R. § 43.51(e) as provided in Regulation of International Accounting Rates, CC Docket No. 90-337, Third Report and Order and Order on Reconsideration, 11 FCC Rcd 12498 (rel. May 20, 1996)); 47 C.F.R. § 64.1001.

International Settlements Policy (ISP).[409] MCI will have ample opportunity to make its arguments, with proper economic support, in the event a BOC interLATA affiliate or any other U.S. international carrier seeks to establish an arrangement for grooming return traffic.[410]

142. We are also unpersuaded that the other conditions imposed in the 20 percent BT investment in MCI are useful or necessary in this case. MCI has not explained how those conditions are relevant to the BOC interLATA affiliates' provision of in-region international service on routes where they have no investment interest in or by a foreign carrier. The conditions imposed on MCI apply to its operations only on the U.S.-U.K. route, where we found that BT controlled bottleneck local exchange and exchange access facilities on the U.K. end, and they were targeted to limiting the potential risks of undue discrimination between a U.S. carrier (MCI) and a foreign carrier with which the U.S. carrier has an equity relationship (BT).[411] To the extent a BOC has an equity interest in a foreign carrier or the foreign carrier has such an interest in a BOC on a particular U.S. international route, it is of course subject to Section 63.10 of our rules. This rule sets forth the framework for imposing certain safeguards on U.S. carriers that are affiliated with foreign carriers that have the ability to discriminate in the favor of their U.S. affiliate through the control of bottleneck services or facilities.[412]

B. Classification of Independent LECs

143. For the reasons discussed below, we conclude that the requirements established in the Fifth Report and Order, together with other existing rules, sufficiently limit an independent LEC's ability to exercise its market power in the local exchange and exchange access markets so that the LEC cannot profitably raise and sustain the price of in-region, interstate, domestic, interexchange services by restricting its own output. We, therefore,

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[409] Regulation of International Accounting Rates, CC Docket No. 90-337, Phase II, Fourth Report and Order, FCC 96-459 (rel. Dec. 3, 1996) (Accounting Rate Flexibility Order). The ISP requires: (1) the equal division of accounting rates; (2) non-discriminatory treatment of U.S. carriers; and (3) proportionate return of U.S.-bound traffic. The ISP is designed to prevent foreign carriers with market power from obtaining discriminatory accounting rate concessions from competing U.S. carriers. See generally Policy Statement on International Accounting Rate Reform, Policy Statement, 11 FCC Rcd 3146 (rel. Jan. 31, 1996).

[410] See Accounting Rate Flexibility Order.

[411] We note that MCI and BT have requested Commission approval of the transfer of control to BT of licenses and authorization held by MCI subsidiaries, which would occur as a result of the proposed merger of MCI and BT. See MCI Communications Corporation and British Telecommunications PLC Seek FCC Consent for Proposed Transfer of Control, GN Docket No. 96-245, Public Notice, DA 96-2079 (rel. Dec. 10, 1996).

[412] See Non-Accounting Safeguards NPRM at ¶¶ 18, 51.

classify independent LECs as non-dominant in the provision of these services. We recognize, however, that an independent LEC conceivably could use its control over local bottleneck facilities to allocate costs improperly, engage in unlawful discrimination, or attempt to price squeeze. We, therefore, impose the Fifth Report and Order separation requirements on all incumbent independent LECs that provide in-region, interstate, domestic, interexchange services. We further conclude that we should apply the same regulatory classification to the independent LECs' provision of in-region, international services that we adopt for their provision of in-region, interstate, domestic, interexchange services.

1. Classification of Independent LECs in the Provision of In-Region, Interstate, Domestic, Interexchange Services

a. Background

144. In the Competitive Carrier Fourth Report and Order, the Commission determined that interexchange carriers affiliated with independent LECs would be regulated as non-dominant carriers.[413] In the Competitive Carrier Fifth Report and Order, the Commission clarified the definition of "affiliate"[414] and identified three separation requirements that the affiliate must meet in order to qualify for non-dominant treatment. These requirements are that the affiliate: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with the LEC; and (3) acquire any services from its affiliated exchange company at tariffed rates, terms, and conditions.[415] The Commission further concluded that, if the LEC provides interstate, interexchange service directly, rather than through an affiliate, or if the affiliate fails to satisfy the three requirements, those services would be subject to dominant carrier regulation.[416] The Commission observed that these separation requirements would provide some "protection against cost-shifting and anticompetitive conduct" by an independent LEC that could result from its control of local bottleneck facilities.[417]

145. In the Non-Accounting Safeguards NPRM, we sought comment on how we

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[413] Fourth Report and Order, 95 FCC 2d 575-79, ¶¶ 31-36.

[414] The Commission defined a carrier affiliated with an independent LEC as "a carrier that is owned (in whole or in part) or controlled by, or under common ownership (in whole or in part) or control with, an exchange telephone company." Fifth Report and Order, 98 FCC 2d at 1198, ¶ 9.

[415] Id.

[416] Id. at ¶ 9-10.

[417] Id. at ¶ 9.

should classify independent LECs' provision of in-region, interstate, interexchange services. We also sought comment on whether, absent the Fifth Report and Order separation requirements, an independent LEC would be able to use its market power in local exchange and exchange access services to disadvantage its interexchange competitors to such an extent that it would quickly gain the ability profitably to raise and sustain the price of in-region, interstate, domestic interexchange service significantly above competitive levels by restricting its output.[418] We suggested that, regardless of our determination of whether independent LECs should be classified as dominant or non-dominant, some level of separation may be necessary between an independent LEC's interstate, domestic, interexchange operations and its local exchange operations to guard against cost misallocation, unlawful discrimination, or a price squeeze.[419] In addition, we sought comment on whether the existing Fifth Report and Order requirements are sufficient safeguards to apply to independent LECs to address these concerns.[420]

b. Comments

146. Commenters generally suggest two different schemes for regulating independent LECs' provision of in-region, interstate, interexchange services. First, independent LECs and others argue that the Commission should find that independent LECS are non-dominant in their provision of in-region, interstate, interexchange services, and that the Fifth Report and Order requirements are no longer necessary. According to these commenters, the Commission should eliminate the existing Fifth Report and Order separate affiliate requirement as a precondition for non-dominant classification.[421] In support of their contention that independent LECs should be regulated as non-dominant in their provision of in-region, interstate, interexchange services, these commenters argue that: (1) independent LECs do not have market power in the in-region, interstate, interexchange market based on the market power factors that the Commission applied in reclassifying AT&T as a non-dominant interexchange carrier; (2) dominant carrier regulation would reduce competition in the long distance market; (3) imposition of the Fifth Report and Order separations requirements on independent LECs' provision of in-region, interstate, interexchange service is inconsistent with the 1996 Act; and (4) the real costs of requiring any level of separation

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[418] Non-Accounting Safeguards NPRM at ¶¶ 156-157.

[419] Id. at ¶ 158.

[420] Id. at ¶ 158.

[421] GTE Aug. 29, 1996 Comments at 2; SNET Aug. 29, 1996 Comments at 1-2; Citizens Aug. 29, 1996 Comments at 3; Independent Telephone & Telecommunications Alliance (ITTA) Aug. 29, 1996 Comments at 3-4; USTA Aug. 29, 1996 Comments at 11-13; NTCA Aug. 29, 1996 Comments at 4; Independent Coalition (Ind. Coalition) Sept. 13, 1996 Reply at 2.

for independent LECs far outweighs the speculative benefits of separation.

147. In addition, these commenters assert that independent LECs have neither the ability nor the incentive to leverage the market power resulting from their control over local facilities to impede competition in the interexchange market.[422] These commenters argue that their inability to leverage control over local facilities is attributable to several factors, including provisions of the 1996 Act that are designed to open the local market to competition; the geographic dispersion and largely rural nature of independent LEC service territories;[423] cost accounting safeguards, price caps on access services, and regulations to prevent non-price discrimination in the quality of access services provided;[424] and the interexchange carriers' increasing emphasis on constructing their own facilities.

148. GTE contends that the Commission is legally prohibited from imposing separation requirements on independent LECs in general, and specifically on GTE. GTE argues that section 601(a)(2) of the 1996 Act, which removes the restrictions and obligations imposed by the GTE Consent Decree, prohibits the Commission from imposing any separate affiliate requirements on GTE.[425] In addition, GTE asserts that section 271 and 272 added by the 1996 Act, apply only to BOCs, therefore, these sections reflect Congress' determination that there is no need to extend the separation requirements of section 272 to independent LECs or GTE.[426] Moreover, GTE maintains that, if the Commission continues to require separate affiliates, it should modify the Fifth Report and Order requirements to allow the affiliate to take exchange access services not only by tariff, but also on the same basis as

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[422] See USTA Aug. 29, 1996 Comments at 5-9. See also GTE Aug. 29, 1996 Comments at 15-35; Citizens Aug. 29, 1996 Comments at 10.

[423] GTE Aug. 29, 1996 Comments at 28-32. See also Sprint Aug. 29, 1996 Comments at 4-5. NTCA asserts that the average size of its members and of REA borrowers in general is evidence that the companies do not have the ability to leverage size or massive resources to the detriment of rival interexchange carriers. NTCA Aug. 29, 1996 Comments at 3.

[424] Commenters also point to several other regulatory tools, including: independent audits that attest every year that each class A LEC's books and records conform with all applicable FCC regulations; the ARMIS system; the nondiscriminatory provisions of access to a LEC's facilities through equal access and expanded interconnection; and the Commission's tariff process and compliant procedures. See GTE Aug. 29, 1996 Comments at 16-24; USTA Aug. 29, 1996 Comments at 5-6; NTCA Aug. 29, 1996 Comments at 4; Bell Atlantic Sept. 13, 1996 Reply Comments at 2-3; Ind. Coalition Sept. 13, 1996 Reply Comments at 5-6; ITTA Sept. 13, 1996 Reply Comments at 5-6; Sprint Sept. 13, 1996 Reply Comments at 2; SNET Aug. 29, 1996 Comments at 21-25; Citizens Aug. 29, 1996 Comments at 4-5 and 10.

[425] GTE Aug. 29, 1996 Comments at 25-27.

[426] GTE Aug. 29, 1996 Comments at 27.

other carriers that have negotiated interconnection agreements pursuant to section 251.[427]

149. Sprint argues that the Fifth Report and Order separation requirements are no longer necessary because those requirements have been incorporated into the Commission's cost allocation rules.[428]

150. In contrast, interexchange carriers, except Sprint, and competing access providers generally argue that the Commission not only should retain the Fifth Report and Order separation requirements as a condition for non-dominant treatment of independent LEC provision of in-region, interstate, interexchange services, but also should impose additional safeguards to prevent independent LECs from engaging in anticompetitive behavior by virtue of their control over bottleneck facilities.[429]

151. Teleport argues that the Commission should impose quarterly reporting requirements that will enable competitors and the Commission to analyze objectively the independent LEC's service record and to compare service to competitors with service to itself or its affiliates.[430] Teleport also recommends that the Commission implement an expedited complaint process to address service quality complaints by competing carriers.[431]

152. AT&T argues that the Fifth Report and Order and our dominant carrier requirements are inadequate to address independent LECs' potential abuse of market power.[432] AT&T contends that the Commission should, therefore, impose the same structural separation and non-discrimination requirements on independent LECs that we impose on BOCs, as well as a modified form of dominant carrier regulation. AT&T also asks the

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[427] GTE Sept. 13, 1996 Reply at 15.

[428] Sprint Aug. 29, 1996 Comments at 6. Sprint notes that, if this interpretation is incorrect, the Commission may prohibit the sharing of switching and transmission plant used to provide local service by interexchange services by modifying the cost allocation rules in 47 C.F.R. § 64.901. Sprint Aug. 29, 1996 Comments at 7.

[429] Teleport Aug. 29, 1996 Comments at 2-3; AT&T Aug. 29, 1996 Comments at 7-10; MCI Aug. 29, 1996 Comments at 5-7. Commonwealth of Northern Mariana Islands (CNMI) also asks the Commission to impose additional safeguards on Micronesia Telephone Company (MTC) which provides telecommunications services in the Commonwealth. MTC is owned by GTE Hawaiian Telephone Company Incorporated (GTE Hawaiian Tel.). CNMI Aug. 29, 1996 Comments at 8.

[430] Teleport Aug. 29, 1996 Comments at 3-5.

[431] Teleport Aug. 29, 1996 Comments at 6.

[432] AT&T Aug. 29, 1996 Comments at 7.

Commission to make clear that equal access requirements apply to independent LECs, including the requirement that a customer seeking local service from such carriers be offered the options for interexchange service in a neutral fashion.[433] AT&T asserts that the Fifth Report and Order allows joint and integrated design, planning, and provisioning of exchange and interexchange services, which inherently discriminates against other carriers and permits the costs of long distance operations to be misallocated to monopoly ratepayers.[434] In addition, AT&T, challenging SNET's claim that geographic rate averaging would mitigate the effects of any unilateral increase in access charges, asserts that access charges are far above cost, and that this enables LECs to impose a price squeeze in the interexchange market.[435]

153. MCI asserts that, given the types of abuses that control over bottleneck facilities allows, it is necessary to review independent LECs' in-region, interexchange rates to ensure that they fully cover independent LEC tariffed access and other costs.[436] MCI further contends that enforcement of the imputation requirement is necessary to protect against an independent LEC's adopting a price squeeze strategy,[437] and maintains that the Commission's cost accounting rules and after-the-fact audits are insufficient to ensure that LEC interLATA rates cover imputed access costs. Like AT&T, MCI claims that, because an independent LEC's actual access costs are much lower than the tariffed rates, an independent LEC could adopt a successful price-squeeze strategy against its interexchange rivals.[438] MCI adds that an independent LEC may be able to increase its total profits by reducing the price of its interLATA service, thereby increasing the demand for its switched access service.[439]

154. The Commonwealth of the Northern Mariana Islands (CNMI) asserts that GTE-owned Micronesian Telecommunications Corporation (MTC), which is the sole provider of both local exchange and exchange access services and a major provider of

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[433] AT&T Aug. 29, 1996 Comments at 9-10. AT&T notes, for example, that SNET has instituted a "PIC-freeze" which requires a subscriber to contact SNET directly when he or she wishes to switch long-distance carriers. AT&T Aug. 29, 1996 Comments at 10-11.

[434] AT&T Aug. 29, 1996 Comments at 8.

[435] AT&T Sept. 13, 1996 Reply at 12.

[436] MCI Aug. 29, 1996 Comments at 5-7.

[437] MCI Aug. 29, 1996 Comments at 5-6.

[438] MCI Sept. 13, 1996 Reply at 8-9.

[439] MCI Sept. 13, 1996 Reply at 9.

domestic and international off-island services in the Commonwealth, currently provides domestic, interexchange services on a nondominant basis, even though it lacks a separate subsidiary. CNMI asks the Commission to recognize explicitly that MTC must comply with the Fifth Report and Order separation requirements or comply with the Commission's dominant carrier requirements.[440] CNMI also asks the Commission to devise specific safeguards applicable to MTC's monopoly operations in the Commonwealth, such as a strengthened form of the Fifth Report and Order separation requirements.[441] GTE disputes CNMI's claims that MTC is providing domestic interexchange services directly as a non-dominant carrier contrary to the requirements of the Commission's Fifth Report and Order and 1985 International Competitive Carrier Order.[442] GTE asserts that, although MTC provides domestic exchange, exchange access and interexchange services on an integrated basis, its domestic interexchange services are provided on a dominant basis.[443] GTE emphasizes that neither the Commission nor any court has found that MTC has engaged in any misconduct of the nature alleged by CNMI.[444] GTE also asserts that imposing additional regulatory requirements on MTC, which serves 16,000 access lines in a rural location, is clearly contrary to the deregulatory spirit and intent of the 1996 Act.[445]

155. CNMI also asks the Commission to clarify that MTC's service between the Commonwealth and the U.S. mainland and other U.S. points is a domestic service, and thus requires domestic tariffing and compliance with the strengthened form of the Fifth Report and Order separation requirements.[446] GTE responds that, because the Northern Mariana Islands have long been considered an international point for service to and from the United States, MTC currently tariffs its service to the U.S. mainland and other U.S. points in its international tariff.[447] GTE contends that, pursuant to the Commission's Rate Integration Order,[448] the integration of the Islands into domestic rate schedules is not required to occur

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[440] CNMI Aug. 15, 1996 Comments at 2-10.

[441] CNMI Aug. 15, 1996 Comments at 8-10.

[442] GTE Sept. 13, 1996 Reply at 15-16.

[443] GTE Sept. 13, 1996 Reply at 16.

[444] GTE Sept. 13, 1996 Reply at 19.

[445] GTE Sept. 13, 1996 Reply at 17.

[446] CNMI Aug. 15, 1996 Comments at 5-8.

[447] GTE Sept. 13, 1996 Reply at 16.

[448] Rate Integration Order, 11 FCC Rcd 9564.

until August 1, 1997.[449] GTE states that these offshore locations will continue to be tariffed as international points for rate purposes until that time.[450]

c. Discussion

i. Traditional Market Power Factors (other than control of bottleneck facilities)

156. As we noted above, dominant carrier regulation is generally designed to prevent a carrier from raising prices by restricting its own output of interexchange services.[451] An independent LEC, therefore, should be classified as dominant in the provision of in-region, interstate, interexchange services only if it has the ability to raise prices by restricting its output of these services.

157. We find that the traditional market power factors (excluding bottleneck control) suggest that independent LECs do not have the ability profitably to raise and sustain prices above competitive levels by restricting their output. Based on an analysis of these traditional market power factors -- market share, supply and demand substitutability, cost structure, size, and resources -- we conclude that independent LECs do not have the ability to raise prices by restricting their own output.[452] First, independent LECs generally have minimal market share, compared with the major interexchange carriers, which suggests they could not profitably raise and sustain interexchange prices above competitive levels. Second, the same high supply and demand elasticities that the Commission found constrained AT&T's pricing behavior also apply to independent LECs. Finally, we find that low entry barriers in the interexchange market and widespread resale of interexchange services constrain independent LECs from exercising market power. We conclude, therefore, that in light of the Fifth Report and Order requirements independent LECs do not have the ability to raise prices above competitive levels by restricting their output of interexchange services.

ii. Control of Bottleneck Access Facilities

158. As we previously found with regard to the BOCs, traditional market power factors are not conclusive in determining whether independent LECs should be classified as

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[449] GTE Sept. 13, 1996 Reply at 16-17. Rate Integration Order at ¶ 69.

[450] GTE Sept. 13, 1996 Reply at 17.

[451] See supra ¶ 85.

[452] See GTE Aug. 29, 1996 Comments at 9; USTA Aug. 29, 1996 Comments at 5, and Statement of Daniel F. Spulber, Northwestern University (Spulber Appendix) at 8-22.

dominant in the provision of in-region, interstate, interexchange services.[453] We noted in the Non-Accounting Safeguards NPRM that an independent LEC may be able to use its control over local exchange and exchange access services to disadvantage its interexchange competitors to such an extent that it will quickly gain the ability profitably to raise the price of in-region, interstate, interexchange services above competitive levels.[454] We therefore must examine whether an independent LEC could improperly allocate costs, discriminate against its in-region competitors, or engage in a price squeeze to such an extent that the independent LEC would have the ability to raise prices for interstate, interexchange services by restricting its output.[455] We find, as we did with regard to BOCs, that independent LECs providing in-region, interstate, interexchange services do not have the ability to engage in these actions to such an extent that they would have the ability to raise prices by restricting output. For the reasons discussed with regard to the BOCs, we thus conclude that dominant carrier regulation of independent LEC provision of in-region, interstate, interexchange services is inappropriate.

159. We disagree, however, with those commenters that assert that independent LECs have no ability to use their bottleneck facilities to harm interexchange competition.[456] We believe that, absent appropriate and effective regulation, independent LECs have the ability and incentive to misallocate costs from their in-region, interstate, interexchange services to their monopoly local exchange and exchange access services within their local service region.[457] Improper allocation of costs by an independent LEC is a concern because such action may allow the independent LEC to recover costs incurred by its affiliate in providing in-region, interexchange services from subscribers to the independent LEC's local exchange and exchange access services. As we stated previously, this can distort price signals in those markets and, under certain circumstances, may give the affiliate an unfair advantage over its competitors.[458] We believe that the improper allocation of costs may cause substantial harm to consumers, competition, and production efficiency.[459] Such cost

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[453] See supra ¶ 96.

[454] Non-Accounting Safeguards NPRM at ¶ 157.

[455] See supra ¶ 100.

[456] See supra ¶ 147. See also USTA Aug. 29, 1996 Comments at 5-9; GTE Aug. 29, 1996 Comments at 15-24; Citizens Aug. 29, 1996 Comments at 10.

[457] See supra ¶ 104.

[458] Non-Accounting Safeguards NPRM at ¶ 135.

[459] See AT&T Aug. 15, 1996 Comments at 63-65; CTA Aug. 15, 1996 Comments at 35; DOJ Aug. 30, 1996 Reply at 24.

misallocations may be difficult to detect and are not necessarily deterred by price cap regulation.

160. Furthermore, an independent LEC, like a BOC, potentially could use its market power in the provision of exchange access service to advantage its interexchange affiliate by discriminating against the affiliate's interexchange competitors with respect to the provision of exchange and exchange access services.[460] This discrimination could take the form of poorer quality interconnection or unnecessary delays in satisfying a competitors' request to connect to the independent LEC's network.[461]

161. We are also concerned that an independent LEC could potentially initiate a price squeeze to gain additional market share.[462] Absent appropriate regulation, an independent LEC could potentially raise the price of access to all interexchange carriers which would cause competing in-region carriers to either raise their retail rates to maintain the same profit margins or attempt to maintain their market share by not raising their prices to reflect the increase in access charges, thereby reducing their profit margins.[463] If the competing in-region, interexchange providers raised their prices to recover the increased access charges, the independent LEC could seek to expand its market share by not matching the price increase. The independent LEC could also set its in-region, interexchange prices at or below its access prices. The independent LEC's in-region competitors would then be faced with the choice of lowering their retail rates, thereby reducing their profit margins, or maintaining their retail rates at the higher price and risk losing market share.[464]

162. As we explained earlier, the Fifth Report and Order identified three separation requirements with which an independent LEC must comply in order to qualify for non-dominant treatment. These requirements are that the affiliate providing in-region, interstate, interexchange services must: (1) maintain separate books of account; (2) not jointly own transmission or switching facilities with the LEC; and (3) acquire any services from its affiliated exchange companies at tariffed rates, terms, and conditions.[465]

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[460] See supra ¶ 111.

[461] Id.

[462] See supra ¶ 125.

[463] See supra ¶ 73.

[464] See supra ¶ 127.

[465] Fifth Report and Order, 98 FCC 2d at 1198, ¶ 9.

163. We conclude that, although an independent LEC's control of exchange and exchange access facilities may give it the incentive and ability to engage in cost misallocation, unlawful discrimination, or a price squeeze, the Fifth Report and Order requirements aid in the prevention and detection of such anticompetitive conduct. We, therefore, conclude that we should retain the Fifth Report and Order separation requirements. More specifically, separate books of account are necessary to trace and document improper allocations of costs or assets between a LEC and its long-distance affiliate as well as discriminatory conduct. In addition, the prohibition on jointly-owned facilities will reduce the risk of improper cost allocations of common facilities between the independent LEC and its interexchange affiliate. The prohibition on jointly owned facilities also helps to deter any discrimination in access to the LEC's transmission and switching facilities by requiring the affiliates to follow the same procedures as competing interexchange carriers to obtain access to those facilities. Finally, we conclude that requiring services to be taken at tariffed rates, or as discussed below, on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251,[466] aids in preventing a LEC from discriminating in favor of its long distance affiliate, and reduces somewhat the risk of a price squeeze to the extent that an affiliate's long distance prices are required to exceed their costs for tariffed services.[467]

164. We agree that we should modify the third Fifth Report and Order requirement to allow independent LECs to take exchange services not only by tariff, but also on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251.[468] GTE contends that, because under the Commission's current rules. LECs must make interconnection agreements available to other carriers,[469] affiliated carriers should

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[466] See infra ¶ 164.

[467] See MCI Aug. 29, 1996 Comments at 5-7.

[468] See GTE Sept. 13, 1996 Reply at 15.

[469] 47 C.F.R. § 51.809. Section 252(i) states as follows:

> (i) Availability to Other Telecommunications Carriers.- A local exchange carrier shall make available any interconnection, service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement. 47 U.S.C § 252(i).

The Commission's pricing rules and interpretation of section 252(i) are currently under stay by the 8th Circuit Court of Appeals. Iowa Utilities Board v. FCC, No. 96-3321 (8th Cir. October 15, 1996) (Order granting stay pending judicial review).

be able to obtain services under such terms as well.[470] In the Non-Accounting Safeguards Order, we concluded that section 272 does not prohibit a BOC interLATA affiliate from providing local exchange services in addition to interLATA services.[471] We also found in that Order that section 251 does not place any restrictions on which telecommunications carriers may qualify as requesting carriers.[472] We concluded in the Non-Accounting Safeguards Order, therefore, that BOC section 272 affiliates should be permitted to purchase unbundled elements under section 251(c)(3) of the Communications Act and telecommunications services at wholesale rates under section 251(c)(4) from the BOC on the same terms and conditions as other competing local exchange carriers.[473] We find no basis for concluding that Congress intended to treat an incumbent LEC differently from any other requesting telecommunications carrier. Accordingly, in addition to taking exchange services by tariff, the LEC may alternatively take unbundled network elements or exchange services for the provision of a telecommunications service, subject to the same terms and conditions as provided in an agreement approved under section 252 to which the independent LEC is a party.

165. As argued by many commenters, independent LECs have been providing in-region, interstate, interexchange services on a separated basis with no substantiated complaints of denial of access or discrimination. The Fifth Report and Order separation requirements have been in place for over ten years. During that time, we have received few complaints from independent LECs about the requirements themselves. Moreover, we previously determined that the Fifth Report and Order requirements are not overly burdensome. As we stated in the Interim BOC Out-of-Region Order, the separation requirements of the Fifth Report and Order require that the LEC interexchange affiliate be a separate legal entity. We do not, however, require actual "structural separation."[474] Thus, as we stated in the Interim BOC Out-of-Region Order, "except for the ban on joint ownership of transmission and switching facilities," the LEC and the interexchange affiliate "will be able to share personnel and other resources or assets."[475]

166. We are not persuaded by the arguments made by Citizens and USTA that the

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[470] GTE Sept. 13, 1996 Reply at 15.

[471] Non-Accounting Safeguards Order at ¶ 312.

[472] Id. at ¶ 313.

[473] Id.

[474] Interim BOC Out-of-Region Order at ¶ 22.

[475] Id.

separate affiliate requirement prevents independent LECs from realizing efficiency gains though the use of joint resources.[476] While joint ownership of transmission and switching facilities by a LEC and its affiliate is not permitted by our rules, the use of transmission and switching facilities by the other is permitted. The affiliate can contract for use of the LEC's transmission and switching facilities at tariffed rates or on the same basis as requesting carriers that have negotiated interconnection agreements pursuant to section 251,[477] and thereby continue to benefit from economies of scope. Furthermore, we conclude that the separate books of account requirement and the requirement that the affiliate obtain LEC services at tariffed rates are not overly burdensome. As we explained in the Interim BOC Out-of-Region Order, "the separate books of account requirement refers to the fact that, as a separate legal entity, the affiliate must maintain its own books of account as a matter of course."[478] Moreover, as we stated previously, in addition to taking exchange services by tariff, to the extent that the independent LEC affiliate meets the requirements of 251, the LEC affiliate may alternatively take unbundled network elements or exchange services subject to the same terms and conditions as provided in an agreement approved under section 252 to which the independent LEC is a party.

167. While we recognize that the Fifth Report and Order requirements impose some regulatory burdens, we find that these burdens are not unreasonable in light of the benefits these requirements yield in terms of protection against improper cost allocation, unlawful discrimination, and price squeezes. We conclude that continued imposition of the Fifth Report and Order separation requirements is necessary to prevent and detect any anticompetitive conduct that may arise as a result of an independent LEC's control of bottleneck facilities.

168. We reject GTE's contention that the 1996 Act prohibits the Commission from imposing structural safeguards on GTE, or on any other independent LEC.[479] We find no reasonable basis for inferring from section 601, or any other provision in the 1996 Act, that Congress intended to eliminate the Fifth Report and Order requirements or to repeal by implication our authority to impose on independent LECs separation requirements that we deem necessary to protect the public interest consistent with our statutory mandates. To the contrary, section 601(c)(1) of the 1996 Act provides that we are not to presume that

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[476] Citizens Aug. 29, 1996 Comments at 6; USTA Sept. 13, 1996 Reply at 8. See GTE Aug. 29, 1996 Comments at 36-38; see also Dec. 20, 1996 Ex Parte Letter from Charles D. Cosson, Regulatory Attorney, USTA, to William Caton, Secretary, FCC at attachment 1. See Interim BOC Out-of-Region Order at ¶ 22.

[477] See supra ¶ 164.

[478] Interim BOC Out-of-Region Order at ¶ 23.

[479] See supra ¶ 148; GTE Aug. 29, 1996 Comments at 25-27.

Congress intended to supersede our existing regulations unless expressly so provided.[480] Furthermore, section 601(a)(2) of the 1996 Act deals solely with a judicial decree, not the Commission's regulations; therefore, GTE's argument is frivolous.

169. We are also not persuaded by Sprint's arguments that the Fifth Report and Order requirements are no longer necessary because other Commission requirements, such as the Commission's access charge rules, imputation requirements, and cost allocation and affiliate transaction rules, prevent anticompetitive conduct by an independent LEC in providing in-region, interstate, interexchange services.[481] While these other requirements have significant beneficial effects, we find that these regulations alone are not an adequate substitute for the Fifth Report and Order separation requirements. As previously discussed, the prohibition against jointly owned transmission and switching facilities ensures that the affiliate obtains such facilities on an arm's length basis. This requirement also helps to ensure that all competing in-region providers have the same access to provisioning of transmission and switching as that provided to the independent LEC's affiliate. There is nothing in the Commission's rules that otherwise prohibits joint ownership of switching and transmission facilities. Although Sprint contends that we should impose this prohibition by modifying the cost allocation rules,[482] such a prohibition is possible only if a LEC provides interexchange service through a separate affiliate, as required by the Fifth Report and Order requirements. In addition, as stated previously, the Fifth Report and Order requirement that the affiliate maintain separate books of account is necessary to trace and document improper allocations of costs or assets between a LEC and its long distance affiliate and to detect unlawful discrimination in favor of the affiliate.[483] The historical purpose for the requirement that the affiliate acquire any services from its affiliated exchange companies at tariffed rates, terms, and conditions was to prevent the LEC from discriminating in favor of its long distance affiliate.[484] The Commission recently reconfirmed the need for such a requirement when it applied the affiliate transaction rules to all transactions between incumbent LECs and

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[480] Section 601(c) provides as follows:

> (c) Federal, State and Local Law. -
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> (1) No Implied Effect. - This Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State, or local law unless expressly so provided in such Act or amendments.
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> Telecommunications Act of 1996, Pub. L. No. 104-104, sec. 601(c), 110 Stat. 56, 143 (to be codified as a note following 47 U.S.C. § 152).

[481] Sprint Aug. 29, 1996 Comments at 5-7.

[482] Sprint Aug. 29, 1996 Comments at 7.

[483] See supra ¶ 163.

[484] Id.

their affiliates.[485] We believe that the Commission's access charge rules, imputation requirements, and cost allocation and affiliate transaction rules continue to serve important purposes. We conclude, however, that the Fifth Report and Order requirements are also necessary under these circumstances to safeguard further ratepayers against cost-shifting, discrimination, and price squeezes.

170. We reject the arguments that we should impose additional requirements on independent LECs, including section 272 requirements, certain aspects of dominant carrier regulation, or any other requirements. Independent LECs tend to be more geographically dispersed and their service territories are largely rural in nature, therefore, they generally serve areas that are less densely populated than BOC services areas. In addition, because the service areas of independent LECs tend to be smaller than the service areas of the BOCs, on average, independent LECs have fewer access lines per switch than BOCs and provide relatively little interexchange traffic that both originates and terminates in their region.[486] We conclude, therefore, that independent LECs are less likely to be able to engage in anticompetitive conduct than the BOCs and that applying the section 272 requirements to independent LECs would be overly burdensome. The Fifth Report and Order requirements appear to balance these competing concerns; they address cost shifting and discrimination, but do not appear to be overly burdensome.[487] Although the independent LECs assert that these requirements increase their costs, none of them has provided specific evidence to support this claim, much less to demonstrate that these additional costs outweigh the benefits.

171. As previously stated, we conclude that we should not apply dominant carrier regulation to independent LECs. The dominant carrier regulation that AT&T and MCI recommend is not necessary to prevent, nor effective in detecting improper cost allocation, unlawful discrimination, price squeezes, or other anticompetitive conduct.[488] The benefits of dominant carrier regulation are outweighed by the burdens imposed on independent LECs.[489] We also reject MCI's argument that we should maintain full dominant carrier regulation in order to enforce effectively the Commission's imputation requirements and to prevent independent LECs from engaging in a price squeeze strategy. As we stated previously, we believe that such predatory behavior can be adequately addressed through our complaint

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[485] See Accounting Safeguards Order at ¶ 256.

[486] See GTE Sept. 13, 1996 Reply at 14.

[487] See supra ¶¶ 166, 167.

[488] See supra ¶¶ 152, 153.

[489] See supra ¶¶ 166, 167.

process and enforcement of the antitrust laws.[490] Moreover, we note that the potential for a price squeeze will be further mitigated as access charges are reformed to reflect cost.[491]

172. Furthermore, we confirm that the equal access restrictions apply to independent LECs.[492] Under the MFJ the BOCs were required to "provide to all interexchange carriers and information service providers exchange access, information access and exchange services for such access on an unbundled, tariffed basis, that is equal in type, quality, and price to that provided to AT&T and its affiliates."[493] Equal access includes the nondiscriminatory provision of exchange access services, dialing parity, and presubscription of interexchange carriers.[494] Exchange access services included, but were not limited to, "provision of network control signalling, answer supervision, automatic calling number identification, carrier access codes, directory services, testing and maintenance of facilities, and the provision of information necessary to bill customers."[495] GTE became subject to similar requirements in 1984,[496] and in 1985 the Commission imposed requirements on independent LECs similar to those imposed on GTE.[497] As we stated in the Non-Accounting Safeguards Order, section 251(g) added by the 1996 Act preserves the equal access requirements in place prior to the passage of the Act, including obligations imposed by the MFJ and any commission rules.[498] We do not decide at this time, however, whether the allegations AT&T raises regarding SNET's alleged pre-subscribed interexchange carrier (PIC) freeze constitutes a violation of the Commission's equal access requirements.[499] AT&T or any other carrier, if it deems appropriate, can file a complaint with the Commission

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[490] See supra ¶ 128.

[491] See supra ¶ 130 (citing First Interconnection Order at ¶¶ 724, 731).

[492] See AT&T Aug. 29, 1996 Comments at 9.

[493] MFJ § II(A), in United States v. Western Elec. Co., 552 F. Supp. 131, 227 (D.D.C. 1982) (subsequent history omitted).

[494] MFJ § IV(F), 552 F. Supp. at 228 and MFJ, app. B, 552 F. Supp. at 233.

[495] Id.

[496] United States v. GTE Corp., 603 F. Supp. 730 (D.D.C. 1984) (subsequent history omitted).

[497] MTS and WATS Market Structure Phase III, CC Docket No. 78-72, Report and Order, 100 FCC 2d 860, 874-878, ¶¶ 47-60 (1983) (subsequent history omitted). See also Michael K. Kellogg et al., Federal Telecommunications Law 275-77, § 5.5.1 (1992).

[498] 47 U.S.C. § 251(g). See also First Interconnection Order at ¶ 362.

[499] See supra n.433.