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

CC Docket No. 90-623

In the Matter of

Computer III Remand Proceedings:
Bell Operating Company Safeguards;
and Tier 1 Local Exchange Company
Safeguards

NOTICE OF PROPOSED RULE MAKING AND ORDER

Adopted: December 13, 1990; Released: December 17, 1990

By the Commission: Commissioner Duggan concurring and issuing a statement.

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I. INTRODUCTION

1. In the *Computer III* proceeding, the Commission adopted major changes to the rules governing the Bell Operating Companies' (BOCs') participation in the enhanced services market.[1] In particular, the Commission replaced the requirement that the BOCs offer enhanced services through separate subsidiaries with a set of nonstructural safeguards designed to protect against both discrimination against competing enhanced service providers (ESPs) and cross-subsidization of BOC enhanced services by basic service offerings. In *California v. FCC*, the United States Court of Appeals for the Ninth Circuit vacated and remanded the first three of the Commission's *Computer III* orders.[2] The Court concluded that the Commission had not sufficiently justified the decision to replace structural separation with nonstructural safeguards for BOC provision of enhanced services. The Ninth Circuit also held that the Commission's preemption of certain kinds of state regulation lacked adequate justification.

2. Since the *California* decision, this Commission has undertaken a re-examination of our regulatory regime in this area to consider what safeguards would best encourage the broad-based delivery of enhanced services to the American consumer through the growth of full and fair competition. A technologically innovative and economically efficient telecommunications infrastructure is central to continued United States prominence in the increasingly information-oriented global economy in which we live. To this end, we must remove unnecessary regulatory barriers that impede the responsiveness of American companies to marketplace incentives that foster increasing use and advancement of the nation's telecommunications assets. At the same time, it is equally critical to the development of full and fair competition to establish and maintain effective regulatory safeguards against possible anticompetitive conduct. Our duty to protect regulated service ratepayers requires us to guard against cross-subsidy between basic and enhanced services. Our goal is to put into place effective regulatory safeguards that will best further these public interest goals and serve American consumers.

3. We here propose to institute a strengthened set of nonstructural safeguards to govern BOC provision of enhanced services, including strengthened cost allocation and accounting safeguards applicable to all Tier 1 LECs. We also propose to re-examine the Customer Proprietary Network Information (CPNI) requirements applied to the integrated provision of interstate basic and enhanced services by the BOCs. [3] We propose as well to preempt only those state regulations differing from our federal safeguards that would thwart or impede federal policy, such as our policy permitting the integrated provision of interstate basic and enhanced services by the BOCs, AT&T, and the independent telephone companies (ITCs). Finally, we extend until the completion of this Rule Making

proceeding the interim waiver of *Computer II* requirements granted the BOCs by the Common Carrier Bureau, and clarify the scope of that waiver.[4]

II. REGULATORY SAFEGUARDS GOVERNING BOC PROVISION OF ENHANCED SERVICES

A. Background

1. *Computer II*

4. In the *Computer II* proceeding,[5] the Commission decided that enhanced services are not subject to Title II of the Communications Act.[6] Nonetheless, the Commission was concerned about the potential for anticompetitive conduct and cross-subsidization that could result from AT&T's participation in the enhanced services market. In particular, the Commission was concerned that AT&T could discriminate against competing ESPs through its control over basic services, and shift costs from unregulated to regulated activities.[7] Accordingly, the Commission required AT&T to offer any enhanced services through a fully separated, arm's length subsidiary.

5. Under *Computer II*, AT&T's separate subsidiary was prohibited from providing basic services or owning any network or local distribution transmission facilities, and AT&T was prohibited from offering enhanced services on an integrated basis.[8] The Commission required that AT&T's separate subsidiary obtain under tariff all transmission facilities necessary for the provision of enhanced services.[9] In addition, the Commission required the subsidiary to elect separate officers; maintain separate books of account; employ separate operating, installation, and maintenance personnel; and perform its own marketing and advertising.[10] Moreover, the Commission prohibited the regulated companies and their affiliates from performing software development for each other. Thus, the enhanced service subsidiary had to undertake software design itself or obtain the software from an independent contractor.[11] The regulated companies, however, could provide the affiliate with other types of research and development so long as any transactions were performed on a fully compensatory basis.[12]

6. In addition, the Commission required that AT&T disclose certain kinds of network information. The Commission required that AT&T disclose network information regarding certain new services and network modifications to the public whenever it disclosed such information to its enhanced service subsidiary or to third parties for the benefit of the subsidiary.[13] Furthermore, the Commission established rules regarding customer proprietary information, which required AT&T to disclose this information to independent ESPs at the same time the subsidiary received the information, and under the same terms and conditions.[14] The *Computer II* decision was affirmed on review.[15]

2. Modification of Final Judgment and BOC Separation Order

7. In 1982, two years after the Commission had imposed structural safeguards on AT&T's provision of enhanced services, the United States District Court for the District of Columbia adopted the Modification of Final Judgment (MFJ) in *United States v. AT & T.*[16] Under the MFJ, AT&T was required to divest itself of its twenty-two wholly-owned operating companies, which were then reorganized into seven regional holding companies. As a result of divestiture, the BOCs owned and operated the local exchange facilities and provided intra-LATA toll service, while AT&T provided inter-LATA services.[17] The Court also prohibited the BOCs from manufacturing telecommunications equipment and providing information services.[18] The MFJ Court initially left the question of whether to apply structural separation requirements to BOC CPE and enhanced service operations to legislators and regulators.[19] The Commission addressed this question in the *BOC Separation Order* in late 1983, and required that the BOCs provide CPE, enhanced services, and cellular services through separate subsidiaries.[20] In deciding to apply structural separation requirements to the BOCs, the Commission recognized that various circumstances, including divestiture and state regulatory oversight, had reduced the opportunities for the BOCs to engage in cross-subsidization and discrimination.[21] Nevertheless, the Commission found that the BOCs retained the ability to shift costs from unregulated to regulated activities, otherwise misallocate joint and common costs, and discriminate against competitors through control of the local exchange. The Commission therefore concluded that the benefits of structural separation outweighed the costs of requiring the BOCs to form and operate separate subsidiaries.

8. The Commission undertook, however, to review the appropriateness of structural separation for BOC unregulated activities within two years.[22] In addition, the Commission permitted the BOCs to engage in some joint operations for the provision of CPE and basic services.[23] In the *BOC Separation Reconsideration Order* of June 1984, the Commission affirmed the imposition of structural separation, but noted that nonstructural safeguards might, in the future, prove adequate to protect the public interest.[24]

3. *Computer III*

9. In the *Computer III* proceeding,[25] the Commission re-examined the regulatory framework for BOC provision of enhanced services adopted in *Computer II* and the *BOC Separation Order*. In the *Phase* I Ord er of June 1986, the Commission found that the competitive nature of the enhanced services market, along with various technical and market developments since *Computer II* and the *BOC Separation Order,* had limited the BOCs' ability to engage in cross-subsidization.[26] Using a cost/benefit analysis, the Commission concluded that when compared to nonstructural safeguards, structural separation requirements for BOC enhanced services imposed significant costs on both the public and the BOCs. These costs included decreased efficiency, innovation, and service availability caused in part by the requirement for BOC duplication of facilities and personnel as well as by limitations on joint marketing. The Commission found that, relative to nonstructural safeguards, the costs of structural separation outweighed the benefits. The Commission therefore replaced structural separation with nonstructural safeguards designed to guard against cross-subsidization and discrimination.[27] These measures included, among other things, CEI requirements to ensure the BOCs' ESP competitors "equal access" to BOC basic network services, ONA provisions for expanded ESP access to unbundled network functionalities, and the rules to be developed in the *Joint Cost* proceeding for the allocation of joint costs between regulated and nonregulated activities.[28]

4. California v. FCC

10. In *California v. FCC,* the Court of Appeals reviewed the cost/benefit analysis underlying the *Computer III* decision to replace structural separation with nonstructural safeguards for the provision of BOC enhanced services. The Court stated that the Commission had justified the use of nonstructural safeguards, such as ONA, to prevent the BOCs from providing ESP competitors with discriminatory access to basic network services.[29] But the Court found that the Commission's decision to rely on cost accounting safeguards was arbitrary and capricious, stating that the record did not adequately support the use of cost accounting safeguards to guard against cross-subsidization of enhanced services by the BOCs.[30] The Court vacated the Commission's decision to substitute nonstructural safeguards for structural separation in its entirety and remanded the proceeding to the Commission.

11. In order to avoid disruption of service to consumers following the Ninth Circuit's decision vacating *Computer III,* the Common Carrier Bureau granted an interim waiver of the *Computer II* requirements to allow the BOCs to continue offering enhanced services on an integrated basis pursuant to approved CEI plans. The BOCs, however, were required to withdraw all pending CEI plans, directed to refrain from filing new CEI plans, and ordered to discontinue integrated planning and development of BOC enhanced services except for those that are the subject of an approved CEI plan. The Bureau invited comment on whether the waiver should be extended for the duration of the remand proceeding.[31]

B. Discussion

1. Benefits of Integrated Enhanced Service Operations

12. The California Court, despite its remand, upheld the Commission's determination in *Computer III* that BOC structural separation requirements impose significant public interest costs. Specifically, the Court found record support for the Commission's conclusion that structural separation has resulted in increased prices for enhanced services, the withdrawal of certain enhanced services from the market, and the unavailability of some new forms of enhanced services.[32] The Court also found record support for the FCC's determination that structural separation imposes costs on consumers who have to pay for separate facilities.[33] The Court specifically noted that in the absence of structural separation, "the BOCs would not have to maintain, and customers would not have to pay for, separate organizations and facilities for operating and repairing basic and enhanced services."[34] Moreover, the Court said that the Commission had record support for its conclusion that integration of BOC enhanced and basic service operations would yield economies of scale. For example, as the *California* Court stated, the removal of structural separation requirements allows the BOCs to market and offer customized basic and enhanced service packages. These packages, according to the Court, minimize transaction costs and reduce delays in the delivery of such services.[35]

13. We propose to readopt the Commission's findings that a structural separation requirement imposes substantial public interests costs and that permitting the BOCs to integrate their enhanced and basic service operations would provide benefits to both the enhanced services industry and consumers. As the Commission found in *Computer III,* and the Court affirmed, the substitution of nonstructural safeguards for structural separation would increase the development and availability of enhanced services not only to large business customers but to residential and small business customers as well.[36] Our experience indicates that since adoption of *Computer III,* the BOCs have successfully begun to market enhanced services to these sectors. We request that parties comment on these tentative conclusions and provide evidence in support of their views. We are particularly interested in receiving comments that draw on parties' own experience to date with integrated operations and that rely as much as possible on existing or planned services.

2. Safeguards Against Cross-Subsidization

14. The *California* Court overturned the Commission's decision in *Computer III* to rely on nonstructural safeguards to protect against cross- subsidization because of an absence of record support for "the Commission's position that market and technological changes since *Computer II* and the *BOC Separation Order* have reduced the danger of cross-subsidization by the BOCs."[37] For instance, the Court found that the Commission had failed to explain the reasons in *Computer III* for its "new-found faith" in the efficacy of state regulation in preventing improper cross-subsidization, which it had just questioned in the *BOC Separation Order.*[38] Nor did the Commission, according to the Court, identify the change in circumstances that occurred during the 14 months between the conclusion of the *BOC Separation* proceeding and the initiation of the *Computer III* proceeding that justified the Commission's new emphasis on the importance of the AT&T divestiture in evaluating the risks of cross-subsidization.[39] In sum, the Court found that the Commission had failed to "cite any changes since the *BOC Separation Order* that logically reduces the danger of cross-subsidization by the BOCs."[40] Although concluding that the record failed to show reduced cost-shifting opportunities or incentives for the BOCs,[41] the Ninth Circuit noted that the FCC could have justified its decision on the grounds "that the national interest in allowing the BOCs to compete more efficiently in the enhanced services industry justified reduced regulatory protection against cross- subsidization," but stated "that this is not the case before us."[42]

15. Given these criticisms in the *California* Court's opinion, we have re-examined the public interest benefits of nonstructural safeguards in light of regulatory developments since adoption of the *BOC Separation Order* in late 1983. A possible cost of permitting integrated operations in reliance on nonstructural safeguards is an increased risk of cross-subsidization. Our goal is to protect ratepayers from possible cross-subsidization without placing unnecessary restrictions on the BOCs that hamper their ability efficiently to provide enhanced services to the American consumer. For the reasons described below, we tentatively conclude that our cost allocation safeguards with the revisions proposed in this *Notice* will effectively guard against cross-subsidization. Even assuming that there may be some diminution in protection with cost allocation safeguards relative to structural separation, we tentatively conclude that the danger of this is outweighed by the benefits of integated operations.[43]

16. One critical factor in this analysis is our experience with the adoption and implementation of detailed cost allocation rules and related cost accounting safeguards that separate nonregulated service costs from regulated service costs.[44] At the time of the *BOC Separation Order,*

and at the time of *Computer III*, no effective cost allocation safeguards existed. These rules are now in place and operating.

17. The Commission's joint cost and affiliate transaction rules represent a careful approach geared to protect ratepayers.[45] In particular, carriers are not permitted to recover costs designated as nonregulated in their provision of regulated products and services. Under the Commission's cost allocation rules, costs are directly assigned to regulated or nonregulated activities whenever possible. Costs that cannot be directly assigned are attributed, if possible, to regulated or nonregulated activities in accordance with cost causation principles. All remaining costs are allocated according to a general allocation factor based on the division of total company expense. In specifying cost allocation factors, the Commission acted to ensure that ratepayer interests were protected. For instance, the Commission declined to adopt an incremental costing approach, which would have encouraged faster development and deployment of enhanced services by fostering lower prices. Instead, the Commission used a fully distributed cost allocation methodology, assigning a portion of general overhead to nonregulated activities, which ensured that regulated service ratepayers benefit from efficiencies gained through joint use of the network. The Commission also adopted affiliate transaction rules that prevent the BOCs from charging ratepayers inflated prices for goods and services obtained from nonregulated affiliates, or from providing these affiliates with goods and services at unduly low prices.[46]

18. The Commission has also implemented various cost accounting mechanisms to enforce the joint cost rules. The *Joint Cost Order* required that AT&T and all Tier 1 LECs[47] file cost allocation manuals implementing the Commission's cost allocation rules. The BOCs filed the required cost allocation manuals in 1987. After public comment and careful review, the Common Carrier Bureau conditionally approved the BOC manuals, but required significant revisions in the manuals for each cost category to ensure that the allocations were as precise as possible. For example, the BOCs initially proposed allocating the costs in many of the executive and administrative categories on the basis of a general allocation factor, *i.e.,* the ratio of all directly assigned or attributable nonregulated expenses to total company expenses. The Commission rejected this method since many of the costs could be directly assigned or attributed.[48] Based on detailed instructions from the Bureau, the BOCs refiled their manuals in early 1988. The Commission has now approved all of the BOCs' revised cost allocation manuals subject to certain conditions.[49]

19. The *Joint Cost Order* also directed each of these carriers to obtain and file audits by independent accounting firms of the carriers' cost allocation results reported to the Commission.[50] In implementing this requirement, the independent auditors were required to provide a positive opinion on whether the carriers' methodologies for separating regulated and nonregulated costs were consistent with the carrier's cost allocation manual approved by the Commission and whether the carrier's financial reports reflected an accurate application of those methodologies.[51] The BOCs have now submitted the 1988 and 1989 independent audits of their joint cost allocations.

20. In a separate proceeding, the Commission has also instituted the Automated Reporting and Management Information System (ARMIS),[52] which establishes a computerized information reporting system that provides detailed cost and revenue information from the BOCs and other large carriers. This system, which was also established after the *Computer III* decision, permits easy benchmark comparisons among large local exchange carriers and across time periods to identify serious discrepancies warranting particular Commission attention. In the *ARMIS Order*, the Commission required carriers to file new computerized reports aimed at detecting improper cost-shifting. The quarterly report contains aggregated financial data reflecting the results of the accounting and cost allocation requirements prescribed in Part 32[53] and Part 64[54] of the Commission's Rules. Also, carriers were required to file an annual USOA Report displaying the results of their total activities for every account in the USOA, and a Joint Cost Report showing the allocation to regulated and nonregulated activities for all accounts involved in the ratemaking process.

21. Now in its third year of implementation, the benchmarking process embodied in the Commission's various cost accounting safeguards has allowed the Commission to identify significant disparities in the individual BOC's cost allocations. For example, in the tariff review process, the Commission relied on information developed in staff audits and used the benchmarking process, along with other regulatory techniques, to save consumers hundreds of millions of dollars by comparing the allocations made by the carriers. In particular, in the 1989 and 1990 annual access tariff review process, the Bureau disallowed approximately $214 million in local exchange carriers' interstate basic service rates. The Bureau concluded that the costs should have been allocated to the installation and maintenance of nonregulated inside wiring rather than regulated service offerings.[55]

22. In another action enforcing our safeguards, we issued a *Notice of Apparent Liability* against the NYNEX telephone companies for apparently improper affiliate transactions between NYNEX's local exchange telephone subsidiaries, New York Telephone (NYT) and New England Telephone and Telegraph Company (NET), and NYNEX's nonregulated affiliate, the Material Enterprises Company (MECO), which provided centralized procurement and support services for the NYNEX telephone companies.[56] Based on a Common Carrier Bureau audit, we tentatively concluded that MECO had overcharged its telephone company affiliates by a total of $118.5 million from 1984 through 1988. Accordingly, this Commission ordered NYT and NET to show cause why they should not be required to remove $32.6 million in excessive capital costs from their rate base, and perform ratemaking adjustments to return $35.5 million in improper charges imposed on interstate ratepayers.[57] This Commission also found NYT and NET apparently liable for forfeitures totaling in excess of $1.419 million for violation of the Commission's rules.[58] On October 3, 1990, this Commission entered into a consent decree in which NYNEX agreed to reduce its interstate capital account balances by $32.6 million, reduce interstate revenue requirements by $35.5 million, and make contributions to the United States Treasury in the amount of $1.419 million.[59] Having obtained for interstate ratepayers and the Treasury all of the relief sought by the *Order to Show Cause*, without delay or litigation risk, we agreed to terminate the proceeding without a finding of wrongdoing on the part of NYNEX.

23. This Commission also has vigorously pursued other apparent violations of our cost accounting rules, and has taken action where appropriate. For instance, as a result of a Commission audit of the National Exchange Carrier Association (NECA), we have notified Pacific Bell, Southwestern Bell Telephone Company, New England Telephone and Telegraph Company and New York Telephone Company that they are apparently liable for forfeitures totaling $ 1 million for violation of our accounting rules. This audit focused on the NECA settlement process and certain unusually large adjustments reported to the NECA pool by these carriers during the last three months of 1988.[60]

24. As the preceding paragraphs demonstrate, the Commission has made significant strides since it committed to develop cost allocation safeguards as part of a system of nonstructural safeguards in the initial *Computer III* decision. We have adopted cost allocation safeguards and affiliate transaction rules, reviewed and required substantial changes in the carriers' implementing cost allocation manuals, reviewed the first two sets of independent audits, and conducted our own field audits. In addition to this, we have undertaken a number of important enforcement actions that produced significant benefits for consumers.[61]

25. This Commission's recent adoption of incentive regulation for the LECs is yet a further step that reduces BOC incentives to cross-subsidize. That major development also has occurred long after the *BOC Separation Order* and was not a part of the record before the Court in *California*. Under price cap regulation, the BOCs are no longer automatically entitled to increase rates to recoup cost increases as they would have been under a cost-plus, rate of return system of regulation. Instead, rate levels are adjusted to reflect inflation and anticipated efficiency gains by the BOCs. Thus, unlike under rate-of-return regulation, any misallocation of nonregulated costs to regulated operations under price cap regulation normally would not permit higher prices and increased earnings.[62] Rather, any such additional costs would merely reduce BOC earnings.[63] Although reducing cross-subsidy incentives, LEC price cap regulation does not by itself eliminate improper cost allocation as a matter of regulatory concern, but serves as an effective complement to cost accounting, reporting, auditing, and enforcement safeguards.

26. After thorough re-examination, we now believe that significant regulatory developments since adoption of the *BOC Separation Order*, and indeed since the Commission's *Computer III* decision, have reduced the incentives for BOCs to engage in improper cross-subsidization of their enhanced service operations, as well as their ability successfully to do so. Nevertheless, our re-examination has identified a number of actions we can take that will substantially strengthen even further our cost accounting safeguards that we have applied to the BOCs and other Tier 1 LECs.![64] Similarly, although this proceeding is being initiated in response to the *California* decision, which addresses cost accounting safeguards applicable to the BOCs, we propose to apply each of our strengthened safeguards to all Tier 1 LECs. Accordingly, we propose to require that: (1) all carriers treat enhanced services as nonregulated activities for accounting and cost allocation purposes; (2) the independent auditors be directed to provide the same level of assurance in their required audits as that undertaken in a financial statement audit engagement; (3) the Common Carrier Bureau study means of achieving greater uniformity in the carriers' cost allocation manuals and, if appropriate, take the steps necessary to accomplish this goal; (4) the carriers quantify the effect of cost allocation manual changes when such changes are submitted to the Commission; and (5) the Bureau study whether to establish a reasonable threshold for determining the materiality of errors and omissions discovered in the independent audits of carrier filings, and, if appropriate, take the steps necessary to implement such a threshold. Appendix A contains new and revised rule language implementing these proposed changes and codifying pre- existing manual filing and independent audit requirements. We believe that these measures will provide regulated service ratepayers and the BOCs' (and other Tier 1 LECs') competitors with important additional protections against cross-subsidization.

27. The first of these measures involves continued nonregulated treatment of enhanced services for accounting and cost allocation purposes. The costs of nonregulated activities are removed from the carriers' prescribed Part 32 accounts prior to the jurisdictional separations process.[65] It is essential that telephone company shareholders, not regulated service ratepayers, bear the costs of telephone company nonregulated operations. Isolating the cost of nonregulated activities before applying jurisdictional separations procedures is a cost-effective means of achieving this goal. Under this approach, the carriers are not required to isolate enhanced service costs in each jurisdiction, because all such costs have been allocated to the nonregulated category through a single set of allocation procedures subject to an independent audit.[66]

28. The second proposal involves strengthening the annual independent audits of carrier cost allocation data filed with the Commission. Based on the Bureau's review of the carriers' 1988 and 1989 independent audits, we believe that these audits can be improved in order to increase further both the reliability of this process and its value as a means of assisting the Commission in the most effective use of our own auditing resources. Specifically, we believe that the independent auditors should provide the same level of assurance as that provided with a financial statement audit engagement. An attest engagement results in an opinion by the auditor about the reliability of a written assertion that is the responsibility of another party. A financial statement audit engagement, by contrast, results in an opinion by the auditor whether the company's financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The audit must include an examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements, an assessment of the accounting principles used and of significant estimates made by management, and an evaluation of the overall financial statement presentation. The professional standards of field work for financial statement audit engagements specifically require auditors to obtain evidential matter through inspection, observation, inquiries, and confirmations to afford a reasonable basis for the statements under examination, and to evaluate internal controls when those controls are relied upon in determining the extent of auditing procedures. We tentatively conclude that these standards' requirements for the additional examination of source data and for the testing of allocation procedures and reported results are necessary to satisfy fully the Commission's cost allocation require-

ments. We propose to require such a heightened level of assurance for all future independent audits required under our rules. [67]

29. This Commission also tentatively concludes that the joint cost allocation process could be improved further through efforts to achieve greater uniformity in the carriers' cost allocation manuals. The Commission has allowed each carrier to file its own cost allocation manual subject to public review and comment and to Commission review. The Commission initially declined to require uniformity in the cost allocation manuals, stating that it was important, at the beginning of the cost allocation process, to allow the carriers to develop different solutions to cost allocation problems so that the Commission and the carriers could evaluate which methods worked best. At the same time, however, the Commission expressed an expectation that the carriers would gradually adopt procedures from each others' manuals, making the manuals more alike. At this point in time, we believe that both the carriers and the Commission have had an adequate opportunity to examine disparate means of dealing with cost allocation issues, and determine which methods produce the best results. We now believe that the cost allocation process would benefit from efforts to increase uniformity. Accordingly, this Commission proposes to direct the Common Carrier Bureau to take the appropriate action on delegated authority to achieve greater uniformity in the cost allocation manuals.[68]

30. In addition, we propose to require carriers to provide estimates, at the time they file future manual revisions, of the dollar effects that these revisions will have on joint cost allocation results. This will assist the Commission staff and other interested parties in focusing attention on the most significant revisions. We further propose to direct the Bureau to examine whether to establish a specfic standard or standards for the materiality of errors and omissions discovered in the independent audit process and, if appropriate, take steps to implement such standards. Establishing specific standards, if practicable, would further define the obligations of the independent auditors and would affect the kinds of procedures they employ in the conduct of their audits as well as the level of scrutiny,[69] and thus could help ensure the correction of all significant cost allocation errors or omissions discovered in these audits.

31. Thus, after re-examination, we tentatively conclude that a set of nonstructural safeguards, particularly as strengthened by the proposals herein, can effectively protect against possible improper cross-subsidization due to misallocation of BOC costs between basic and enhanced services. We recognize that this approach represents a change from the *BOCSeparation Order*. While we were concerned in that proceeding that effective accounting safeguards against cross-subsidization might be difficult to develop, we have now developed, implemented, and enforced such safeguards and believe that they are indeed effective. In this regard, there have been a number of recent Rule Making and enforcement actions (not before the Court in *California)* demonstrating our commitment and ability to deter, and if it occurs, to detect and remedy, cross-subsidization. Implementation of our detailed cost accounting regime has resulted in FCC actions to prevent or remedy improper cost allocations, and thereby limited BOC opportunities to cross-subsidize. Implementation of the added safeguards proposed in this *Notice* will, as a whole, strengthen the effectiveness of our cost accounting safeguards, and thus further limit BOC cross-subsidization opportunities. Furthermore, implementation of price cap regulation for the BOCs will sever the direct link between any improperly shifted costs and regulated basic service prices, and thereby should reduce BOC incentives to cross-subsidize.

32. We therefore tentatively conclude that our regulations will protect ratepayers and others from the effects of any misallocation of costs between basic and enhanced services, and that structural separation is not now necessary to guard against cross-subsidization. In light of this conclusion and the public interest benefits of permitting integrated BOC enhanced service operations,[70] we tentatively conclude, contrary to the Commission decision in late 1983 in the *BOC Separation Order*, that the costs of a structural separation requirement outweigh any benefits. To the extent cost accounting safeguards may involve any diminution in protection against cross-subsidization, the danger of this is outweighed by the benefits of integration. We seek comment on these tentative conclusions and on our proposals to strengthen our cost accounting safeguards. Although our tentative view is that reliance on nonstructural safeguards is the best means for accomplishing our public interest goals, parties may also comment on alternative approaches. To the extent that any parties support retention of structural separation, we ask that they provide evidence to show why they believe structural separation to be more effective than nonstructural safeguards in detecting and deterring discrimination and cross-subsidization, and that they identify the specific benefits of structural separation that would outweigh the costs -- in terms of lost public benefits -- of structural separation.

3. Safeguards Against Discrimination

33. In the *Computer III Phase I* and *Phase II* orders, the Commission established a number of nonstructural safeguards to protect against possible BOC discrimination against their competitors in the provision of access to underlying basic services. In the *Phase I Order*, the Commission adopted CEI requirements to ensure that unaffiliated ESPs could obtain nondiscriminatory access to underlying basic network services. Thus, the BOCs were required to provide their ESP competitors with "equal access" interconnections to basic network services at the same rates that the BOCs themselves paid.[71] As a result, the basic services used by the BOC enhanced service operations had to "be available to others on an unbundled basis, with technical specifications, functional capabilities, and other quality and operational characteristics, such as installation and maintenance times, equal to those provided to the carrier's enhanced services."[72] As an interim measure, the Commission allowed the BOCs to provide enhanced services on an integrated basis pursuant to Commission-approved service-specific CEI plans, prior to implementing ONA.[73]

34. The Commission also required that the BOCs implement ONA, which extends CEI principles to the overall design of the BOCs' basic networks. In addition, ONA requires that the BOCs give their competitors access to BOC network functionalities by tariffing unbundled basic service building blocks (basic service elements or BSEs). After significant revisions and improvements in the plans resulting from the BOCs working with the ESP industry

under Commission direction, the Commission approved the BOCs' amended ONA plans on May 8, 1990, subject to minor modifications.[74]

35. The Commission adopted additional nonstructural safeguards in the *Phase II Order*. First, the Commission required that the BOCs file quarterly nondiscrimination reports concerning the timing of installation and maintenance, and the quality and reliability, of the basic services used by the BOCs' competitors.[75] Second, the Commission adopted network information disclosure rules to ensure that independent ESPs obtained timely access to technical information related to new or modified network services affecting the interconnection of enhanced services to the network. Finally, the Commission established rules governing BOC and ESP access to CPNI.[76]

36. In reviewing the *Computer III* decisions, the *California* Court did not criticize the Commission's nondiscrimination safeguards. In fact, the Court stated that the record supported the Commission's conclusions that "ONA, CEI, and the growth of bypass technology will be effective in reducing the risk of BOC access discrimination,"[77] and that "lifting the structural separation requirements will benefit consumers of enhanced services by permitting the BOCs to operate more efficiently in the enhanced services market."[78] Thus, despite the decision to vacate the *Computer III* orders, the Court did not find fault with the Commission's nonstructural safeguards designed to prevent discrimination against the BOCs' competitors in access to basic services.

37. In this proceeding, we propose to readopt the *Computer III* nonstructural safeguards against discrimination except for ONA, which we have adopted in our companion order,[79] and for our CPNI requirements, which are discussed separately below. The Commission's experience to date confirms the *Computer III* conclusion that these nonstructural safeguards, implemented within the ONA framework, are sufficient to guard against discrimination. We have received very few complaints from ESPs concerning discriminatory access to the BOC networks. Indeed, many of the later CEI plans filed by the BOCs generated little or no public comment. We seek comment on our tentative reaffirmation of our *Computer III* conclusion. We also note that this proposal includes readoption of our *Computer III* decisions to eliminate both the capitalization plan requirement[80] and the prohibition against the regulated BOC company and its affiliates performing software development for one another. Accordingly, we seek comment on our proposal to reinstitute the pre-existing nonstructural safeguards designed to ensure nondiscriminatory access to BOC basic services. We also ask parties to comment on any relationship between LEC price cap regulation and those nonstructural safeguards that are designed to protect against possible discrimination. We also seek comment on readopting the *Computer III* decisions concerning capitalization plans and software development independent of the broader regulatory regime ultimately adopted in this proceeding.

38. While we propose generally to reinstitute the nondiscrimination safeguards, we request comment about whether we should modify our CPNI rule for enhanced services, which addresses the question of access by the BOCs and by independent ESPs to a customer's CPNI for the purpose of marketing enhanced services. In this area, the Commission has balanced the goals of promoting efficiency in BOC delivery of enhanced services to customers, protecting customer expectations of privacy, and promoting competitive equity in the provision of enhanced services by the BOCs and independent ESPs. Under the current rule,[81] BOC enhanced service personnel are allowed generally to access a customer's CPNI for marketing purposes, but the customer has a right to require the BOC to withhold CPNI from its enhanced service personnel. Upon customer request, the BOCs are required to release CPNI to unaffiliated ESPs on the same terms and conditions that it is made available to their own enhanced service personnel.[82] Thus, if a customer does not affirmatively choose to withhold its CPNI from BOC enhanced service personnel or release it to unaffiliated ESPs, BOC enhanced service personnel can access a customer's CPNI for marketing purposes but independent ESPs cannot.

39. In the *BOC ONA Reconsideration Order* this past spring, we noted that BOC implementation of the current rule may give rise to legitimate concerns regarding the important issues of informed customer choice and competitive equity. We found that the implementation of the rule could affect "whether a customer purchases BOC enhanced services before it is aware either that independent enhanced service providers exist or that those providers can make use of whatever benefits that CPNI provides in structuring a service offering for that customer's needs." We decided that the BOCs "must evidence a good faith effort to address any legitimate concerns of their ESP competitors on this issue," and specifically required that the BOCs include proposed solutions to these issues in their amended ONA plans to be filed in April 1991.[83]

40. Although the *California* Court did not find fault with the Commission's nonstructural safeguards against possible discriminatory conduct, we have decided to expand and accelerate the scope of our review of the CPNI safeguard applicable to BOC provision of enhanced services. We here request not only proposals for improving the implementation of the current CPNI rule, but also comment on possible modifications to the current CPNI rule, such as applying a prior authorization requirement to the BOCs as well as to independent ESPs in some or in all circumstances.[84] Parties should demonstrate in their comments how their proposed rule or implementation procedures effectively balance considerations of efficiency, competitive equity, and privacy. Parties proposing to change the current rule should also address the propriety of various requirements that implement the current rule, such as requirements for the annual notification of multiline business customers and for a computerized password/ID system.

III. PREEMPTION

A. Background

41. As explained above, in *Computer II* the Commission permitted AT&T and its operating companies to provide enhanced services only through corporate affiliates fully separated from their basic services operations. The Commission preempted the states from exempting AT&T and its operating companies from the Commission's structural separation requirements for intrastate regulatory purposes.[85] The Commission did not, however, preclude states from imposing safeguards to protect intrastate ratepayers in addition to those created by the Commission;[86] and states were free to impose structural separation requirements on the unregulated activities of GTE and

other ITCs.[87] In the *BOC Separation Order* the Commission similarly preempted the states from altering the structural separation requirements imposed on the BOCs.[88]

42. In *Computer III* the Commission concluded that it would be in the public interest to permit AT&T and the BOCs to integrate their provision of basic and enhanced services pursuant to nonstructural safeguards. The Commission found that state structural separation requirements would interfere with federal policies, and that facilities and services used by carriers for the provision of basic and enhanced services could not practicably be separated into interstate and intrastate components in a manner that would permit application of conflicting federal and state safeguards.[89] Accordingly, the Commission preempted the states from imposing structural separation requirements or inconsistent nonstructural safeguards on the enhanced service operations of AT&T and the BOCs.[90] The Commission also found that it would be anomalous to have more stringent safeguards applicable to the enhanced services of the ITCs than applied to the BOCs, in view of the ITCs' smaller potential for engaging in anticompetitive conduct. Therefore, the Commission preempted states from imposing on the ITCs structural separation requirements or nonstructural safeguards more stringent than those applied to the enhanced service operations of AT&T and the BOCs.[91]

43. *California v. FCC* vacated the Commission's *Computer III* preemption decisions. The Court was not persuaded that the Commission had adequately justified preemption of state structural separation requirements and of inconsistent nonstructural safeguards. The Court found that the Commission had failed to demonstrate that *all* state-imposed structural separation requirements would negate the federal interest in permitting AT&T and the BOCs to offer integrated enhanced services because the *Computer III Order* failed to address the possibility that some enhanced services might be offered on a purely intrastate basis. The Court stated that the Commission had made a plausible argument that some forms of state structural separation requirements -- for instance, those that could require physical separation of intrastate enhanced and basic service facilities -- could negate federal policies permitting structural integration.[92] The Court found, however, that the Commission had failed to explain how the possibility that some forms of state structural separation requirements could negate federal policy justified the Commission's preemption of *all* state structural separation requirements.[93]

44. The Court also found that the Commission had failed to justify the breadth of the preemption of inconsistent state nonstructural safeguards applicable to AT&T and the BOCs.[94] The Court found inadequate as well the Commission's explanation for preemption of state nonstructural safeguards applicable to the ITCs more stringent than those imposed by the Commission on AT&T and the BOCs.[95] According to the Court, the Commission stated only that it is desirable that the ITCs not be subject to a greater degree of regulation than the BOCs.[96]

B. Discussion

45. This Commission is committed to the development of a strong information services market that makes new, innovative services available to the general public as well as to large businesses. Our goals, which we believe are shared by many state commissions, are to promote the efficient provision of enhanced and basic services by common carriers, while protecting against anticompetitive behavior. In this *Notice*, we tentatively conclude that the best way of achieving these goals at the federal level is to permit the BOCs to develop and market interstate enhanced services on an integrated basis, subject to the safeguards described above. ITCs, under prior Commission determinations, are permitted to integrate their basic and enhanced services. With the adoption of the *Report and Order* today, we have readopted nonstructural safeguards for AT&T's provision of enhanced services.[97] This *Notice* considers the extent to which this Commission might find it necessary to preempt state safeguards applicable to provision of intrastate enhanced services by these carriers.

46. It is inevitable that the various state and federal regulatory authorities will have different perspectives and experiences, and this may lead state commissions to adopt safeguards that are at variance with each other, and with the federal safeguards. Some state requirements are likely to be very similar to federal requirements; others may be complementary. Section 2(b) of the Communications Act generally leaves to the states regulatory jurisdiction over intrastate communications. We may, however, preempt inconsistent state regulation that as a matter of economics and practicality of operation "would necessarily thwart or impede" federal regulation.[98] We propose in this *Notice* to preempt only state regulation of intrastate communications that would necessarily thwart or impede federal regulation.

47. At the same time, we must ensure that disparate federal and state regulatory requirements do not undermine the efficiency of interstate communications. The enhanced services market generally is national or regional in scope, and a degree of certainty and uniformity may be necessary to enable the enhanced services market to develop in the way that both state commissions and this Commission desire. Ensuring a rapid and efficient nationwide communications system is one of the explicitly stated purposes for creation of this Commission,[99] and a mandate which we are committed to fulfilling. Thus, we emphasize that the Commission has jurisdiction over interstate enhanced services,[100] and our jurisdiction over interstate communications encompasses communications over physically intrastate facilities used in those communications.[101]

1. Structural Separation Requirements

48. In *Computer III* the Commission preempted states from requiring AT&T, the BOCs, and ITCs to provide enhanced services through a separate corporate entity with separate facilities and personnel. In this proceeding we propose to preempt those categories of state structural regulation that, as a practical matter, prevent these carriers from integrating their interstate basic and enhanced service operations, thereby thwarting or impeding a valid federal regulatory goal.

49. It is possible that some state structural regulation may not impermissibly thwart federal policies in this area. For example, upon initial analysis, it appears that a simple requirement that a carrier establish a separate corporate entity for provision of intrastate enhanced services by itself may not make it impractical for carriers to provide interstate basic and enhanced services on an integrated basis. It appears to us, however, that a state requirement that separate facilities or personnel be used

for provision of intrastate enhanced services would, as a practical matter, make it impossible for carriers to integrate their interstate basic and enhanced service operations. For instance, as the *California* Court noted, it would appear that general state requirements that carriers use separate facilities to provide intrastate enhanced services would almost inevitably require a separation of facilities used to provide interstate basic and enhanced services because the same facilities are ordinarily used to provide both interstate and intrastate services.[102] If such state structural regulation were not preempted, many of the public interest benefits we have identified as associated with integration would be lost.

50. We seek comment on the practical ability of AT&T and the BOCs to separate different types of facilities and personnel functions for provision of intrastate enhanced services while simultaneously integrating interstate basic and enhanced services pursuant to federal nonstructural safeguards. Specifically, we seek comment on state regulation requiring separate communications facilities and equipment, computer facilities and software, and other facilities such as real estate and vehicles. We also seek comment on the effect of state structural regulation on the following personnel functions: general management, operations, marketing, installation and maintenance, and research and development. These types of facilities and personnel functions should not be regarded as rigidly divided categories. They will in some cases overlap and be closely related. Commenters are requested to delineate special features that weigh for, or against, permitting states to apply structural separation requirements to these types of facilities and personnel functions, or to any other BOC activities. Commenters should fully support claims of economic, technical, or other practical impossibility. If the record shows that state regulations requiring separation of any of these facilities, functions, or activities would thwart or impede the ability of AT&T and the BOCs to integrate their interstate basic and enhanced services, the Commission proposes to preempt those state requirements.

51. In *Computer III* the Commission preempted state structural separation requirements applicable to the ITCs, as well as to AT&T and the BOCs, thereby permitting ITCs to provide integrated interstate enhanced and basic services. We tentatively conclude that the scope of any preemption of state structural requirements adopted in this proceeding likewise should not differ when applied to the ITCs. We solicit comment on this tentative conclusion. Any commenter advocating a different scope of preemption should identify the considerations justifying such a different result, and should define with specificity the suggested scope of preemption.

2. Network Disclosure Rules

52. In *Computer III* we applied special network disclosure rules to the BOCs and AT&T.[103] In this proceeding we propose to re-establish the *Computer III* network disclosure rules applicable to the BOCs. In CC Docket No. 90-368 the Commission is today re-establishing the *Computer III* network disclosure rules applicable to AT&T. These network disclosure obligations are designed to address the potential that these carriers, in the absence of structural separation, may discriminate against their enhanced service competitors in designing new network services or changing network technical specifictions. These rules help ensure that independent ESPs can obtain, on a nondiscriminatory basis, technical and marketing information related to any new or modified network service affecting interconnection of enhanced services to the network. In general, disclosure subject to a protective agreement is required to independent ESPs at the "make/buy" point, *i.e.*, the point in time at which the carrier decides to make itself, or to procure from an unaffiliated entity, any product the design of which affects or relies on the network interface. Public disclosure generally is required at least twelve months before introduction of a new or modified network service.[104] These rules strike a balance between assuring that independent ESPs receive network information on a timely basis and preventing premature disclosure that could impair carriers' development efforts and inhibit network innovation.

53. We tentatively conclude that it will be impossible to apply different state and federal timing requirements for initial disclosure of this network information. In our view, disclosure is inseverable for interstate and intrastate regulatory purposes because, by definition, initial disclosure can occur only once. A state network disclosure rule that mandates disclosure at an earlier time, or prevents disclosure at the time specified in the federal rule, effectively negates the timing specified in the federal rule. Accordingly, we propose to preempt that part of any state network disclosure rule that requires initial disclosure at a time different than that in the federal rule.[105] We do not propose, however, to preempt state procedures that require broader dissemination of this information, but do not affect the timing of the disclosure. We solicit comment on these proposals and on the potential for state network disclosure rules generally to frustrate the ability of AT&T and the BOCs to provide interstate integrated enhanced services. We also solicit comment on whether state network disclosure rules applicable to the ITCs could frustrate their ability to integrate interstate basic and enhanced services.

3. Customer Proprietary Network Information Rules

54. Under *Computer III*, the Commission established CPNI safeguards identical to those applied to the integrated provision by AT&T and the BOCs of CPE and basic services. Balancing efficiency, privacy, and competitive equity considerations, those rules generally permit the carriers' enhanced service operations to access CPNI, but require carriers to provide customers with the right to direct that their CPNI be withheld from the carrier's enhanced services personnel and/or released to other enhanced service vendors. Thus, ESPs are required to obtain a customer's permission in order to access that customer's CPNI, whereas AT&T and the BOCs may access this CPNI without such prior authorization. As set forth earlier in this *Notice*, we are proposing to re-examine the CPNI safeguard as applied to the integrated provision by the BOCs of interstate basic and enhanced services. In a companion order, we are readopting the *Computer III* CPNI restrictions applicable to AT&T's integrated enhanced service operations. States may wish to adopt CPNI rules for intrastate regulatory purposes that differ from FCC rules. We seek comment on whether any preemption of state CPNI regulation differing from federal CPNI safeguards is appropriate or necessary. We also seek comment on whether any preemption of state CPNI requirements should also apply to the ITCs.[106] Parties arguing for preemption of some types of state CPNI regulations

should craft their proposals so that the proposals affect only those narrow categories of state requirements that would thwart or impede federal policy.

4. Nondiscrimination Reporting Requirements

55. In this proceeding we are proposing to re-establish the nondiscrimination reporting requirements applicable to the BOCs. In a companion order, we are readopting reporting requirements applicable to AT&T. The purpose of these requirements is to reduce the potential for the BOCs and AT&T to discriminate in the timing or quality of their provision of basic services to their enhanced service competitors or their competitors' customers. Under these requirements, AT&T and the BOCs report quarterly on the timing of installation and maintenance of, and file annual affidavits on the quality of, basic services provided under CEI plans and ONA.[107] The ITCs are not subject to federal nondiscrimination reporting requirements. We solicit comment on which, if any, state reporting requirements differing from federal requirements would thwart or impede those objectives, or the ability of carriers to integrate provision of interstate basic and enhanced services.

IV. WAIVER OF COMPUTER II

56. After the Ninth Circuit vacated *Computer III*, the BOCs filed a joint petition for an interim waiver of the *Computer II* rules.[108] The Common Carrier Bureau granted an interim waiver of *Computer II* to allow the BOCs to offer enhanced services on an integrated basis to existing and new customers under previously approved CEI plans.[109] The Bureau, however, directed the BOCs to refrain from filing any new CEI plans, to withdraw all pending CEI plans before the Bureau but not yet approved, and to discontinue the integrated planning and development of BOC enhanced services except for those services subject to an approved CEI plan. The waiver order requested comment on whether the waiver should continue throughout the pendency of the remand proceeding, and if so, under what conditions.[110] In light of our proposal to adopt nonstructural safeguards for BOC provision of enhanced services, we conclude that it would be in the public interest to extend the waiver until the completion of the remand proceeding. We take this opportunity to clarify certain aspects of the Bureau waiver, but decline to expand its scope.

57. Most commenters support an extension of the interim waiver for the duration of this Rule Making.[111] Generally, these parties state that it is in the public interest to waive the *Computer II* rules requiring structural separation for BOC enhanced service operations until conclusion of these proceedings in order to avoid disruption for the thousands of customers that currently subscribe to BOC enhanced services.[112]

58. Only three parties, MCI, ATSI and Mid Atlantic, oppose extending the waiver during the pendency of the remand proceeding.[113] MCI and ATSI assert that to obtain a waiver of the *Computer II* rules, a petitioner must demonstrate that concerns about cross-subsidization are outweighed by the possibility of imposing unreasonable costs upon consumers, or the unavailability of an enhanced service if the waiver is not granted.[114] MCI contends that the BOCs have failed to make the showing necessary to justify a waiver.[115] MCI, ATSI and Mid Atlantic also oppose an extension of the waiver on the grounds that the Commission's cost accounting and nonstructural safeguards are not effective in protecting ratepayers and consumers against anticompetitive behavior by the BOCs.[116]

59. For the reasons stated below, we conclude that a limited interim waiver of the Commission's *Computer II* rules to permit the BOCs to offer enhanced services on an integrated basis to existing and new customers pursuant to previously approved CEI plans is in the public interest. The narrow waiver we grant today will avoid unnecessary disruption to customers and the industry, with little attendant risk of anticompetitive behavior.

60. We agree with those parties that state that establishing structural separation requirements on BOC enhanced service operations during the remand proceeding is likely to impose substantial costs on ratepayers and enhanced service customers.[117] To comply with such a requirement, the BOCs would have to form and organize a separate subsdiary, maintain separate books of account, hire separate officers and operating personnel and utilize computer equipment and telecommunications facilities separate from those used in the provision of regulated services.[118] Indeed, in light of the limited duration of this proceeding, the significant costs involved in forming a fully separate subsdiary and the loss of efficiencies of integrated operations, failure to extend this waiver might force the BOCs to suspend some enhanced service offerings and make some enhanced services unavailable in the marketplace.[119] These costs, and the risk of loss of service, will prove to be unnecessary if we adopt our proposed nonstructural safeguards.[120] Thus, requiring structural separation for BOC enhanced services during this interim period would create severe customer disruption and dislocation.[121]

61. Furthermore, we have responded to the *California* Court's concerns. For example, we have prevented the BOCs from expanding the enhanced services that they provide on an integrated basis. They instead are limited to those services that have been the subject of notice and comment and individualized Commission scrutiny in the CEI process. In addition, we are confident that our current cost accounting rules and CEI requirements, as strengthened by interim Bureau actions, will minimize the potential risk of anticompetitive behavior by the BOCs during the pendency of the Rule Making proceeding.[122] Therefore, we have determined that extending the limited waiver granted by the Bureau would serve the public interest by preventing unnecessary customer dislocation and industry disruption with little attendant risk of anticompetitive behavior by the BOCs.[123] We believe our conclusion is consistent with relevant case law. Courts have upheld an agency's authority to adopt interim measures to prevent industry disruption after agency rules have been vacated, and these interim measures may remain in effect while the agency conducts remand proceedings.[124]

62. Several parties also request that we expand the scope of the interim waiver and permit the BOCs to file new CEI plans and to continue integrated planning and development for new enhanced services.[125] U S West requests the right to amend existing CEI plans to add new, "related" enhanced services.[126] Two BOCs also request that the Commission clarify whether the BOCs can file permanent CEI plans for enhanced services presently offered under a market trial waiver upon expiration of that trial.[127] Several BOCs urge us to waive the *Computer II* restriction prohibiting joint research and development for

software."[128] Finally, a few BOCs request that we define "planning and development.""[129] Several parties other than the BOCs assert that any waiver should be limited to the terms of the *Interim Waiver Order.* "[130]

63. We decline to expand the scope of the waiver beyond the *Interim Waiver Order,* but take this opportunity to clarify the parameters of the waiver. During the pendency of this proceeding, the BOCs may not file new CEI plans or engage in integrated planning or development of enhanced services other than those for which CEI plans have been approved. We recognize that the scope of the waivers for AT&T and the BOCs are quite different, but determine that this different treatment is appropriate. The Commission's decision to substitute nonstructural safeguards for structural separation for the BOCs was challenged and briefed before the Court of Appeals; the Commission's decision on structural relief for AT&T was not. It was not necessary to limit the scope of AT&T's waiver, but it is necessary to place limits on the BOC waiver in order to be consistent with the Court's decision. "[131] Moreover, services that have not yet been approved do not raise the customer disruption issues that have led to our decision to grant a limited interim waiver for BOC enhanced services that are the subject of approved CEI plans. To the extent that the BOCs offer enhanced services through a separate subsidiary, they are free to engage in joint research and development, provided that they comply with the *Computer II* requirement for full compensation, which may be achieved through compliance with our affiliate transaction rules."[132]

64. We also wish to clarify several aspects of this waiver. The BOCs may not file new CEI plans or engage in integrated planning and development for enhanced services that are "direct outgrowths" or "logical extensions" of enhanced services offered under approved CEI plans."[133] Second, the BOCs may not amend existing CEI plans to add "related" enhanced services or file permanent CEI plans for enhanced services offered pursuant to a market trial waiver."[134] The *California* decision found that the Commission had not adequately justified use of cost accounting safeguards to protect against cross-subsidization. We think it important, during the pendency of this proceeding, to safeguard against concerns identified by the Court by not generally permitting the BOCs to expand the enhanced services they can provide on an integrated basis. Administratively, we want to avoid questions of line-drawing that these BOC requests would appear to entail."[135] We will, however, permit companies that currently do software research and development on a joint basis to continue to do so for the duration of the Rule Making. Our proposed regulations permit carriers to do joint research and development for software."[136] It appears unnecessarily disruptive to compel a carrier to move its software development for enhanced services into a separate subsidiary when that removal may be temporary."[137] If we decide not to alter the software rule, we will require carriers to separate their software development at that time.

65. In the companion ONA proceeding, Bell Atlantic raises an issue regarding capitalization plans. Bell Atlantic asks that the Commission reinstate the *Computer III* decision eliminating the requirement that the BOCs have a capitalization plan approved before a separate subsidiary may operate. Our proposal, if adopted, would eliminate the capitalization plan requirement."[138] It appears unnecessarily burdensome and not particularly useful to require the BOCs to file capitalization plans for any interim *Computer II* subsidiaries they may establish. During the pendency of this proceeding, the BOCs may establish separate subsidiaries without filing capitalization plans, provided that they comply with the Commission's accounting safeguards. Should we decide not to eliminate the capitalization plan rule, we will require the BOCs to file capitalization plans at that time.

66. Finally, some BOCs have asked us to clarify the meaning of planning and development. It is neither reasonable, nor necessary, to prohibit BOC employees from thinking any thoughts that might lead to the development of an enhanced service."[139] When a company develops a business plan, however, and assigns resources to a specific service, we will consider, for purposes of this waiver, that it is engaged in planning and development. Accordingly, the BOCs must use separate subsidiaries to conduct technology or market trials, and to prepare feasibility studies for enhanced services that are not the subject of an approved CEI plan. The BOCs, however, may perform on an integrated basis activities that precede planning and development, including the identification of customer needs, general market research, and analysis of service or product alternatives."[140]

V. REGULATORY FLEXIBILITY ACT ANALYSIS

67. We certify that the Regulatory Flexibility Act"[141] is not applicable to the rule changes we are proposing in this proceeding. In accordance with the provisions of Section 605 of that Act, a copy of this certification will be sent to the Chief Counsel for Advocacy of the Small Business Administration at the time of publication of a summary of this *Notice* in the Federal Register.

VI. PAPERWORK REDUCTION ACT ANALYSIS

68. The proposals contained herein have been analyzed with respect to the Paperwork Reduction Act of 1980 and found to impose new or modified information collection requirements on the public. Implementation of any new or modified requirement will be subject to approval by the Office of Management and Budget as prescribed by the Act.

VII. EX PARTE REQUIREMENTS

69. For purposes of this non-restricted notice and comment Rule Making proceeding, members of the public are advised that *ex parte* presentations are permitted except during the Sunshine Agenda period. *See generally* Section 1.1206(a) of the Commission's Rules, 47 C.F.R. § 1.1206(a). The Sunshine Agenda period is the period of time which commences with the release of a public notice that a matter has been placed on the Sunshine Agenda and terminates when the Commission: (1) releases the text of a decision or order in the matter; (2) issues a public notice stating that the matter has been deleted from the Sunshine Agenda; or (3) issues a public notice stating that the matter has been returned to the staff for further consideration, whichever occurs first. Section 1.1202(f) of the Commission's Rules, 47 C.F.R. § 1.1202(f). During the Sunshine Agenda period, no presentations, *ex parte* or otherwise, are permitted unless specifically requested by the Commission or staff for the clarification or adduction

of evidence or the resolution of issues in the proceeding. Section 1.1203 of the Commission's Rules, 47 C.F.R. § 1.1203.

70. In general, an *ex parte* presentation is any presentation directed to the merits or outcome of the proceeding made to decision-making personnel which: (1) if written, is not served on the parties to the proceeding; or (2), if oral, is made without advance notice to the parties to the proceeding and without opportunity for them to be present. Section 1.1202(b) of the Commission's Rules, 47 C.F.R. § 1.1202(b). Any person who makes or submits a written *ex parte* presentation shall provide on the same day it is submitted two copies of same under separate cover to the Commission's Secretary for inclusion in the public record. The presentation (as well as any transmittal letter) must clearly indicate on its face the docket number of the particular proceeding(s) to which it relates and the fact that two copies of it have been submitted to the Secretary, and must be labeled or captioned as an *ex parte* presentation.

71. Any person who in making an oral *ex parte* presentation presents data or arguments not already reflected in that person's written comments, memoranda, or other previous filings in that proceeding shall provide on the day of the oral presentation an original and one copy of a written memorandum to the Secretary (with a copy to the Commissioner or staff member involved) which summarizes the data and arguments. The memorandum (as well as any transmittal letter) must clearly indicate on its face the docket number of the particular proceeding and the fact that an original and one copy of it have been submitted to the Secretary, and must be labeled or captioned as an *ex parte* presentation. Section 1.1206 of the Commission's Rules, 47 C.F.R. § 1.1206.

72. All relevant and timely comments and reply comments will be considered by this Commission. In reaching our decision, this Commission may take into account information and ideas not contained in the comments, provided that such information or a writing containing the nature and source of such information is placed in the public file, and provided that the fact of this Commission's reliance on such information is noted in the Order. For purposes of this proceeding, we incorporate the record before the Commission in the *Computer III* docket.

VIII. ORDERING CLAUSES

73. Accordingly, IT IS ORDERED that NOTICE IS HEREBY GIVEN of the proposed regulatory changes described above, and that COMMENT IS INVITED on these proposals."[142]

74. IT IS FURTHER ORDERED that pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules, 47 C.F.R. §§ 1.415 and 1.419, comments SHALL BE FILED with the Secretary, Federal Communications Commission, Washington, D.C. 20554 on or before February 15, 1991, and reply comments SHALL BE FILED with the Secretary on or before March 18, 1991. To file formally in this proceeding, participants must file an original and four copies of all comments, reply comments, and supporting comments. If participants want each Commissioner to receive a personal copy of their comments, an original plus nine copies must be filed. In addition, parties should file two copies of any such pleadings with the Policy and Program Planning Division, Common Carrier Bureau, Room 544, 1919 M Street, N.W., Washington, D.C. Parties should also file one copy of any documents filed in this docket with this Commission's copy contractor, International Transcription Services, Inc., Suite 140, 2100 M Street, N.W., Washington, D.C. Comments and reply comments will be available for public inspection during regular business hours in the Docket Reference, Room 239, 1919 M Street, N.W., Washington, D.C. 20554.

75. IT IS FURTHER ORDERED, that a waiver of the *Computer II* rules IS GRANTED to the extent described herein.

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy
Secretary

APPENDIX A

Proposed Amendments to the Code of Federal Regulations

Title 47 of the C.F.R., Part 64, is proposed to be amended as follows:

Part 64 -- Miscellaneous Rules Relating to Common Carriers

1. The authority citation for Part 64 continues to read as follows:

Authority: Sec. 4, 48 Stat. 1066, as amended; 47 U.S.C. 154. Interpret or apply secs. 201, 218, 48 Stat. 1070, as amended, 1077; 47 U.S.C. 201, 218.

2. New section 64.903 is added to read as follows:

64.903 Cost Allocation Manuals

(a) Each local exchange carrier with annual operating revenues of $100 million or more shall file with the Commission a manual containing the following information regarding its allocation of costs between regulated and nonregulated activities:

(i) A description of each of the carrier's nonregulated activities;

(ii) A list of all the activities to which the carrier now accords incidental accounting treatment and the justification therefor;

(iii) A chart showing all of the carrier's corporate affiliates;

(iv) A statement identifying each affiliate that engages in or will engage in transactions with the carrier and a description of the nature, terms and frequency of each transaction;

(v) A table showing, for each account containing costs incurred in providing regulated services, the cost pools within that account, the procedures used to place costs into each cost pool, and the method used to apportion the costs within each cost pool between regulated and nonregulated activities; and

(vi) A description of the time reporting procedures that the carrier uses, including the methods or studies designed to measure and allocate non-productive time.

(b) Each carrier shall ensure that the information contained in its cost allocation manual is accurate. Carriers must update their manuals at least quarterly, except that changes to the sections dealing with time reporting and cost allocation procedures must be filed at least 60 days before the carrier plans to implement the changes. Proposed changes in time reporting and cost allocation procedures must be accompanied by a statement quantifying the impact of each change on regulated operations. The Chief, Common Carrier Bureau may suspend any such changes for a period not to exceed 180 days, and may thereafter allow the change to become effective or to prescribe a different procedure.

(c) The Commission may by order require any other communications common carrier to file and maintain a cost allocation manual as provided in this section.

3. New section 64.904 is added to read as follows:

64.904 Independent Audits

(a) Each local exchange carrier required by this Part or by Commission order to file a cost allocation manual shall have performed annually, by an independent auditor, an audit that provides a positive opinion on whether the carrier's cost allocation methodologies used in preparing reports to the Commission are in conformity with its cost allocation manual and whether the reported results are an accurate application of those methodologies and fairly present the financial results of the company's operations. In conducting this audit, the auditors shall obtain evidential matter through inspection, observation, inquiry and confirmation to afford a reasonable basis for the statements under examination. They shall also evaluate and report on the internal controls when those controls are relied upon in determining the extent of auditing procedures.

(b) The report of the independent auditor shall be filed at the time that the local exchange carrier files the annual report required by Section 43.21(f) of this Chapter.

APPENDIX B

Parties Filing Comments

American Newspaper Publishers Association (ANPA Comments)

Ameritech Operating Companies (Ameritech Comments)

Association of Telemessaging Services International, Inc. (ATSI Comments)

Bell Atlantic Telephone Companies (Bell Atlantic Comments)

BellSouth Corporation (BellSouth Comments)

CompuServe Incorporated (CompuServe Comments)

MCI Telecommunications Corporation (MCI Comments)

NYNEX Telephone Companies (NYNEX Comments)

People of the State of California and the Public Utilities Commission of the State of California (California Comments)

Public Service Commission of the District of Columbia (DC PSC Comments)

Southwestern Bell Telephone Company (SWBT Comments)

United States Telephone Association (USTA Comments)

U S West, Inc. (U S West Comments)

Parties Filing Replies

American Newspaper Publishers Association (ANPA Reply)

Ameritech Operating Companies (Ameritech Reply)

Bell Atlantic Telephone Companies (Bell Atlantic Reply)

BellSouth Corporation (BellSouth Reply)

Boston Technology, Inc. (Boston Reply)

CompuServe Incorporated (CompuServe Reply)

Florida Telemessaging Coalition

MCI Telecommunications Corporation (MCI Reply)

Mid-Atlantic Association of Enhanced Service Providers (Mid-Atlantic Reply)

NYNEX Telephone Companies (NYNEX Reply)

Pacific Bell and Nevada Bell (Pacific Reply)

People of the State of California and the Public Utilities Commission of the State of California (California Reply)

Public Service Commission of the District of Columbia (DC PSC Reply)

Southwestern Bell Telephone Company (SWBT Reply)

U S West, Inc. (U S West Reply)

FOOTNOTES

[1] Amendment of Sections 64.702 of the Commission's Rules and Regulations (*Computer III*), CC Docket No. 85-229, Phase I, *Report and Order*, 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) (*Phase I Further Reconsideration Order*), *second further recon.*, 4 FCC Rcd 5927 (1989) (*Phase I Second Further Reconsideration Order*), *Phase I Order* and *Phase I Reconsideration Order vacated sub nom.* California v. FCC, 905 F.2d 1217 (9th Cir. 1990), *appeal pending sub nom.* Illinois Bell Telephone Co. v. FCC, No. 88-1364 (D.C. Cir. pet. for rev. filed May 16, 1988); Phase II, 2 FCC Rcd 3072 (1987) (*Phase II Order*), *recon.*, 3 FCC Rcd 1150 (1988) (*Phase II Reconsideration Order*), *further recon.*, 4 FCC Rcd 5927 (1989) (*Phase II Further Reconsideration Order*), *Phase II Order vacated sub nom.* California v. FCC, 905 F.2d 1217 (9th Cir. 1990), *appeal pending sub nom.* California v. FCC, No. 88-7183 (9th Cir. pet. for rev. filed May 13, 1988).

[2] California v. FCC, 905 F.2d 1217 (9th Cir. 1990) (*California*). The *Computer III* decisions before the Ninth Circuit were the *Phase I Order*, the *Phase I Reconsideration Order*, and the *Phase II Order*. Amendment of Sections 64.702 of the Commission's

Rules and Regulations, CC Docket No. 85-229, *Phase I Order*, 104 FCC 2d 958 (1986); *Phase I Reconsideration Order*, 2 FCC Rcd 3035 (1987); *Phase II Order*, 2 FCC Rcd 3072 (1987).

[3] We do not consider in this proceeding all the issues raised by the Ninth Circuit's opinion. On August 6, 1990, we issued a *Notice of Proposed Rule Making* that focused on certain *Computer III* decisions that were not addressed in the briefs before the Ninth Circuit, such as the adoption of Open Network Architecture (ONA) requirements and the application of nonstructural safeguards to AT&T's provision of enhanced services. Computer III Remand Proceedings, 5 FCC Rcd 5242 (1990). In a companion order, we today reinstate our ONA requirements established in the *Computer III* and *ONA* proceedings, regardless of whether the Commission ultimately readopts nonstructural, rather than structural, safeguards for the provision of BOC enhanced services. In that order, we also readopt nonstructural safeguards for AT&T's provision of enhanced services and decide a limited number of other *Computer III* issues. Computer III Remand Proceedings, CC Docket No. 90-368, FCC 90-415 (released December 17, 1990).

[4] The Ninth Circuit's vacation of the Commission's *Computer III* decision generally returned the industry to a *Computer II* regime. *See* Bell Operating Companies' Joint Petition for Waiver of Computer II Rules, 5 FCC Rcd 4714 (Com.Car.Bur. 1990) (*Interim Waiver Order*). Upon petition by the BOCs, the Common Carrier Bureau issued a limited interim waiver to allow the BOCs to continue offering enhanced services on an integrated basis pursuant to approved comparably efficient interconnection (CEI) plans. The Bureau invited comment on whether the Commission should extend the waiver until completion of the remand proceedings, and if so, under what conditions. *Id.* at 4715, para. 10.

[5] Amendment of Section 64.702 of the Commission's Rules and Regulations (*Computer II*), 77 FCC 2d 384 (1980) (*Final Decision*), *modified on recon.*, 84 FCC 2d 50 (1981) (*Reconsideration Order*), *modified on further recon.*, 88 FCC 2d 512 (1981) (*Computer II Further Reconsideration Order*), *affirmed sub nom.* Computer and Communications Industry Association v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

[6] *Final Decision*, 77 FCC 2d at 428-430, paras. 114-118.

[7] *Id.* at 463-464, para. 208.

[8] *Id.* at 475-486, paras. 233-260; *Reconsideration Order*, 84 FCC 2d at 75-86, paras. 72-105; 47 C.F.R. § 64.702.

[9] 47 C.F.R. § 64.702.

[10] *Final Decision*, 77 FCC 2d at 487, para. 261.

[11] *Id.* at 479-480, para. 243. This prohibition against software develpment did not preclude the separate subsidiary from obtaining generic software embedded in customer premises equipment (CPE) from the regulated company. *Id.* at 480, para. 244.

[12] *Id.* at 480-481, paras. 247-248.

[13] *Phase I Order*, 104 FCC 2d at 1081, para. 247; 47 C.F.R. § 64.702(d)(2). Other carriers were required to make such disclosure reasonably in advance of implementation. *Id.* at 970, para. 15.

In 1983, the Commission required AT&T to disclose all technical information involving new network services or modifications in network services, as well as information relating to the timing of introduction, pricing, and geographic availability of new network services or capabilities, at the time AT&T provides such information to its separate subsidiary or to others for the benefit of its separate subsidiary. Computer and Business Equipment Manufacturers Association, *Report and Order*, 93 FCC 1226, 1238, para. 37 (1983). Also, the Commission required AT&T to disclose information involving joint research and development by AT&T and its separate subsidiary leading to the design or manufacture of any product affecting the network interface or relying on an interface not yet implemented, as well as information relating to the development of new network services or features at the request of the subsidiary. Such disclosure was required at the "make/buy" point, *i.e.*, at the time when AT&T decides to manufacture the product itself or to procure the product from an unaffiliated company. *Id.* at 1239, 1244-1245, paras. 40, 58, 60.

[14] *Final Decision*, 77 FCC 2d at 481, para. 249; 47 C.F.R. § 64.702(d)(3).

[15] Computer and Communications Association v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983).

[16] 552 F.Supp. 131 (D.D.C. 1982), *affirmed sub nom.* Maryland v. United States, 460 U.S. 1001 (1983).

[17] As part of the AT&T divestiture, the Court divided the BOC service territories into Local Access and Transport Areas that, with certain exceptions, define the geographic scope of toll service provided by the BOCs.

[18] 552 F.Supp. at 227. The Court subsequently authorized BOC provision of certain information transmission and gateway services, but prohibited BOC provision of information content. United States v. Western Electric Co., Inc., 714 F.Supp. 1 (D.D.C. 1988).

[19] 552 F.Supp. at 193, n. 251. For purposes of this *Notice*, the terms enhanced service and information service are used interchangeably. The District Court later required that the BOCs establish separate subsidiaries for the provision of noncommunications services as a condition of MFJ waivers. *See* U.S. v. Western Electric Co., 592 F.Supp. 846, 870-871 (D.D.C. 1984), *appeal dismissed*, 777 F.2d 23 (D.C. Cir. 1985). When Judge Greene modified the line of business restrictions in the first triennial review, the separate subsidiary requirement for the provision of noncommunications services was eliminated. U.S. v. Western Electric Co., 673 F.Supp. 525, 599 (D.D.C. 1987); United States v. Western Electric Co., 714 F.Supp. 1 (D.D.C. 1988), *motions for amendment and clarification denied*, 690 F.Supp. 22 (D.D.C. 1988).

[20] Policy and Rules Concerning the Furnishing of Customer Premises Equipment, Enhanced Services and Cellular Communications Equipment by the Bell Operating Companies, CC Docket No. 83-115, *Report and Order*, 95 FCC 2d 1117, 1120, para. 3 (1984) (*BOC Separation Order*), *affirmed sub nom.* Illinois Bell Telephone Co. v. FCC, 740 F.2d 465 (1984), *affirmed on recon.*, FCC 84-252, 49 Fed. Reg. 26056 (1984) (*BOC Separation Reconsideration Order*), *affirmed sub nom.* North American Telecommunications Association v. FCC, 772 F.2d 1282 (7th Cir. 1985).

[21] *BOC Separation Order*, 95 FCC 2d at 1129-1130, para. 28.

[22] *Id.* at 1140, para. 61.

[23] *See id.* at 1140-1145, para. 62-71.

[24] *BOC Separation Reconsideration Order* at para. 20.

[25] *See* note 1 *supra*.

[26] *Phase I Order*, 104 FCC 2d at 1010-1011, paras. 95-96.

[27] *Id.* at 1011-1092, paras. 98-99, 127-131, 147-166, 171-186, 190-193, 198-200, 210-222, 234-240, 246-255, 260-265.

[28] *See id.* at 1026-1077, paras. 127-131, 147-166, 210-222, 234-240.

[29] *California*, 905 F.2d at 1233, 1238.

[30] *Id.* at 1238.

[31] *See* note 4 *supra*.

[32] *California*, 905 F.2d at 1232.

[33] *Id.* at 1231.

[34] *Id.*

[35] *Id.*

[36] *Phase I Order*, 104 FCC 2d at 1007-1008, paras. 89, 91; *California*, 905 F.2d at 1232.

[37] *California*, 905 F.2d at 1238.

[38] *Id.* at 1236-1237.

[39] *Id.* at 1228, 1237.

[40] *Id.*

[41] *Id.* at 1238.

[42] *Id.* at 1238-1239.

[43] *See* paras. 12, 13 *supra*.

[44] Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities & Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates, CC Docket No. 86-111, 2 FCC Rcd 1298 (1987) (*Joint Cost Order), recon.*, 2 FCC Rcd 6283 (1987) (*Joint Cost Reconsideration Order), further recon.*, 3 FCC Rcd 6701 (1988) (*Joint Cost Further Reconsideration Order), affirmed sub nom.* Southwestern Bell Corporation v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

[45] Several parties appealed portions of the affiliate transaction rules to the United States Court of Appeals for the District of Columbia Circuit. That Court affirmed the Commission's decision. Southwestern Bell Corporation v. FCC, 896 F.2d 1378 (D.C. Cir. 1990).

[46] 47 C.F.R. § 32.27.

[47] Tier 1 companies are those companies having annual revenues from regulated telecommunications operations of $100 million or more. The initial class of a company is determined by its lowest annual operating revenues for the five immediately preceding years. Subsequent changes in classification are made if annual operating revenues shows a greater or lesser classification for five consecutive years. Commission Requests for Cost Support Material to be Filed with January 1, 1991 Access Tariff Revisions, DA 90-1499, para. 3 n. 7 (released October 24, 1990).

[48] *See e.g.*, Nevada Bell's Permanent Cost Allocation Manual and Pacific Bell's Permanent Cost Allocation Manual, 3 FCC Rcd 287, 299 (Com.Car.Bur. 1988). The Commission also rejected several other BOC proposals to allocate the cost of land and buildings, finding that they did not reflect actual usage. *See e.g.*, Southwestern Bell Telephone Company's Permanent Cost Allocation Manual, 3 FCC Rcd 447, 454-455 (Com.Car.Bur. 1988).

[49] The approved cost allocation manuals describe, in considerable detail, the methods each carrier uses to implement the Commission's cost allocation requirements. For example, Pacific's manual describes how it allocates salary and wage expenses between regulated and nonregulated activities. Pursuant to its manual, Pacific uses an analysis of job functions to directly assign or attribute costs to regulated and nonregulated operations whenever possible. It also uses job functions to assign costs to cost pools for allocation between regulated and nonregulated operations. When direct assignment or attribution is not possible, Pacific uses positive time reporting, which requires that employees account for all their time in 15-minute increments, and exception time reporting, which requires that employees occasionally working on nonregulated projects report such activities when the time involved exceeds one hour. In addition, Pacific uses special studies to allocate salary and wage expenses in the case of employees whose functions involve increments of time that are impractical to report. Pacific's manual details the application of each of these methods to Pacific's various employment categories. *See* Pacific Bell's Permanent Cost Allocation Manual, page 2-1, filed December 30, 1988, page 2-2, filed December 29, 1989, page 2-3, filed January 31, 1990, pages 2-5 to 2-9, filed June 29, 1990, pages 2-10 to 2-18, filed December 29, 1990.

[50] *Joint Cost Order*, 2 FCC Rcd at 1304, para. 47.

[51] *See* Responsible Accounting Officer (RAO) Letter 12, DA 88-1060, revised July 7, 1988.

[52] Automated Reporting Requirements for Certain Class A and Tier 1 Telephone Companies (Parts 31, 43, 67, and 69 of the FCC's Rules), 2 FCC Rcd 5770 (1987) (*ARMIS Order), recon.*, 3 FCC Rcd 6375 (1988).

[53] Part 32 contains the Uniform System of Accounts (USOA), which lists over 250 accounts that are used by the carriers to record the costs and revenues of their regulated and nonregulated activities.

[54] Part 64 contains the rules adopted in the *Joint Cost Order* that separate regulated costs from the costs of nonregulated activities.

[55] *See* Annual 1990 Access Tariff Filings, CC Docket No. 90-320, 5 FCC Rcd 4177, 4179-4184, paras. 12-52 (Com.Car.Bur. 1990); Annual 1989 Access Tariff Filings, 4 FCC Rcd 3638, 3646-3647, paras. 81-85 (Com.Car.Bur. 1989), *recon. dismissed*, 4 FCC Rcd 5684 (Com.Car.Bur. 1989); applications for rev. pending; Local Exchange Acess Tariff Rate Levels, 4 FCC Rcd 5533, 5536-5540, paras. 28-64 (1989), Southwestern Bell Telephone Company Revisions to Tariff F.C.C. No. 68, 4 FCC Rcd 7939, 7940-7942, paras. 17-26 (Com.Car.Bur. 1989).

[56] *See* New York Telephone Co. and New England Telephone and Telegraph Co., Apparent Violations of the Commission's Rules and Policies Governing Transactions with Affiliates, *Order to Show Cause and Notice of Apparent Liability for Forfeitures*, 5 FCC Rcd 866 (1990).

[57] *Id.* at 870-871, paras. 31, 33. This $35.5 million represents the interstate portion of the apparently excessive charges imposed on ratepayers from 1984 through 1988. The remainder was assigned to the intrastate jurisdiction through the separations process. *Id.* at 872 n. 2, 873 n. 27.

[58] *Id.* NYT and NET denied any allegations of wrongdoing.

[59] New York Telephone Co. and New England Telephone and Telegraph Co. Apparent Violations of the Commission's Rules and Policies Governing Transactions with Affiliates, 5 FCC Rcd 5892 (1990), *pets. for recon. pending*, filed by Allnet Communication Services, Inc., November 2, 1990, Scott J. Rafferty, November 5, 1990, and New York State Department of Law and New York State Consumer Protection Board, November 5, 1990.

[60] New York Telephone Co., Apparent Violations of the Commission's Rules, *Notice of Apparent Liability for Forfeiture and Order to Show Cause*, FCC 90-384 (released November 9, 1990); New England Telephone and Telegraph Co., Apparent Violations of the Commission's Rules, *Notice of Apparent Liability for Forfeiture and Order to Show Cause*, FCC 90-383 (released November 9, 1990); Pacific Bell, Apparent Violations of the Commission's Rules, *Notice of Apparent Liability for Forfeiture and Order to Show Cause*, FCC 90-385 (released November 9, 1990); Southwestern Bell Telephone Company, Apparent Violations of the Commission's Rules, *Notice of Apparent Liability for Forfeiture and Order to Show Cause*, FCC 90-386 (released November 9, 1990).

[61] We also note that Congress recently authorized significant increases in the FCC's statutory authority to assess forfeitures. Pub. L. No. 101-239, 103 Stat. 2131 (1989). The Commission can now assess forfeitures for accounting rule violations under sec-

tion 220(d) of the Communications Act of up to $6,000 per day of the continuance of each such violation, with no cap. Forfeitures against common carriers under section 503(b)(2)(B) of the Act can be assessed for as much as $100,000 per violation with no cap, or $100,000 per day in the case of continuous violations subject to a cap of $1 million. Previously, the Commission's forfeiture authority under section 220(d) was limited to $500 per day with no cap, and its forfeiture authority regarding common carriers under section 503(b)(2)(A) was limited to $2000 per violation, or per day of a continuous violation, with a cap of $20,000 for a single Notice of Apparent Liability. The 1989 legislation also increased the Commission's forfeiture authority respecting common carriers under sections 202(c), 203(e), 205(b), 214(d), and 219(b) of the Communication's Act.

[62] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, FCC 90-314, at paras. 200, 213 (released October 4, 1990), *pets. for recon. pending*, filed November 19, 1990.

[63] To a limited extent, there may be some incentive under price cap regulation for a LEC whose earnings might be approaching the sharing mark to attempt to shift costs to the regulated side of its operations.

[64] The *Joint Cost Order* applied our most detailed cost accounting safeguards to all Tier 1 LECs, and not just to the BOCs. *Joint Cost Order*, 2 FCC Rcd at 1300, 1304-1305, paras. 4, 47-49.

[65] Because the Commission had preemptively deregulated enhanced services in *Computer III*, these services were classified as nonregulated for accounting and cost allocation purposes pursuant to the *Joint Cost Order* and the Commission's rules. *See* Section 32.23 (a) of the Commission's Rules, 47 C.F.R. § 32.23 (a). After the *California* decision, the Chief, Accounting and Audits Division directed the carriers to continue to account for enhanced services as nonregulated on an interim basis pending a Commission decision on permanent accounting treatment. Responsible Accounting Officer (RAO) Letter 16, DA 90-1408 (released October 18, 1990), *applications for rev. pending*, People of the State of California and the Public Utilities Commission of the State of California, filed November 16, 1990, Public Service Commission of the District of Columbia, filed November 19, 1990.

[66] Detariffing the Installation and Maintenance of Inside Wiring, *Second Further Notice of Proposed Rule Making*, CC Docket No. 79-105, 5 FCC Rcd 3407, 3409-3410 (1990). *See also Joint Cost Order*, 2 FCC Rcd at 1308-1309, para. 79.

[67] The Accounting and Audits Division of the Common Carrier Bureau has already implemented a similar requirement on a one-time basis for purposes of the 1990 independent audits. The 1988 and the 1989 independent audits involved a lesser standard. *See* note 51 *supra*.

[68] Given the differences in the carriers' operations and in their various nonregulated activities, we expect that certain differences in the manuals will remain.

[69] In general, the lower the threshold for materiality of errors and omissions, the closer and more costly the scrutiny required for the auditors to make the necessary certification.

[70] *See* paras. 12, 13 *supra*.

[71] We did not mandate exact technical equality so long as any technical variations were no greater than those for the basic services used by the BOCs. We did, however, reject proposals for interconnection that afforded only "rough comparability." *See Phase I Order*, 104 FCC 2d at 1036 n. 210, 1037, para. 150.

[72] *Id.* at 1036, para. 147.

[73] *Id.* at 1054-1055, para. 190. The Commission has approved 21 CEI plans and four market trial waivers. *Interim Waiver Order*, 5 FCC Rcd at 4715, para. 8.

[74] Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2 Phase I, 5 FCC Rcd 3084 (1990) (*BOC ONA Reconsideration Order), pets. for rev. pending*, filed by Pacific Bell and Nevada Bell, BellSouth, NYNEX, U S West, and Southwestern Bell Telephone Company on August 6, 1990. In a companion order adopted today, we reinstitute our prior ONA requirements. *See* note 3 *supra*.

[75] *See Phase II Order*, 2 FCC Rcd at 3082, 3084, paras. 73, 89. In the *BOC ONA Order* and the *BOC ONA Amended Plans Order*, the Commission found that the BOCs had shown that their mechanized procedures and systems precluded quality-based discrimination. Accordingly, the Commission removed the quality reporting requirement for all the BOCs and, instead, required that the BOCs file annual affidavits attesting that they have not discriminated in the quality of services provided to ESP competitors. Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase I, 4 FCC Rcd 1, 248-249, para. 481 (*BOC ONA Order)*; 5 FCC Rcd 3103, 3120, para. 145 (*BOC ONA Amended Plans Order). See also Phase II Reconsideration Order*, 3 FCC Rcd at 1160, paras. 76-77.

[76] *Phase II Order*, 2 FCC Rcd at 3093-3098, paras. 141-176.

[77] *California*, 905 F.2d at 1238.

[78] *Id.*

[79] Issues related to ONA and nonstructural safeguards for AT&T are addressed in a separate order adopted today unless otherwise indicated herein. *See* note 3 *supra*.

[80] *See Phase I Order*, 104 FCC 2d at 1076-1077, paras. 238-240; *Phase II Order*, 2 FCC Rcd at 3098-3099, paras. 177-186.

[81] The BOCs are permitted to provide certain enhanced services on an integrated basis pursuant to the interim waiver granted by the Bureau and extended here until the end of this proceeding. *See* para. 56 *infra*. That waiver conditions provision of these services on compliance with the *Computer III* CPNI rule.

[82] *Phase II Order*, 2 FCC Rcd at 3095, paras. 154-155. Multiline business customers annually receive notification of their CPNI rights. *Id.* at 3096, paras. 165-165.

[83] *BOC ONA Reconsideration Order*, 5 FCC Rcd at 3094, para. 83.

[84] As a consequence, we eliminate the requirement that the BOCs amend their ONA plans on April 15, 1991, to address competitive equity and informed customer choice issues in implementing the current CPNI requirements. *BOC ONA Amended Plans Order*, 5 FCC Rcd at 3121 (1990). We will incorporate our consideration of those issues within the review of the CPNI safeguard in this proceeding.

[85] *Computer II Further Reconsideration Order*, 88 FCC 2d at 541, para. 83 n. 34.

[86] *Id.* at 541-542, para. 85.

[87] *Phase I Order*, 104 FCC 2d at 1125, para. 343.

[88] *BOC Separation Order*, 95 FCC 2d at 1131, paras. 34-35.

[89] *Phase I Reconsideration Order*, 2 FCC Rcd at 3062, para. 188.

[90] *Phase I Order*, 104 FCC 2d at 1127-1128, paras. 347-348.

[91] *Phase II Order*, 2 FCC Rcd at 3102, para. 210.

[92] *California*, 905 F.2d at 1244.

[93] *Id.*

[94] *Id.*

[95] *Id.* at 1245.

[96] *Id.* The *California* Court also found fault with our preemption of state tariff regulation of intrastate enhanced services provided by communications common carriers. *See California*, 905 F.2d at 1239-1243, 1246. We do not consider that issue in this *Notice*.

[97] Computer III Remand Proceedings, CC Docket No. 90-368, FCC 90-415 (released December 17, 1990).

[98] *California,* 905 F.2d at 1243, quoting NARUC v. FCC, 880 F.2d 422, 430 (D.C. Cir. 1989). *See also* Lousiana Public Service Commission v. FCC, 476 U.S. 355, 375 n. 4 (1986); North Carolina Utilities Commission v. FCC, 537 F.2d 787, 791 (4th Cir. 1976), *cert. denied,* 429 U.S. 1027 (1976); North Carolina Utilities Commission v. FCC, 552 F.2d 1036 (4th Cir. 1977), *cert. denied,* 434 U.S. 874 (1977); *Atlantic Richfield Co.,* 3 FCC Rcd 3089 (1988), *affirmed sub nom.* Public Utility Commission of Texas v. FCC, 886 F.2d 1325 (D.C. Cir. 1989).

[99] Section 1 of the Communications Act, 47 U.S.C. § 151.

[100] *Final Decision,* 77 FCC 2d at 432, paras. 124-126; *Reconsideration Order,* 84 FCC 2d at 91-96, paras. 120-133.

[101] Section 3(a) of the Act gives the Commission jurisdiction over interstate communications "between the points of origin and reception." 47 U.S.C. § 153(a). "[J]urisdiction over interstate communications does not end at the local switchboard, it continues to the transmission's ultimate destination." *Southern Pacific Communications,* 61 FCC 2d 144, 146 (1976). "The key to jurisdiction is the nature of the communication itself rather than the physical location of the technology." New York Telephone Company v. FCC, 631 F.2d 1059, 1066 (2d Cir. 1980). *See also* United States v. AT&T, 57 F.Supp. 451, 454 (S.D.N.Y. 1944), *affirmed sub nom.* Hotel Astor v. United States, 325 U.S. 837 (1945); Puerto Rico Telephone Company v. FCC, 553 F.2d 694, 699 (1st Cir. 1977); MCI Communications Corp. v. AT&T, 369 F. Supp 1004, 1029 (E.D. Pa. 1973).

[102] *See California,* 905 F.2d at 1244.

[103] ITCs were never subject to the *Computer III* network disclosure rules. All carriers, however, are subject to the network disclosure requirements of Section 68.110(a) and (b), or the Commission's Rules. 47 C.F.R. § 68.110(a) and (b). We do not address in this *Notice* preemption based on possible conflicts with the requirements of those rule sections.

[104] A carrier may introduce a new or modified service between six and twelve months after the make/buy point if it makes public disclosure at the make/buy point.

[105] This proposed preemption applies to state requirements for disclosure of the information encompassed within the federal network disclosure rules. If necessary, the Commission will address state requirements for disclosure of information different from that covered by the federal rule in the context of particular state actions.

[106] In *Computer III* the Commission did not apply, and we are not in this proceeding proposing to apply, CPNI restrictions to the integrated provision of interstate basic and enhanced services by the ITCs.

[107] *See Phase II Reconsideration Order,* 3 FCC Rcd at 1159-1160, paras. 66-71, 76-77; Filing and Review of Open Network Architecture Plans, CC Docket No. 88-2, Phase II, 4 FCC Rcd 2449, 2456-2457, paras. 56-62; *see also* note 75 *supra.*

[108] BOC Joint Contingency Petition for Interim Waiver of the Computer II Rules, filed July 3, 1990.

[109] *Interim Waiver Order,* 5 FCC Rcd at 4715, para. 10. In the *Interim Waiver Order,* the Bureau referred to both CEI plans and CEI waivers as CEI plans. We adopt that usage in this Order as well. *Id.* at 4716 n. 9.

[110] *Id.* at 4715, para. 10.

[111] As listed in Appendix B, thirteen parties filed comments and fifteen parties filed reply comments in this proceeding.

[112] Ameritech Comments at 3; Bell Atlantic Comments at 1; BellSouth Comments at 3-4; NYNEX Comments at 2-3; SWBT Comments at 4; U S West Comments at 1; USTA Comments at 1-2; Ameritech Reply at 2; and Boston Reply at 3-4.

[113] *See also* Letter from the Florida Messaging Coalition which opposes extending the waiver during the pendency of the remand proceeding.

[114] MCI Comments at 8-9; ATSI Comments at 5.

[115] MCI Comments at 13-16; MCI Reply at 2-8.

[116] ATSI Comments at 1, 4-13; MCI Comments at 24-49; Mid-Atlantic Comments at 1-3; and MCI Reply at 9-12.

[117] Bell Atlantic Comments at 4; SWBT Comments at 6; U S West Comments at 3-5; Ameritech Reply at 2; Bell Atlantic Reply at 3; BellSouth Reply at 13-14; NYNEX Reply at 4-5; and SWBT Reply at 5-6.

[118] *See* SWBT Comments at 7; U S West Comments at 3-5; and BellSouth Reply at 13-14.

[119] Bell Atlantic Comments at 4; BellSouth Comments at 4; Bell Atlantic Reply at 3; BellSouth Reply at 15-16; Boston Reply at 5; and SWBT Reply at 6.

[120] *See* Bell Atlantic Comments at 4; NYNEX Comments at 3; SWBT Comments at 4, 6; U S West Comments at 3-5; Ameritech Reply at 3-4; Bell Atlantic Reply at 3; BellSouth Reply at 15; Pacific Reply at 13-14; and SWBT Reply at 5, 9.

[121] Ameritech Comments at 3; U S West Comments at 5; Ameritech Reply at 2; BellSouth Reply at 15; Boston Reply at 3; NYNEX Reply at 5; Pacific Reply at 13-14, n. 38; and SWBT Reply at 5-6.

[122] *See* Bell Atlantic Comments at 5-6; BellSouth Comments at 5-6; SWBT Comments at 6; U S West Comments at 5; NYNEX Reply at 5-6, 9-11; and Pacific Reply at 10-12. The Bureau's Accounting and Audits Division has applied strengthened requirements to the BOCs' 1990 independent audits.

[123] To the extent that ATSI, MCI and Mid Atlantic wish to raise issues regarding the efficacy of our nonstructural and cost accounting safeguards for purposes of the choice of permanent safeguards rather than a limited, interim waiver, they will have another opportunity to file comments in this proceeding.

[124] The Courts have also stated that an interim measure following vacation should include sufficient provisions to safeguard against concerns identified by the Court on an interim basis, but should also avoid industry disruption. *See* Mid-Tex Electric Cooperative Inc., v. Federal Energy Regulatory Commission, 822 F.2d 1123 (D.C.Cir. 1987); American Gas Association v. Federal Energy Regulatory Commission, 888 F.2d 136 (D.C.Cir. 1989).

[125] Bell Atlantic Comments at 6-8; BellSouth Comments at 7-8; NYNEX Comments at 3-7; SWBT Comments at 8-11; USTA Comments at 2-4; Ameritech Reply at 7-9; BellSouth Reply at 17-23; Boston Reply at 6; and Pacific Reply at 18-22.

[126] U S West Comments at 10, n. 20.

[127] BellSouth Comments at 7 n. 7; U S West Comments at 10.

[128] U S West Comments at 11; Ameritech Reply at 9-10; BellSouth Reply at 20-21.

[129] U S West Comments at 7-8 n. 19; BellSouth Reply at 7, 21.

[130] ANPA Comments at 1, 3; CompuServe Comments at 1, 6-9; DC PSC Comments at 2-3; CompuServe Reply at 1-2; and DC PSC Reply at 2-3.

[131] *See* CompuServe Reply at 6-7; DC PSC Reply at 3; and MCI Reply at 12-14.

[132] *See* note 44 *supra*.

[133] *See* U S West Comments at 8-10.

[134] *See* U S West Comments at 10 n. 20.

[135] *See* CompuServe Reply at 7-8; MCI Reply at 15, n. 45. Of course, we understand that we cannot foreclose entirely the possibility that a BOC may justify a waiver of the *Computer II* requirement of structural separation on the basis of a public interest showing. *See* WAIT Radio v. FCC, 418 F.2d 1153 (D.C.Cir. 1969). We note, however, that any application for such a waiver faces a "high hurdle even at the starting gate," and that a petitioner "must plead with particularity the facts and circumstances which warrant such action." *Id.* at 1157 (quoting in part Rio Grande Family Radio Fellowship, Inc. v. FCC, 406 F.2d 664 (D.C.Cir. 1968)).

[136] *See* para. 37 *supra*.

[137] *See* U S West Comments at 7-8, n. 19; BellSouth Reply at 20-21.

[138] *See* para. 37 *supra*.

[139] U S West Comments at 11-12.

[140] By granting this waiver, we do not attempt or intend to prevent any state from regulating the provision of wholly intrastate enhanced services by the BOCs. *See* California Comments. We do require, however, that the BOCs inform us of any specific state regulatory proposals or actions in this area. This waiver does not alter BOC obligations to comply with the restrictions set forth in the MFJ.

[141] 5 U.S.C. §§ 601-612. The BOCs and AT&T are dominant carriers under the Commission's Rules and are not small entities as defined by the Regulatory Flexibility Act. We have also concluded that small telephone companies are dominant in their fields of operation and therefore are not small entities as defined by the Regulatory Flexibility Act. Thus, the parties directly subject to the proposals, do not fall within the Act's definition of a small entity. *Id.* § 601. *See* Third Report and Order, MTS And WATS Market Structure, CC Docket No. 78-72, Phase I, 93 FCC 2d 241, 338-339, paras. 358-362 (1983). Accordingly, this Commission is not required to apply the formal procedures set forth in the Regulatory Flexibility Act. We are nevertheless committed to reducing the regulatory burdens on small telephone companies whenever possible consistent with our other public interest responsibilities.

[142] This action is taken pursuant to Sections 1, 4(i), 4 (j), 201-205, 218, 220, and 403 of the Communications Act as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-205, 218, 220, and 403.

CONCURRING STATEMENT OF COMMISSIONER ERVIN S. DUGGAN

In Re: Computer III Remand Proceedings: Bell Operating Company Safeguards; and Tier 1 Local Exchange Company Safeguards

Coming into the debate on current common carrier issues like price caps, open network architecture and nonstructural safeguards has been, for me, something like climbing aboard a rapidly moving train.

I have no particular desire to stop the train. I have no illusions about my my ability to do so, even if that were my desire. I do think, however, that there may be some value in asking some serious questions as we hurtle forward: questions designed not to disrupt the trip, but rather to help us arrive, as safely and sensibly as possible, at the destination we desire.

I endorse this action to open a Rule Making to resolve an important question: What safeguards should we put in place to govern enhanced services provided by the Bell Operating Companies? I endorse our effort to resolve, as quickly as we can, the uncertainties created by the Ninth Circuit's decision vacating our *Computer III* orders. And certainly I want to do everything possible to hasten the day that enhanced services are widely available at fair, competitive prices.

I fear, however, that in our eagerness to bring about these worthwhile results, we may allow our enthusiasm to overwhelm our caution; that we may overstate our confidence about the safeguards in which we place our hope. The dangers of letting zeal rather than experience guide us--- of placing too much confidence, for example, in accounting safeguards that are new and relatively untested--- are twofold. First, we risk weakening, by overstatement, the very arguments on which we build our case. Second, we risk--- if we are guided by hope and credulity rather than cool prudence and hard experience--an even worse fate: to have been wrong, and to watch the enhanced services market and the public suffer the consequences.

I choose, therefore, to concur in the action that the Commission takes today--- not because I have any doubt that our goals are worthwhile, but because I wish to underscore some questions that need to be faced as we pursue those goals.

THE JOINT COST ALLOCATION RULES

Our joint cost rules are, as this item argues, now in place, and the carriers' cost allocation manuals have been generally approved. These rules, we hope, will greatly improve our ability to require carriers to separate the costs of providing nonregulated services from those of regulated services. Our affiliate transaction rules also should help prevent manipulation of prices for transactions between regulated and nonregulated affiliates. The Commission, moreover, has made clear its seriousness about compliance with its rules by its actions in recent enforcement proceedings.

Are these straws in the wind enough, given the vast magnitude of what we must audit--- billions in revenues and thousands of accounting transactions--- and given the reality of our severely limited auditing resources? The very size of the task could threaten the efficacy of our cost

allocation rules. Even under those rules, moreover, there is room for carrier discretion in allocating costs--- room, therefore, for some cost shifting. Requiring greater uniformity among manuals, as we propose in this notice today, will help. But under the Commission's proposal, the joint cost allocation process is our primary safeguard against cross subsidization. Is this membrane strong enough to bear the weight that is soon to press against it?

PRICE CAP REGULATION

Price cap regulation for the Bell Operating Companies will indeed change the incentives these companies face. Our hope and belief is that price caps will reduce carriers' incentives to shift nonregulated costs to regulated operations, because carriers will no longer be able to obtain an automatic rate increase to cover the shifted costs. But price caps are unlikely, in my judgment, to remove totally the threat of cost-shifting. For example, even under price caps a carrier might have the incentive to shift unregulated costs to regulated operations, because by doing so it could reduce its obligation to share with ratepayers any earnings above the no-sharing zone. Or, if we set our productivity factor too low, a company operating under price caps could use its extra earnings to subsidize its enhanced services operations.

IMPLEMENTATION OF ONA

Open Network Architecture, like price caps, holds out great hope. But hope and confidence are not precisely the same thing. ONA is still more a concept than a reality. It is, to be sure, the regulatory equivalent of the Modified Final Judgment's equal access requirement, which has been crucial in promoting competition in the interexchange market. Will ONA perform the same function for the enhanced services market--- preventing BOC control over bottleneck facilities from giving the BOCs an unfair competitive advantage? I hope so; I hope that ONA will prove as successful as the MFJ's equal access requirement. But it seems to me that the absence of a genuine track record on ONA calls for greater modesty and diffidence on the Commission's part at this stage. Hope is surely warranted; certainty can be gained only with experience.

Isn't it possible, for example, that the pricing flexibility afforded to the BOCs under price caps will threaten to subvert the effectiveness of ONA as a safeguard against discrimination? Although ONA services, at least for now, are outside the price cap scheme, cost-based pricing for ONA services may be difficult to achieve once we have moved away from cost-based tariff review of the other basic services that are subject to price caps. Will it still be possible, after price caps, for the Commission to deter and detect discrimination in the prices that BOCs charge for ONA services that competing providers of enhanced services depend upon? We simply don't know--- and in the absence of greater knowledge, claiming too much certainty will weaken, rather than strengthen, our argument for moving irretrievably away from all structural separation.

ALTERNATE APPROACHES?

Despite our uncertainty about these questions, the notice we adopt today treats the issue with confidence bordering upon insouciance, and poses a stark, either/or choice: nonstructural safeguards versus *Computer II* -type structural separation. Perhaps there is no realistic middle ground between these two polar options. But elementary prudence, and an eagerness to be guided by experience rather than hope, suggest to me that the Commission should be calling for comment on alternate approaches, such as stricter nonstructural safeguards or modified forms of structural separation. Isn't it also conceivable that structural separation might be appropriate in some cases, though not all? The practical difficulties of deciding between such cases would, no doubt, be great. We need to be open to the possibility, nevertheless, that while the benefits of integration may be great for services such as protocol processing or perhaps voice messaging, structural separation might be appropriate in other situations.

MERGERS AND ACQUISITIONS

Whether or not we conclude that substituting nonstructural safeguards for structural separation is in the public interest, we may be faced with a somewhat different question if the BOCs begin to acquire large enhanced services competitors on the same scale that they have acquired out-of-region cellular telephone companies.[1] Would the benefits of integration still outweigh the risks to ratepayers and competitors in the enhanced services market? I would like to see comments on this question, and on whether the Commission should develop standards for reviewing such acquisitions.

AN OPEN MIND

Even as I raise these questions, I want to emphasize that I am fully prepared to approve substituting nonstructural for structural safeguards if the record demonstrates that the benefits of integration (which are undoubtedly substantial) do indeed outweigh the risks of lifting structural separation. I hope that the record developed in this proceeding will present convincing evidence on the efficiencies of joint operations. I would find particularly persuasive any evidence that particular services will be withheld unless the BOCs are allowed to offer them on an integrated basis. Evidence that services can be more efficiently provided through physical integration of network facilities--- for example, through switch software modifications--- will also carry weight.

My goal in this proceeding is that the Commission conduct its balancing of costs and benefits with its eyes open, not filled with stars. Potential safeguards, after all, do not necessarily constitute real safeguards; mere hopes of public benefits do not necessarily constitute actual benefits. As the possibility of widespread BOC participation in the enhanced services industry increases, it is crucial that our safeguards be effective--- both in permitting BOC entry and in guarding against anticompetitive activity.

FOOTNOTE FOR STATEMENT

[1] I assume the near-term removal or further relaxation of the information services restriction contained in the MFJ.