networks. In Congress' judgment, the first step to competition in services now dependent on the ILEC bottleneck is full implementation of section 251(c), not creation of a separate affiliate.

Sections 271 and 272 provide an analogy here. Those provisions permit the BOCs to provide in-region long-distance services through a separate affiliate only <u>after</u> they have fully implemented the competitive checklist that incorporates the requirements of section 251(c). Fundamental to section 272 is that a separate BOC affiliate cannot begin providing in-region-interLATA service until section 271 is satisfied by full implementation of the competitive checklist and the development of local competition. Congress thus rejected the notion that a separate affiliate would solve the problems of discrimination in favor of BOC long-distance operations that used BOC local exchange and exchange access facilities. Moreover, in section 10(d), Congress precluded the Commission from forbearing from the requirements of sections 271 and 272 by letting the BOCs provide in-region-long-distance services based on promises to implement the competitive checklist after they began to provide those services.

Just as separation requirements are not a panacea for the intractable problem of BOC discrimination in favor of its long-distance operations, the Commission should not allow ILECs to avoid their section 251(c) obligations based on the hope that separate affiliates will magically solve the problem of discrimination and cross-subsidy for broadband services using advanced capabilities. In sections 271 and 272, Congress recognized that creation of a separate affiliate to provide long-distance service is not enough, by itself, to ensure that the BOC will open its local markets to competition or that effective local competition will ever be achieved. Similarly, it is unrealistic to believe that it would facilitate competition in the provision of advanced services to permit the ILECs to avoid compliance with some portions of section 251(c) by providing these services through affiliates.

To the extent the Commission's rationale is that its separate affiliate approach will advance local competition by inducing the ILECs to comply with some of their section 251(c) obligations (those relating to xDSL-capable loops and collocation), its rationale is misguided and contrary to the congressional plan in the 1996 Act. For more than two and a half years, the ILECs have been under a duty to provide elements such as xDSL-capable loops and collocation on reasonable and nondiscriminatory terms, and to make advanced services available for resale at wholesale rates. If they are not complying with that duty today, they should not be rewarded with the elimination of their current obligation to provide access to DSLAMs and other xDSL-related unbundled networks elements on the terms mandated by section 251(c). ILECs that are not complying with numerous obligations under section 251(c) should not be granted absolution from some of them if they bring themselves into compliance with the rest. Section 10(d) mandates a different incentive structure: ILECs have the incentive to fully implement <u>all</u> of the requirements of section 251(c) because they know that this is the only means to obtain forbearance from <u>any</u> of them. To grant the functional equivalent of forbearance from some of these requirements in order to encourage fuller compliance with other requirements is unlawful and results in bad policy.

The statutory command is clear: unless and until the ILECs fully implement all of the requirements of section 251(c), including unbundled access to advanced services network elements and collocation, they may not be excused from compliance with any of the requirements, whether they provide advanced capabilities and services directly (as they have done and plan to continue to do) or indirectly through a separate affiliate created for the sole purpose of avoiding unbundling and resale obligations that would otherwise apply. Because the ILECs have not fully implemented all of the requirements of section 251(c), ILECs and their affiliates that assume their functions must continue to provide unbundled access to all advanced capabilities and to make advanced services available for resale at wholesale rates.

III. ALLOWING ILECS TO PROVIDE "ADVANCED" LOCAL SERVICES THROUGH AFFILIATES TREATED AS CLECS WOULD HARM THE DEVELOPMENT OF LOCAL COMPETITION

Even if the Commission has discretion under section 251(h) not to treat the "advanced" services affiliate as an ILEC, permitting an ILEC to establish an affiliate for the provision of advanced local services on a non-incumbent basis would have severe anticompetitive effects. Treating a category of ILEC local telecommunications services as non-incumbent services simply because they are provided through a separate affiliate would be a fiction that would allow the development of local service competition to be controlled by what is, in effect, the unregulated ILEC provision of local services. The discrimination, coordination and market division that such a structure would inevitably entail, and the inextricable intertwining of the functions of the ILEC and its affiliate, would guarantee that any such affiliate would be no more than an arm of the ILEC.

As the Commission points out, [t]o the extent that an advanced service does no more than transport information of the user' s choosing between or among user-specified points ... it is telecommunications...."[20] Moreover, there is nothing in the 1996 Act that limits the definition of

[20] Order at ¶ 35.

local exchange service to any particular technology or type of service.[21] The installation of a new technology or new architecture by an ILEC to deliver local exchange and access services has never been considered grounds to treat such services as anything but ILEC dominant services.

Requiring an affiliate rather than the ILEC own equipment dedicated to provision of undefined "advanced" service and to employ personnel dedicated to that part of the local telephone business would not prevent discrimination. Such separation may facilitate deterrence and correction of certain types of discrimination (depending on reporting requirements, commitment of regulatory resources, and a host of other variables), but the methods of discrimination are too varied and subtle to permit separation to be a panacea. As a result, the affiliate will necessarily enjoy substantial benefits from affiliation with the ILEC. And for that reason, the affiliate should share the burdens as well.

Permitting an ILEC local advanced service affiliate to be treated as a CLEC would facilitate a wide variety of anticompetitive strategies. As discussed above, the Notice proposes, in effect, that ILECs be permitted to avoid their Section 251(c) obligations by having such affiliates provide local services that would be subject to Section 251(c) if offered by the ILEC itself. Thus, for example, an ILEC could use such an affiliate to avoid its Section 251(c)(3) obligation to provide access to DSLAMs as a network element when failure to do so would impair CLECs' ability to provide competing services, for example, because collocation was not available in a central office or remote terminal.

The basic problem posed by such an arrangement is that, as long as the ILEC and its

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[21] Id. at ¶ 41.

affiliate are under common ownership, no amount of structural separation will cause them to operate independently of one another, and regulation cannot effectively prevent price and non-price discrimination. They will inevitably relate to each other differently than CLECs will relate to ILECs. As the Michigan Public Service Commission found, in reviewing the request of Ameritech Communications, Inc. (ACI) for certification to provide local service in Ameritech Michigan's service area, ACI was not intended to compete with Ameritech Michigan.[22] That is true of any ILEC local service affiliate, including, by its own admission, BellSouth local service affiliate, BellSouth BSE.[23] Such entities thus are CLECs without the initial "C"; they are simply alter egos of their affiliated ILECs. There is no conceivable reason to expect that the advanced service affiliates will act any differently.

ILECs and their advanced service affiliates can also exploit the ILECs' bottleneck monopoly by using the affiliates as the vehicles to invest in new technology that supports "advanced" services, while the ILEC's standard local services are allowed to degrade and become technological backwaters serving residential users and other CLECs. Because the ILECs will enjoy continued monopoly, or at least highly dominant, status for the foreseeable future,

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[22] Order Approving Application at 18, In the matter of the application of Ameritech Communications, Inc., for a license to provide basic local exchange service in Ameritech Michigan and GTE North Incorporated exchanges in Michigan, Case No. U-11053 (Mich. PSC Aug. 28, 1996).

[23] BellSouth's own witness has testified that BellSouth BSE, "[does not] want to really compete with BellSouth's incumbent local service affiliates; rather, its services will be complementary to BellSouth's incumbent services." See Testimony of Robert C. Scheye, Transcript of Testimony and Proceedings at 17, Application of BellSouth BSE, Inc. for a Certificate of Public Convenience and Necessity to Provide Local Exchange Telecommunications Services, Docket No. 97-361-C, Hearing No. 9703 (S.Car. PSC Nov. 5, 1997).

they are under no competitive pressures to invest in the existing local network. They will have every incentive to move as much investment to the affiliate, and as much expense to the ILEC, as possible. Meanwhile, if the ILECs' advanced service affiliates are not treated as incumbents, they will be under no legal obligation to provide their retail services at wholesale rates for resale or reasonably priced UNEs comprising those services to other CLECs.

Consider, for example, packet switches. Vendors of existing voice switches are adding packet switching adjuncts to their existing telephone switches. In a competitive market, ILECs would purchase these adjuncts physically integrating their voice and packet switches as part of an evolution or migration of their network from pure voice to increased data services. With new adjuncts, the ILECs would be able to use some memory and processing elements for voice and data, enjoying some economies of scope the would redound to all customers. With the creation of a separate affiliate, however, the parent company, if permitted, likely would purchase packet switches for its new CLEC affiliate and leave the ILEC network an inefficient provider of data services.

Thus, other CLECs and residential and small business subscribers will be stuck with the ILEC's increasingly outmoded and inadequate network services and UNEs at the current excessive rates, while the ILEC's favored large customers will have access to state-of-the-art advanced services from its affiliate. Thus, no customers, not even the larger ones, will enjoy the full benefits of competition.

In recognition of such dangers, the Texas Public Utilities Commission denied GTE Communications Corporation (GTE-CC), GTE's CLEC affiliate, a certificate of operating authority to provide local services in GTE's incumbent service areas.[24] One of the Commissioners explained that such certification raised concerns as to

> whether it's anti-competitive and whether it circumvents regulation and whether or not it basically is counterproductive to opening these markets in a fair way to everybody...
>
> And we have on these affiliate issues said that we=re not going to allow these 100 percent related affiliates to circumvent the requirements of our statute and the [1996 Act] for what these companies have to do... [I]t would make a mockery of the whole regulatory and legal scheme.[25]

Similarly, the Michigan Public Service Commission granted GTE-CC local service authority only in areas where Ameritech is the ILEC, adopting the position that GTE "cannot be permitted to provide basic local exchange service in GTE North's exchanges until those exchanges are irreversibly open to competition."[26]

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[24] Order, Application of GTE Communications Corporation for a Certificate of Operating Authority, Docket No. 16495, SOAH Docket No. 473-96-1803 (Tex. PUC Nov. 20, 1997).

[25] Comments of Commissioner Walsh, In the Matter of the Open Meeting to Consider Docket and/or Project Nos. 16495, et al., (Tex. PUC Oct. 22, 1997), at 94, 96. Similarly, Pacific Bell Communications (PB Com), an affiliate of Pacific Bell, withdrew its application to provide local service in Pacific Bell's service area after consumer advocates and competitive carriers objected that such an arrangement could provide an opportunity for preferential treatment of PB Com by Pacific Bell. See Proposed Decision of ALJ Walker at 20-21, Application of Pacific Bell Communications for a Certificate of Public Convenience and Necessity to Provide InterLATA, IntraLATA and Local Exchange Telecommunications Services Within the State of California, Application 96-03-007 (Cal. PUC May 5, 1997), withdrawn by Assigned Commissioner's Ruling (Oct. 15, 1997).

[26] Opinion and Order at 3, In the matter of the application of GTE Communications Corporation for the issuance of a license to provide and resell basic local exchange service in Ameritech Michigan and GTE North Incorporated exchanges in the State of Michigan and related approvals, Docket No. U-11440 (Mich. PSC Dec. 12, 1997).

More recently, the Kentucky Public Service Commission denied BellSouth BSE's request for approval to provide local service in BellSouth's local service territory.[27] The Commission explained that

> [t]he evidence demonstrates that [BSE's] operations are intricately intertwined with those of [BellSouth]. It is the alleged potential for anti-competitive behavior and distortion of the competitive local exchange market that are the problematic issues here...
>
> [T]he close relationship between BSE and [BellSouth] does raise concerns regarding the operational separation of the entities and the resulting potential for gaining an unfair pricing advantage. If BSE acquires services at a discount from [BellSouth] and those services are delivered in the same manner as if the transaction never occurred, then it appears that overhead expenses associated with providing service incurred by a typical CLEC may never be realized by BSE...
>
> [B]SE also contends it would be economically irrational to operate in a less than profitable manner. The latter argument, however, does not take into account the ultimate benefit to BellSouth of eliminating competitors from the local market; and while it is true that anti-competitive behavior of the nature predicted by the Intervenors has not yet occurred, the Commission finds that the potential for such behavior would be greatly exacerbated by granting BSE the authority it seeks.[28]

In addition to the strategies discussed above, the affiliate is also in the unique position of influencing the ILEC's choice of architecture and technology for the deployment of advanced telecommunications capabilities. The relationship between the ILEC and its affiliate creates a natural incentive to develop advanced infrastructure and services that other CLECs are not in a position to provide or can only roll out more slowly because they do not have the benefit of the ILEC's updated information. Moreover, to the extent that advanced service affiliates are able to

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[27] Order, Application of BellSouth BSE, Inc. for Authority to Provide Local Exchange Service, Case No. 97-417 (Ky. PSC June 8, 1998).

[28] Id. at 3-6.

develop a product that other CLECs cannot immediately replicate; such affiliates have the distinct and significant benefit of first mover advantage in the market. If, for example, because of its relationship with the ILEC, an affiliate encourages the ILEC to choose a particular technology that other CLECs are not using, it has the ability to guide the ILEC's future network architecture, OSS and interface development, UNE definition, loop capability and availability as well as network maintenance and operation. These same concerns arise where the ILEC has shared crucial design information with its affiliate before advising others of its intentions with respect to infrastructure construction.

Taking the example of the affiliate's ability to shape the ILEC's UNE definition, the affiliate could request new UNEs from the ILEC configured for the affiliate's unique needs that are not useful to other CLECs. Ostensibly, such UNEs would be available to all on a nondiscriminatory basis, but, since only the ILEC's affiliate would want them in the form in which the ILEC offered them, there would be no practical check on the ILEC's preferential development or pricing of UNEs or other discrimination in favor of the affiliate in the provision of such UNEs. Such favoritism would be magnified if the ILEC were to provide operating, installation and maintenance services for the specially configured UNEs.

Given the detailed, technical nature of UNEs, it would be extremely difficult and time-consuming to articulate and enforce rules against such preferential development. The Commission would have to expend considerable resources in the day-to-day monitoring of ILEC product development and the local service affiliate's operations, as well as other CLECs' operations, that would be necessary to ensure that UNEs were not being developed that would be of more use to the ILEC's affiliate than to other CLECs. Such detailed, intrusive regulation, of course is precisely the sort of function that the Commission is trying to avoid, thus making it extremely unlikely that this type of discrimination would ever be effectively monitored or prevented.

The inherently anticompetitive advantages accruing from an ILEC's use of a lightly regulated local service affiliate in these ways are magnified on account of the architecture of advanced services. Access to the already existing ILEC infrastructure, not available to CLECs, means that the affiliate could quickly monopolize high-speed data and other advanced services, as the price of collocation is excessive. The data network requires that xDSL equipment be collocated where copper loops are terminated, and there are thousands of ILEC end offices and remote terminals housing these loops. Interconnectivity and access to the loops would require significant expenditures on the part of CLECs. If the affiliate has ready access to the ILEC's infrastructure and customer base, only the affiliate will be able to afford to collocate xDSL equipment in every end office, and thus quickly dominate advanced services. The affiliate would therefore have a significant advantage over its competitors even before the CLECs could take advantage of section 251(c).

Because of their common ownership and participation in the very same local services market, the advanced services affiliate will enjoy unique advantages because of its relationship with the ILEC that cannot realistically be controlled, such as preferred access to ILEC economies of scope and scale, unbundled loops, collocation space, facilities and equipment, personnel, rights of way, and systems and procedures. For example, ILECs have already refused to provide CLECs access to the same loop the ILECs use to provide service. Thus, competitors seeking to provide advanced data services to a customer are not being permitted to use the same loop that the ILEC uses to provide voice service.[29] It will be virtually impossible to prevent all forms of such anticompetitive conduct.

If the Commission proposes adoption, as a guiding principle, that the affiliate must be "truly separate" from the ILEC and that its relationship with the ILEC must be no different from that of an independent CLEC. If the Commission is successful, as it apparently believes (mistakenly) that it can be, in applying that principle, then presumably the affiliate will have no advantage over the CLEC, and it will therefore not be profitable for the affiliate to provide advanced services in any area where it is not also profitable for an independent CLEC. Since, as the Commission has noted, CLECs are able to raise money to invest where it is profitable to do so, entry by an ILEC affiliate is not necessary for competition to occur.

If, however, the Commission believes that its proposal is necessary to encourage investment in advanced services that CLECs would not otherwise make, then the Commission must believe that the affiliate will enjoy advantages from its relationship with the incumbent that will make entry profitable for the affiliate where it is not profitable for CLECs. In that case, the affiliate cannot be "truly separate." Equally as important, if it is economically efficient for only one LEC to provide advanced services in some areas (which must be true if CLECs will not invest because their costs are necessarily higher than those of the incumbent), then the way to maximize competition is to require that the ILEC to share the economies of scale with competitors through enforcement of the requirements set forth section 251(c). That will maximize the amount of competition that consumers can enjoy and that is why Congress

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[29] See e.g., SBC Petition at n. 17, (stating that competitors will have to use a second line if they wish to only provide data services).

imposed section 251(c) requirements not only on incumbents but also on their successors and assigns, and comparable carriers.

IV. SHOULD THE COMMISSION DECIDE -- INCORRECTLY -- TO ADOPT ITS ILEC "ADVANCED SERVICES AFFILIATE" PROPOSAL, SUCH AN AFFILIATE MUST BE STRUCTURED TO BE AS "TRULY SEPARATE" AS POSSIBLE

A. Even Though It Is Legally And Practically Insufficient, The Commission Must Adhere To A Strict "Truly Separate" Standard

As explained above, MCI WorldCom believes that the Commission lacks the legal authority to allow the ILECs to establish "non-ILEC" affiliates to provide advanced telecommunications capabilities and services. In addition, such an affiliate would possess inherent advantages and benefits derived from the ILEC that would render the entire arrangement discriminatory and anticompetitive. Further, there is no factual basis for the concept that the ILECs require additional "incentives" to deploy advanced services, and that the separate affiliate proposal is necessary to give the ILECs those incentives.[30] As a result, MCI WorldCom urges the Commission to abandon its advanced affiliate proposal as unlawful, untenable, and unsupported.

Nonetheless, should the Commission decide to allow the ILECs to establish a separate advanced services affiliate free from any ILEC obligations, MCI WorldCom agrees that the proper governing standard should be an affiliate that is "truly separate" from the parent ILEC. As a practical matter, MCI WorldCom does not believe that any wholly-owned ILEC affiliate can ever be "truly separate" from the parent ILEC. The numerous advantages and benefits of

[30] See Joint Comments of MCI Communications Corporation and WorldCom, Inc., CC Docket No. 98-146 (filed Sept. 14, 1998).

affiliation with an incumbent LEC are simply too great, and too interwoven into the ILEC/affiliate relationship, to be removed effectively by anything short of total divestiture. As a result, the basis for granting the ILECs any regulatory relief -- determining whether an ILEC affiliate is "truly separate" -- requires nothing short of an absolute separation, and effective nondiscrimination safeguards.

In this respect, it is imperative that the "truly separate" standard becomes more than a mantra, devoid of meaning. The standard must have "teeth" if there is any chance of nurturing real competition in the local services market. The Commission does not provide any substantive meaning to its phrase, except to conclude that the ILEC affiliates must offer advanced services "on the same footing as any of their competitors."[31] In MCI WorldCom's view, the test for determining that an affiliate is "truly separate" boils down to a simple question -- does an independent CLEC have the same opportunity, under the same terms and conditions, to obtain from the ILEC the same access to infrastructure, services, personnel, and facilities as the wholly-owned affiliate? If the ILEC affiliate has any unique opportunities based on its relationship with the ILEC, and these opportunities are denied to CLECs, the affiliate has the advantage of superior "footing" in the market and thus cannot be deemed "truly separate."

There are several critical reasons why the Commission must impose as much of a separation as possible between the ILEC and its affiliate, in order to diminish somewhat the inevitable injury to competition. First, without "true" separation, the affiliate could easily use its ILEC-derived advantages to shut out competitors, and deny consumers the benefits of

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[31] NPRM, at ¶ 86.

competition. Integration with the ILEC in any aspect of business would give the affiliate monopoly-derived "economies of scope and scale" that are denied to CLECs. In other words, the affiliate can directly benefit from the ILEC's overt or covert discrimination and subsidization.

Second, by allowing the ILECs to create a separate subsidiary exempt from section 251's interconnection, unbundling, pricing, and resale requirements, the Commission would be creating the real possibility of an enormous loophole for ILEC compliance with section 251. The separation between the ILEC and affiliate must be comprehensive enough to limit somewhat the ILECs' incentives and ability to use their affiliates as a means of avoiding their section 251 obligations.

Third, because much of the same equipment and facilities are used to provide voice and data services, the ILECs' ratepayers have had no choice but to contribute to the ILECs' construction of infrastructure. Under the FCC's proposal, there is a significant risk that ratepayers will become unwilling contributors to the affiliate.

Fourth, if the affiliate truly is separate, and compelled to obtain the same essential facilities and services in the very same fashion as its competitors, it is possible that the ILEC might decide to provide interconnection and access on a nondiscriminatory basis, at nondiscriminatory prices, and with adequate operational support.[32] By acting in its own self interest (to provide high-quality facilities and services to its affiliate), the ILEC might provide the same to all comers. It is far more likely, however, that the ILEC could simply sabotage this outcome by giving preferential treatment to the affiliate.

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[32] This would also include any infrastructure that the CLECs are referred to build for interconnection with the ILEC.

Finally, it is nearly impossible to prove discrimination after the fact, and in the majority of interconnection agreements, no adequate remedy exists for anticompetitive activities. Thus, in order to protect competitive markets, and allow competition to take root in monopoly markets, the Commission must adopt straightforward prophylactic measures that deter anti-competitive behavior, police ILEC actions and immediately and adequately remedy CLECs for discriminatory behavior. These measures are critical whether ILECs provide "advanced" services directly or through an affiliate.

B. The Section 272 Affiliate Structure Is Inadequate To Ensure Creation Of A "Truly Separate" ILEC Advanced Services Affiliate

Although the NPRM does not state so explicitly, the Commission appears to rely on section 272 as the basis for its "optional alternative pathway" of an advanced services affiliate concept.[33] All seven criteria listed in the NPRM are based on statutory language in section 272. In turn, the Commission implemented that provision in its Non-Accounting Safeguards Order. On balance, MCI WorldCom believes that the Commission's section 272 rules will be able to prevent some, but certainly not all, discriminatory practices by the RBOCs and their long distance affiliates. However, in the context of the Commission's section 706 proposal, neither section 272 nor the Non-Accounting Safeguards Order offer adequate safeguards to protect competitors and consumers from discriminatory ILEC behavior. Thus, while the general criteria outlined in the NPRM are something of a beginning, the Commission must clarify and supplement that criteria significantly to ensure a more complete and total separation between ILEC and affiliate.

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[33] NPRM, at ¶ 96.

Section 272 was intended by Congress as a prophylactic measure applicable only after the BOCs demonstrated that they had complied with all aspects of section 271, including: (1) track A or B; (2) the competitive checklist; and (3) the public interest test. In other words, section 272 was intended to apply only after local competition had developed in the BOC's market. Section 272 certainly was not intended to apply to the BOCs in lieu of such section 271 compliance, but, instead, was tailored to provide a way to ensure that BOCs would not revert to behavior that would close the local market upon their receipt of section 271 authority. By contrast, according to the Commission's proposal, the advanced services affiliate would exist in a local market that lacks any modicum of competition, and that is still dominated by the ILECs.

Moreover, section 272, like other separation requirements, was fashioned as a means of preventing the BOCs from leveraging their monopoly power in the local service market into adjacent competitive markets, such as enhanced services (in Computer II, Computer III and section 272) or long distance service (section 272). Here, however, such separation cannot serve the same safeguard function, since both entities -- the ILEC and its advanced services "CLEC" -- are engaged in the provision of local telecommunications services. The ILEC's advanced services cannot be considered nondominant, non-incumbent competitive services just because they are relatively new, anymore than a new ILEC central office and local loops installed to serve a new office complex can be viewed as providing nondominant competitive services.

Regardless of the wisdom or lawfulness of employing section 272 safeguards before section 271 compliance, the Commission has ample authority to go beyond the dictates of section 272 to fashion separation requirements and nondiscrimination safeguards to govern the ILECs' advanced services affiliates. Unlike section 272, which automatically applies once a BOC has gained long distance entry, the establishment of an advanced services affiliate is voluntary. As such, there is no statutory limitation to the types of requirements and safeguards that the Commission establishes to promote competition and protect consumers where an ILEC chooses to house its data services.

C. The Separation And Nondiscrimination Requirements In The NPRM Must Be Considerably More Stringent Than Those Contained In The Earlier Non-Accounting Safeguards Order

1. The affiliate must "operate independently

The first, and most important, of the separation requirements outlined in the NPRM is the requirement that the ILEC and affiliate must operate independently from each other. This requirement appears to mirror section 272(b)(1) of the 1996 Act. In the Non-Accounting Safeguards Order, the Commission viewed this requirement of the 1996 Act as independent of the other statutory separation requirements.[34] The ILEC and its affiliate must display operational independence in every way, so that neither is involved in the other's business activities. The common denominator is that the affiliate must operate "truly separate" from the ILEC -- not "partially" separate, or "somewhat" separate, or even "mostly" separate. The ILEC and affiliate must not be allowed to commingle operations, or else the affiliate would amount to a shell, with the ILEC providing -- and its ratepayers paying for -- these services and facilities. In order to protect consumers and promote competition, the division between ILEC and its affiliate must be complete and all-encompassing. In all cases, this separation also should extend to the parent company of the ILEC, and all other ILEC affiliates. The ILECs must not be able to bypass the

[34] Non-Accounting Safeguards Order at ¶ 156.

separation requirements, and avoid their section 251(c) obligations, by shifting resources and expenses between different corporate shells.

Unfortunately, as MCI explained in its petition for reconsideration of the Non-Accounting Safeguards Order, the separation rules established in that order -- particularly those related to the operational independence requirement -- are insufficient to carry out the requirements of section 272.[35] MCI pointed out that the concept of independent operation necessarily requires a prohibition on any joint activities between the ILEC and its affiliate. In particular, a blanket prohibition on joint ownership or activities lessens the likelihood of ILEC discrimination in favor of the affiliate, requires the affiliate to operate independently, and avoids the need to allocate joint costs.[36] Since, as explained above, separation rules that would be sufficient for section 272 purposes would not suffice here, the Commission should impose much more stringent separation rules for ILEC advanced services that it did in the Non-Accounting Safeguards Order for BOC in-region long distance services.

Thus, it is critical that the ILEC and its data affiliate not be allowed to operate in concert. The operational independence requirement may be summarized in terms of the following components:

a. No shared or jointly-utilized services of any kind.

First, the ILEC and its affiliate must not be allowed to engage in joint marketing or advertising. If the affiliate can ride the incumbent's coattails, it will be able to benefit from the

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[35] See Petition for Reconsideration of MCI Telecommunications Corporation, CC Docket No. 96-149, dated February 20, 1997 ("MCI Recon. Petition").

[36] MCI Recon. Petition at 7-8.

ILEC's massive budget, extensive personnel base, and community presence. No CLEC can hope to approximate that size, scope, and level of influence. Moreover, many CLECs are looking to provide nationwide service, while the ILECs have focused on their own regions. Therefore, while the CLECs are attempting to establish marketing and advertising strategies for the entire country, the ILECs are able to use a greater proportion of dollars to advance their cause in their respective regions. The CLECs cannot compete with that.

Second, the ILEC and its affiliate must not be allowed to share any support or administrative services or expenses. This includes a wide range of activities, such as personnel, facilities administration, operating, legal services, procurement, accounting, auditing, recruitment, management, finance, tax, insurance, and pensions. Again, no CLEC is in a position to have its administrative expenses and personnel subsidized by a monopoly local provider.

Third, the ILEC and its affiliate must not share research and development ("R&D"), joint equipment design or development, or intellectual property. In addition to the likelihood of favorable treatment of the affiliate, such sharing opens the door for improper cost allocations.

Finally, the ILEC and its affiliate must not engage in joint hiring or training on each other's behalf. In addition, the ILEC and its affiliate must not jointly use a common outside provider of any service (outsourcing), be it consultants, attorneys, engineers or accountants. In each case, the affiliate would be able to share in the associated costs and thus derive benefits which are denied to other CLECs.

b. <u>No jointly owned or utilized infrastructure or property</u>.

The ILEC and its affiliate must not be allowed to use any commonly or jointly leased or owned physical space, land, buildings, facilities, equipment, or switches. Because the costs of wired telephony networks and network premises are largely fixed and shared among local, access, and other services, allowing the ILEC and its affiliate to share facilities and equipment would provide a significant opportunity for improper allocation of costs. By insisting on clear separation, the Commission also would increase the chances that the affiliate and an independent CLEC both would receive equivalent opportunities for access to ILEC facilities and equipment.

In addition, the ILEC must not purchase, install, or maintain equipment for the affiliate. Moreover, the affiliate, where applicable, must purchase under public tariff applicable to all CLECs. Again, the affiliate and all other CLECs must stand in the same shoes vis-a-vis the ILEC.

c. No structural incentives to discriminate.

The NPRM presents a conflicted view of the ILEC affiliate. While assuring that it will remove section 251(c) obligations only from "truly separate" affiliates, the Commission also appears to assume that the affiliate will possess certain advantages in the marketplace that necessitate allowing the ILEC to provide those services via the affiliate. Indeed, the very definition of an affiliate implies an association or alignment with another entity's interests. MCI WorldCom does not believe that any wholly-owned ILEC affiliate can ever be free from structural incentives to discriminate. As long as the parent ILEC has any financial stake in the affiliate's success, discrimination is inevitable.

In order to create a "truly separate" affiliate that lacks any structural incentives for the ILEC to discriminate, the Commission should require the ILEC to "spin off" the affiliate completely. With no common ownership, the structural problems inherent in a wholly-owned affiliate largely disappear. At the very least, a sizable amount of independent ownership, free of any ILEC influence or control, should be mandated.

In any event, MCI WorldCom believes there should be no ILEC compensation based on the financial performance of the affiliate, and vice versa. This includes prohibiting the ILEC from using its stock to compensate the affiliate's employees.

d. No monopoly benefits.

An ILEC has certain structural and operational attributes that stem solely from its position as the traditional monopoly provider of local exchange and exchange access services in a given region. The affiliate should not be able to benefit in any way from those attributes.

First, the ILEC affiliate must not be allowed to use the ILEC's corporate name, doing business name, brand name, logo, trademark, or service marks. The affiliate name should be unambiguously distinct, in a way that would support a third party infringement action. Without such a prohibition, consumers will assume that the affiliate, with its ILEC-derived name and services, is directly linked with, or even standing in place of, the ILEC. Obviously the affiliate benefits enormously from such customer confusion. Because the ILEC has built the value of its brand name largely through its monopoly heritage, such a benefit should not be conferred upon a supposedly "truly separate" affiliate.[37]

Second, there should be no transfers of ILEC local exchange customers/accounts to the affiliate, and no transfer of advanced services customers from the affiliate to the ILEC. The ILECs also must be prohibited from transferring their customers "indirectly" to the affiliate. No

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[37] See Comments of MCI Communications Corp. on BellSouth Louisiana Section 271 Application, CC Docket No. 98-121, filed August 4, 1998, at 70 ("MCI BellSouth Louisiana Comments").

independent CLEC has the ability to acquire customer accounts from the ILECs.

Third, as will be discussed in further detail below, ILECs must not be permitted to transfer any ILEC equipment or facilities (such as DSLAMs and end user modems) to the affiliate.

Fourth, the affiliate must not be able to take all available space in the ILEC central office ("CO"). This collocation space is a scarce resource, one vulnerable to rapid exhaust, and consequently ILEC manipulation. If the affiliate on Day One is able to occupy all existing space in its parent ILEC's central offices, advanced services competition from other CLECs will be effectively foreclosed. The Commission must adopt measures to prevent such an outcome, such as (1) limiting the affiliate to a certain percentage of available CO space, or (2) requiring the affiliate to unbundle its advanced services equipment for competitors to use where no further CO space is available.

Fifth, the affiliate must not have any preferential access to ILEC rights of way, conduits or ducts. Again, where the affiliate can utilize a monopoly-derived ILEC asset, and other CLECs cannot, the affiliate has gained an anticompetitive advantage in the marketplace.

Sixth, the affiliate must correctly impute all ILEC expenses, such as access charges. In an environment where affiliate payments to the ILEC verge on one pocket paying another, the affiliate must adhere to strict imputation requirements to prevent discrimination.

Finally, if the ILEC and its affiliate engage in joint billing and collection, the same arrangements must be offered to independent CLECs as well. The affiliate should not be allowed exclusive rights to such a relationship with the ILEC.

2. Affiliate transactions must be at "arm's length"

The second fundamental criterion listed in the NPRM is that all transactions between the ILEC and its affiliate must be at arm's length. This requirement is mirrored in section 272(b)(5) of the 1996 Act. The purpose of this requirement is to increase the transparency of any transaction between them, making it easier to monitor and enforce nondiscrimination requirements.

In general, MCI WorldCom urges the Commission to implement detailed, stringent rules for all affiliate transactions to ensure that they are (1) arms-length and nondiscriminatory, (2) with appropriate compensation and charges, (3) in writing, and (4) available for public inspection. The ILEC must provide sufficient detail and disaggregation to enable competitors to determine whether they have been offered and may obtain service from the ILEC on comparable terms.

The affiliate must purchase any permissible services or facilities from the ILEC pursuant to tariffs, at cost-based rates, or via publicly-filed contract. All dealings must be subject to public scrutiny, to ensure that the affiliate does not receive favorable treatment from the ILEC. It is also important, in light of the Eighth Circuit's decision, that the affiliate's reliance on terms of an interconnection agreement not be used to disadvantage CLECs. That is to say, as the law now stands, CLECs would be required to take the entire agreement under 252(i) to obtain what might be more preferable terms under the affiliate's agreement.

Second, the ILECs cannot be allowed to purchase telecommunications services from the affiliate (such as DSL service), and then resell those services to the public free from section 251 obligations. In this cases, the CLECs must be afforded the opportunity to resell these services at the discounted rate. The ILECs must be held to their section 251(c) obligations, and not allowed to use the affiliate structure to evade those obligations.

Third, the affiliate must use the same Operations Support Systems ("OSS") as other CLECs. Not only will this requirement ensure that the affiliate and other CLECs receive equal treatment, it also should give the ILECs important, if insufficient, incentives to provide high-quality OSS capabilities to all comers.

Fourth, the affiliate should not receive any direct funding from the ILEC or its corporate parent. In the alternative, the Commission should establish a cap on the amount of money that the ILEC can provide to its affiliate. This cap would help prevent the affiliate from having the ILEC subsidize losses that for others would mean lost viability in the market.

3. The affiliate must keep separate books and records

The NPRM indicates that the ILEC and its affiliate must keep separate books and records, similar to the requirement in section 272(b)(2). Without separate books and records, the likelihood of covert monetary benefits from the ILEC, and improper cost allocations, increases dramatically. To that end, the affiliate must be requested to: (i) keep and file separate financial statements, which must be maintained and signed by separate finance and accounting departments; (ii) maintain its books so that they are auditable in accordance with generally acceptable accounting principles (GAAP); and (iii) submit to annual audits and reporting requirements, which should be performed by independent third party auditors.

4. The affiliate must employ separate officers, directors, and employees

The NPRM proposes that the affiliate employ separate officers, directors, and employees. This requirement is identical to section 272(b)(3) of the 1996 Act. Allowing the same personnel to perform services for the ILEC and its affiliate creates an obvious opportunity for substantial integration of operating functions, which would preclude operational independence. As such, the affiliate must have, not only separate officers, directors, and employees, but also a completely separate board of directors, CEO, CFO, and operating personnel (i.e., no person employed by an ILEC should also be employed by the affiliate, and vice versa). In addition, the ILEC cannot be allowed to transfer, reassign, or "contract out" its employees to the affiliate. At minimum, any employee transfers allowed should be treated as if the employee was hired away from a non-ILEC; as a result, the former ILEC employee should no longer receive, or be eligible for, any ILEC benefits, such as unvested pensions or accrued vacation time, and must abide by the same non-compete provisions that are generally used throughout the industry.[38] Finally, as mentioned above, there should be no shared functions between the ILEC and its affiliate, as integrated operations only lead to concerns about misallocation of costs and undue advantages bestowed upon the affiliate.

5. Creditors of the affiliate should not have recourse to the ILEC's or parent's assets

This provision appears identical to section 272(b)(4) of the 1996 Act. It would protect ratepayers from shouldering the costs of a default by the affiliate, and prevent discriminatory treatment of the affiliate.

MCI WorldCom favors a more stringent separation approach that ensures that the affiliate is financially independent from the ILEC. In particular, MCI WorldCom believes that: (i) the ILEC must not be able to secure a line of credit for the benefit of the affiliate; (ii) the affiliate

[38] See MCI Comments on BellSouth Louisiana, at 68-69.