all location where the requirements of this AD can be accomplished.

Issued in Renton, Washington, on July 25, 1996.

Darrel M. Pederson,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 96–19524 Filed 7–31–96; 8:45 am]

BILLING CODE 4910–13–M

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Part 59

[AD–FRL–5545–4]

Notice of Meeting for the Proposed National Volatile Organic Compounds Emission Standards for Architectural Coatings

AGENCY: U.S. Environmental Protection Agency (EPA).

ACTION: Notice of meeting.

SUMMARY: The EPA is holding a public meeting to discuss the proposed national volatile organic compounds emission standards for architectural coatings. This meeting is being conducted to provide an opportunity for the EPA to continue dialogue with the architectural coatings industry and obtain additional input on the potential impacts of the proposed rule. The intent is to discuss the proposed rule with particular emphasis on the potential economic and technological impacts to small businesses.

DATES: A public meeting will be held on August 13, 1996, beginning at 10:00 a.m.

ADDRESSES: The public meeting will be held at the Westin Hotel O'Hare, 6100 N. River Road, Rosemont, IL.

FOR FURTHER INFORMATION CONTACT: Ms. Ellen Ducey, Coatings and Consumer Products Group (MD–13), U.S. Environmental Protection Agency, Research Triangle Park, North Carolina 27711, phone number (919) 541–5408.

SUPPLEMENTARY INFORMATION: On June 25, 1996, the EPA proposed the national volatile organic compounds emission standards for architectural coatings and a notice of public hearing for that proposed rule (61 FR 32729). The EPA would like to provide a further opportunity to engage in dialogue with architectural coating manufacturers, particularly with regard to economic and technological impacts of the proposed rule on small manufacturers. Therefore, the EPA is holding a public meeting to discuss the proposed national volatile organic compounds emission standards for architectural coatings and answer any questions concerning the proposed rule.

Docket. Docket No. A–92–18, containing supporting information for the proposed national volatile organic compounds emission standards for architectural coatings, is available for public inspection and copying between 8:00 a.m. and 4:00 p.m., Monday through Friday, except for Federal holidays, at the following address: U.S. Environmental Protection Agency, Air and Radiation Docket and Information Center (6102), 401 M Street SW, Washington, DC 20460; telephone: (202) 260–7548. The docket is located at the above address in Room M–1500, Waterside Mall (ground floor). A reasonable fee may be charged for copying. A copy of the proposed rule and the Background Information Document (BID) is also available on the *Technology Transfer Network* (TTN). The TTN is one of the EPA's electronic bulletin boards and provides information and technology exchange in various areas of air pollution control. The service is free except for the cost of a phone call. Dial (919) 541–5472 for up to a 14,400 bits-per-second (bps) modem. The TTN is also accessible through the Internet at ''Telnet ttnbbs.rtpnc.epa.gov.'' If more information on the TTN is needed, call the help desk at (919) 541–5384. The help desk is staffed from 11:00 a.m. to 5:00 p.m., Eastern time. The help desk utilizes a voice menu system at other times.

Dated: July 25, 1996.

John S. Seitz,

Director, Office Air Quality Planning and Standards, Office of Air and Radiation.

[FR Doc. 96–19421 Filed 7–31–96; 8:45 am]

BILLING CODE 6560–50–M

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Parts 32 and 64

[CC Docket No. 96–150, FCC 96–309]

Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996

AGENCY: Federal Communications Commission.

ACTION: Proposed rule.

SUMMARY: The Commission is issuing this Notice of Proposed Rulemaking which seeks comment on proposed measures to satisfy the accounting safeguards requirements, including those for affiliate transactions, of Sections 260 and 271 through 276 of the Telecommunications Act of 1996 (''1996 Act''). These sections outline the conditions under which incumbent local exchange carriers may offer telemessaging and alarm monitoring services and under which the Bell Operating Companies (''BOCs'') may manufacture and sell telecommunications equipment, manufacture customer premises equipment, offer interLATA telecommunications, information, electronic publishing and payphone services. Sections 271 through 274 and 276 of the 1996 Act generally prohibit the BOCs from subsidizing services permitted under those sections with revenues from regulated telecommunications services. Sections 260 and 275 generally prohibit incumbent local exchange carriers, including the BOCs, from subsidizing their telemessaging and alarm monitoring services with revenues from regulated telecommunications services. This action was intended to implement the accounting safeguards provision of the 1996 Act.

DATES: Comments are due on or before August 26, 1996 and Reply Comments are due on or before September 10, 1996. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed and/or modified information collections on or before September 30, 1996.

ADDRESSES: Comments and Reply Comments should be sent to Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W., Room 222, Washington, D.C. 20554, with a copy to Ernestine Creech of the Common Carrier Bureau's Accounting and Audits Division, 2000 L Street, N.W., Suite 257, Washington, D.C. 20554. Parties should also file one copy of any documents filed in this docket with the Commission's copy contractor, International Transcription Services, Inc., 2100 M Street, N.W., Suite 140, Washington, D.C. 20037. In addition to filing comments with the Secretary, a copy of any comments on the information collections contained herein should be submitted to Dorothy Conway, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, D.C. 20554, or via the Internet to dconway@fcc.gov, and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725–17th Street, N.W., Washington, D.C. 20503 or via the Internet to fain__t@al.eop.gov.

FOR FURTHER INFORMATION CONTACT: John V. Giusti, Attorney, Common Carrier Bureau, Accounting and Audits Division, (202) 418–0850, or Mark B.

Ehrlich, Attorney, Common Carrier Bureau, Accounting and Audits Division, (202) 418–0850. For additional information concerning the information collections contained in this NPRM contact Dorothy Conway at 202–418–0217, or via the Internet at dconway@fcc.gov.

SUPPLEMENTARY INFORMATION: This is a summary of the Commission's Notice of Proposed Rulemaking adopted July 17, 1996 and released July 18, 1996, 1996 (FCC 96–309). This NPRM contains proposed or modified information collections subject to the Paperwork Reduction Act of 1995 (PRA). It has been submitted to the Office of Management and Budget (OMB) for review under the PRA. OMB, the general public, and other Federal agencies are invited to comment on the proposed or modified information collections contained in this proceeding. The full text of this Notice of Proposed Rulemaking is available for inspection and copying during normal business hours in the FCC Reference Center (Room 239), 1919 M St., NW., Washington, D.C. The complete text also may be purchased from the Commission's copy contractor, International Transcription Service, Inc., (202) 857–3800, 2100 M St., NW., Suite 140, Washington D.C. 20037.

Paperwork Reduction Act

This NPRM contains either a proposed or modified information collection. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collections contained in this NPRM, as required by the Paperwork Reduction Act of 1995, Public Law No. 104–13. Public and agency comments are due at the same time as other comments on this NPRM; OMB notification of action is due September 30, 1996. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

OMB Approval Number: None.

Title: Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996.

Form No.: N/A.

Type of Review: New collection.

Information collection	No. of respondents (approx.)	Estimated time per response (hours/hour)	Total annual burden (hours)
Affiliate Company Books, Records and Accounts	20	6,056.25	121,125
Biennial Federal/State Audit	20	250.00	5,000
Filing Written Contract	[1] 7	1.00	7
Compliance Audit	[1] 7	250.00	1,750
Report of Exceptions	[1] 7	80.00	560
10–K Requirement	[1] 7	1,711.00	11,977

[1] BOCS.

Total Annual Burden: 140,419 hours.

Respondents: Bell Operating Companies and/or incumbent local exchange carriers and/or affiliated companies.

Estimated cost per respondent: $632,500. This cost represents the total annual/startup costs associated with the annual and biennial audits and does not include the burden hour cost of the information collection. Of the $632,500, $316,250 represents our estimate of the biennial Federal/State audit. By definition, this cost will only be incurred once every two years. The total cost also includes a cost of $316,250 which represents our estimate of the annual compliance audit requirement. The $316,250 figure was derived by averaging the range of audit costs ($32,500—$600,000). We expect the actual cost of the audits to vary considerably.

Needs and Uses: The NPRM seeks comments on a number of issues, the resolution of which may lead to the imposition of information collections subject to the Paperwork Reduction Act. the NPRM seeks comment on certain reporting requirements to implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the 1996 Act.

SYNOPSIS OF NOTICE OF PROPOSED RULEMAKING

I. Introduction

1. In February 1996, Congress passed and the President signed the ''Telecommunications Act of 1996.'' This legislation makes sweeping changes affecting all consumers and telecommunications service providers. The intent of this legislation is ''to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition.''

2. In this Notice of Proposed Rulemaking (''NPRM''), we consider rules to implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the 1996 Act. Those sections address Bell Operating Company (''BOC'') and, in some cases, incumbent local exchange carrier provision of particular telecommunications and information services.

3. This proceeding is one of a series of interrelated rulemakings that collectively will implement the 1996 Act. Certain of these proceedings focus on opening markets to entry by new competitors. Other proceedings will establish rules for fair competition in the markets that are opened to competitive entry by the 1996 Act.

4. This NPRM focuses on the accounting safeguards that Congress adopted in the 1996 Act to foster the development of robust competition in all telecommunications markets. As discussed more fully below, these safeguards are intended both to protect subscribers to regulated monopoly services provided by the BOCs and, in some cases, other incumbent local exchange carriers against the risk of being forced to ''foot the bill'' for the carriers' entry into, or continued participation in, competitive services, and to promote competition in new markets by preventing carriers from using their existing market power in

local exchange services to obtain an anticompetive advantage in those new markets the carriers seek to enter.

A. Background

5. the 1996 Act permits the BOCs to engage in previously proscribed activities if the BOCs satisfy certain conditions that are intended to prevent them from misallocating costs of their new ventures to subscribers to local exchange access services and from discriminating against their competitors in these new markets. Other incumbent local exchange carriers are subject to similar conditions if they elect to enter or continue to participate in certain markets.

6. In lifting or modifying the restrictions on the BOCs, we believe Congress also recognized that BOC entry into in-region interLATA services, manufacturing and other areas raises serious concerns for consumers and competition, even after a BOC has satisfied the requirements for entry. BOCs currently possess market share for local exchange and exchange access in areas where they provide such services of approximately 99.5 percent as measured by revenues. Other incumbent local exchange carriers have similar market shares within their local exchange and exchange access service areas. Under rate-of-return regulation, price caps with sharing (either for interstate or intrastate services), or price caps that may be adjusted in the future, or if its entitlement to any revenues may be affected by the costs that it classifies as regulated, an incumbent local exchange carrier may have an incentive to misallocate to its regulated core business costs that would be properly allocated to its competitive ventures. While the 1996 Act promotes competition and encourages BOC entry, it also prescribes a judicious mix of structural and non-structural safeguards that are intended to protect ratepayers, consumers and competitors against potential cost misallocation and discrimination. Where BOCs already participate in a market, as with alarm monitoring services and payphone services, or where the Act addresses services other incumbent local exchange carriers may provide, the Act requires compliance with similar safeguards. The purpose of this proceeding is to establish accounting safeguards to constrain potential cost misallocation and discrimination against competitors.

7. Although we could prescribe rules that would completely prevent improper cost allocations by enforcing complete separation between regulated telecommunications operations and new activities, we recognize that it would be difficult, if not impossible, to enforce such rules. Moreover, our success might destroy the potential competitive benefits of the economies of scope that BOCs and other incumbent local exchange carriers could realize, benefits that constitute a major incentive for the BOCs and other incumbent local exchange carriers to enter or continue to participate in these markets. Our task in this proceeding is to protect against improper cost allocations, while allowing the BOCs and other incumbent local exchange carriers to realize their reasonable competitive advantages and ensuring that the consumers of those carriers' regulated telecommunications services are able to share in the carriers' economies of scope.

8. We expect that once competition exists in the local exchange and exchange access services markets and incumbent local exchange carrier revenues are not dependent on costs, the need for the accounting safeguards proposed in this NPRM may vanish. With the advent of competition, we can and will act to eliminate any unnecessary rules. With our adoption of the *Notice of Proposed Rulemaking* to implement Section 251, 61 FR 18311 (April 25, 1996), we have taken a major step to achieve that goal. Reform of other regulations, like price cap rules, jurisdictional separations rules, and the access charge regime, will also move us more quickly toward that goal. In the meantime, while we continue to seek to minimize the burden our rules impose those subject to them, we also will ensure that ratepayers and competition remain protected from cost misallocation and anticompetitive discrimination.

B. Specific Considerations

9. The challenge in setting cost allocation rules that prevent subsidization without eliminating legitimate economies of scope arises because there are some costs that cannot be allocated based on economic cost-causation principles. The greater the economies of scope between or among services, the greater the share of costs that cannot be allocated among them on economic cost-causation principles. Given these circumstances, we believe that the rules we develop for allocating these costs should be clear, consistent, and predictable. They should also assure that subscribers to the BOCs' and other incumbent local exchange carriers' core services share in any economies of scope realized when entering those markets from which they were previously barred or continuing to participate in other markets addressed in the 1996 Act. We believe, for example, that a policy that would permit the BOCs to allocate all common costs of shared facilities to regulated services would pose a risk that subscribers to the BOCs' regulated telecommunications services would pay more than the stand-alone costs of the services they receive, and would thus be subsidizing the BOCs' competitive activities rather than sharing the economies of scope realized because of the BOCs' diversification.

10. It is also essential that the affiliate transactions rules discourage, and facilitate detection of, cost misallocations. Statutory structural separation requirements, like the prohibition on sharing employees or the obligation that all affiliate transactions be ''on an arm's length basis,'' reduce the risk that cost misallocations will accompany BOC entry into manufacturing and interLATA service markets. This protection of ratepayer interests, however, is not cost free. Structural separation restrictions that protect ratepayers also make it more difficult for a BOC or other incumbent local exchange carrier to capture the economies of scope that benefit both regulated and nonregulated service subscribers. Only our success in removing barriers to competition in the BOCs' and other incumbent local exchange carriers' regulated services markets will enable us to remove these restrictions.

11. A threshold question is to what extent, if any, we should rely upon our existing accounting safeguards to achieve our twin goals of protecting subscribers to BOCs' and other incumbent local exchange carriers' regulated telecommunications services against improper cost allocations and competitors against unreasonable discrimination. Those safeguards are found in Parts 32 and 64 of our rules. They consist of cost allocation and affiliate transactions rules that were designed to keep incumbent local exchange carriers from imposing the costs and risks of their competitive ventures on interstate telephone ratepayers, and to ensure that interstate ratepayers share in the economies of scope incumbent local exchange carriers realize when they expand into additional enterprises. As we implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the 1996 Act, for each of these sections, we seek comment on whether our current rules can or should be applied as they are, with some modification, or eliminated. We tentatively conclude that our rules, with the modifications we describe below, will best meet the statutory

requirements of these sections and their underlying goals. We invite comment on this tentative conclusion.

12. In reaching this tentative conclusion, we note our belief that the accounting safeguards this NPRM proposes are no more detailed than those in our current rules except where the 1996 Act requires more detailed safeguards or where our experience with current rules has made clear that more detailed safeguards are necessary to prevent improper subsidization. We invite comment on whether less detailed accounting safeguards would suffice to achieve the aims of Sections 260 and 271 through 276 of the 1996 Act. We note that those urging that we adopt more detailed accounting safeguards than those in our current rules or those specifically mandated by the 1996 Act bear a heavy burden of persuading us to adopt such safeguards.

13. The 1996 Act creates opportunities for competitive entry in the local exchange, exchange access, and interLATA telecommunications markets, among others. These opportunities may affect which accounting safeguards we adopt in two apparently countervailing ways. The incumbent local exchange carrier may be reluctant to increase rates for local exchange and exchange access service if the increases would induce competitive entry in the markets in which it would otherwise continue to have market power. This would militate against the adoption of stringent accounting safeguards. On the other hand, a carrier entering or continuing to participate in a nonregulated market will have an increased incentive to shift the costs and risks of its competitive activities to these regulated services if such shifting permits the carrier to increase the rates for these regulated services. The increased rates would not reduce substantially the carrier's market share for local exchange and exchange access service.

14. Several provisions of the 1996 Act prohibit BOCs, or, in some cases, all incumbent local exchange carriers from using their telephone exchange service and exchange access operations to subsidize their competitive ventures. We believe that Congress's primary intent in prohibiting this subsidization was to protect subscribers to these services from increased rates, and seek commenters' help in determining how best to fulfill that intent. We propose that the accounting safeguards we adopt in this proceeding apply to all services for which Section 260 and 271 through 276 require accounting safeguards.

15. Control over the bottleneck facility may enable a BOC or other incumbent local exchange carrier to engage in predatory behavior. For example, the ability to discriminate in favor of its interexchange affiliate with respect to the price of access (*i.e.*,) charging the affiliate a lower access rate than it charges competing IXCs) could facilitate an incumbent local exchange carrier's engaging in a ''price squeeze,'' In such a situation if the incumbent local exchange carrier's interexchange affiliate lowers its retail rate to reflect its unfair cost advantage, competing IXCs would be forced either to match the price reduction and decrease their profit margins, or to maintain their retail prices at preexisting levels and lose market share (and therefore profits). As a practical matter, an incumbent local exchange carrier can achieve the same result by charging the same price for access to all interexchange providers, while providing a higher quality of service to its affiliate than to competing IXCs. In this case, an IXC that attempted to match the incumbent local exchange carrier affiliate's retail price would lose market share since its lower quality of access would mean that it would be offering a lower quality of interexchange service. A third type of potentially anticompetitive, discriminatory behavior occurs when an incumbent local exchange carrier discriminates in favor of its affiliates when purchasing goods or services. For example, to the extent that the incumbent local exchange carrier is the predominant purchaser of telecommunications equipment that is used in the local exchange network, purchasing such equipment only from its affiliate manufacturing entity could adversely effect the ability of a competitor to operate profitably.

16. We also note that a carrier subject to rate-of-return regulation may have an incentive to engage in predatory pricing, if losses from below-cost pricing in the competitive market can be shifted to its regulated cost of service. We expect, however, that such predatory pricing by a BOC or other incumbent local exchange carrier is unlikely to occur. First, while an incumbent local exchange carrier may possess the legal ability to raise rates in the regulated market to subsidize its competitive activities, the threat of entry into the regulated market may prevent it from doing so. Even if such subsidization were to allow a BOC or other incumbent local exchange carrier to sustain prices below cost for a period of time sufficient to drive out competing IXCs, the local exchange carrier would be unlikely to raise prices above the competitive level, since each IXC's network represents an embedded facility which could be purchased in a bankruptcy proceeding and used if the local exchange carrier affiliates subsequently attempted to raise prices above the competitive level. We invite comment on the extent to which the opportunities to engage in predatory behavior should affect our decisions in this proceeding.

C. Overview of Sections 260 and 271 Through 276

17. In Section 260 and 271 through 276, Congress delineated the conditions under which incumbent local exchange carriers would be permitted to offer telemessaging and alarm monitoring services and under which BOCs would be permitted to manufacture and sell telecommunications equipment, to manufacture customer premises equipment, and to offer interLATA telecommunications, information, alarm monitoring and payphone services. In some cases, separate affiliates are required. In other cases, integrated operation is permitted.

18. Section 260 provides that an incumbent local exchange carrier, including a BOC, the provides telemessaging service ''shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access,'' but does not require a separate affiliate.

19. Section 271(b) authorizes the BOCs to provide ''out-of-region'' interLATA services as of February 8, 1996, even if the services terminate within the BOC's region, and ''in-region'' interLATA services upon Commission approval. Section 271(g) lists specific ''incidental interLATA services'' that BOCs and their affiliates may provide after February 8, 1996. Section 271(h) states that ''[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market.''

20. Section 272 permits a BOC (including any affiliate) that is an incumbent local exchange carrier to manufacture equipment (as defined in the AT&T consent decree), originate in-region interLATA telecommunications services, other than incidental and previously authorized interLATA services, and provide certain interLATA information services only if it does so through one or more separate affiliates. Each of the separate affiliates must ''maintain [separate] books, records, and accounts in the manner prescribed by the Commission'' and ''shall conduct all

transactions with the Bell operating company of which it is an affiliate on an arm's length basis.'' In its dealings with the separate affiliate, each BOC must ''account for all transactions * * * in accordance with accounting principles designated or approved by the Commission.''

21. Section 273(d)(3) sets forth an additional separate affiliate requirement for manufacturing of telecommunications equipment and customer premises equipment by entities that certify the same class of telecommunication equipment and customer premises equipment produced by unaffiliated entities.

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

23. Section 275(b)(2) bars an incumbent local exchange carrier that provides alarm monitoring services from ''subsidiz[ing] its alarm monitoring services either directly or indirectly from telephone exchange service operations,'' but does not require a separate affiliate.

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

25. Section 254(k) prohibits a telecommunications carrier from ''us[ing] services that are not competitive to subsidize services that are subject to competition.'' Section 254(k) further states that '' [t]he Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.''

D. Structure of This NPRM

26. Section II of this NPRM discusses accounting safeguards that would apply when an incumbent local exchange carrier, including a BOC, provides a service addressed in Sections 260 and 271 through 276 of the 1996 Act on an integrated, or in-house, basis. For the provision of services on an integrated basis, we tentatively conclude in Section II that our existing Part 64 cost allocation rules generally satisfy the 1996 Act's accounting safeguards requirements. Section III discusses accounting safeguards that would apply when an incumbent local exchange carrier, including a BOC, uses an affiliate to provide a service addressed in Sections 260 and 271 through 276 of the 1996. In Section III, we tentatively conclude that, except where the 1996 Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the statue's requirement of accounting safeguards when an incumbent local exchange carrier conducts transactions with its affiliate. In that section, we do propose several modifications to the affiliate transactions rules to provide greater protection against improper subsidization. Within Sections II and III, subsections discuss issues related to the application of the individual statutory sections. In Section IV of this NPRM, we seek comment on whether and, if so, how price cap regulation alters the need for accounting safeguards to ensure against the subsidization of services permitted under Sections 260 and 271 through 276 of the 1996 Act with revenues from regulated telecommunications services to subsidize other services. In that same section, we seek comment on whether our proposals in this NPRM satisfy the requirements of Section 254(k).

II. Safeguards For Integrated Operations

A. General

27. In this section, we discuss the provisions in Sections 260, 271, 275, and 276 of the 1996 Act relating to accounting safeguards for telemessaging, certain interLATA telecommunications and information, alarm monitoring, and payphone services that the BOCs and other incumbent local exchange carriers might be permitted to provide on an integrated basis (*i.e.*, within the telephone operating companies). We tentatively conclude that our existing Part 64 cost allocation rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services. We invite comment on this tentative conclusion.

28. We developed the cost allocation rules in our *Joint Cost* and *Computer II Proceedings* to help ensure that interstate ratepayers do not bear the costs and risks of the telephone companies' nonregulated activities. These rules prescribe how carriers separate the costs of activities regulated under Title II of the Communications Act of 1934, as amended, from the costs of nonregulated activities, where the nonregulated activities are performed directly by the carrier rather than through an affiliate. Under these rules, incumbent local exchange carriers may not assign the costs of nonregulated activities to regulated products and services. Incumbent local exchange carriers have implemented internal cost allocation systems to help ensure their compliance with these rules. Redesigning these internal systems to accommodate a fundamentally different cost allocation approach might impose substantial administrative and financial costs on the carriers. We seek comment on whether the benefits of a fundamentally different approach to cost allocation would be outweighed by the costs that implementation of such a system would entail. Alternatively, we invite comment on whether, and how, we might adapt the existing cost allocation system to accommodate any or all of the services we address in Section II.B, below.

B. Specific Services

1. Section 260—Telemessaging Service

a. Statutory Language

29. Section 260(a)(1) of the 1996 Act prohibits each ''local exchange carrier subject to the requirements of section 251(c) that provides telemessaging service [from] subsidiz[ing] its telemessaging service directly or indirectly from its telephone exchange service or its exchange access.'' Section 251(c), in turn, applies to every ''incumbent local exchange carrier.'' Section 260(c) defines ''telemessaging service'' as ''voice mail and voice storage and retrieval services, any live operator services used to record, transcribe, or relay messages (other than telecommunications relay services), and any ancillary services offered in combination with these services.'' The principal goal of the prohibition against subsidization in Section 260(a)(1) appears to be to ensure that the telemessaging service operations of incumbent local exchange carriers do not result in increased rates for telephone exchange service and exchange access. Section 260(b) also

requires the Commission to establish procedures for expedited consideration of any complaint alleging ''material financial harm to a provider of telemessaging service.'' In providing for this expedited consideration, Congress intended to protect providers of telemessaging service that are not themselves, or affiliated with, incumbent local exchange carriers against subsidization.

30. Our present Part 64 rules classify telemessaging service as a nonregulated activity for Title II accounting purposes. Consequently, provision of telemessaging services is already governed by our Part 64 rules and, to the extent telemessaging is provided through affiliates, our affiliate transactions rules also apply. Our Part 64 rules require carriers to use a cost allocation methodology based on fully distributed costs (''FDC''). This methodology establishes a hierarchy of cost apportionment rules designed to prevent subsidies. These rules are applied to costs recorded in the accounts specified in the Uniform System of Accounts (''USOA'') set out in Part 32 of our rules. The methodology requires carriers to assign costs directly, wherever possible, to regulated or nonregulated activities. If costs cannot be directly assigned, they are considered ''common costs'' and must be placed in homogeneous cost pools. The carrier must then divide the costs in each pool between regulated and nonregulated activities using formulas or factors known as ''allocators.'' Depending upon the information available, carriers must apply these allocators in the following order. Whenever possible, common costs must be directly attributed based upon a direct analysis of the origins of those costs. Common costs that cannot be directly attributed must be indirectly attributed based on an indirect, but cost-causative, linkage to another cost pool or pools for which a direct assignment or attribution is possible. Only if direct or indirect attribution factors are not available may the carrier allocate a pool of common costs using what is known as a ''general allocator.'' For regulated activities, the general allocator is expressed as the ratio of all expenses directly assigned or attributed to regulated activities (numerator) to all expenses directly assigned or attributed to both regulated and nonregulated activities (denominator).

31. Our Part 64 cost allocation rules also require incumbent local exchange carriers to allocate their network investment plant between activities that we regulate under Title II and nonregulated activities. This allocation must be based on the peak ''relative regulated and nonregulated usage'' projected for the network plant over a three-year period. BOC provision of telemessaging service may result in the reallocation of this plant from regulated to nonregulated activities. In the *Joint Cost Proceeding,* we determined that, absent waiver, any such reallocation ''must be made at undepreciated baseline cost and must include interest calculated at the authorized interstate rate of return.''

32. Section 64.901(b)(4) of our rules requires a carrier at the beginning of each calendar year to forecast peak relative nonregulated use of jointly-used network plant over a three-year period. The relative split between usage for activities regulated under Title II and nonregulated usage at the point in time when nonregulated usage is greatest in comparison to regulated defines the allocation factor to be applied. If application of this method would increase the allocation to nonregulated activities for any account from the previous year, the carrier must make the reallocation. If application of this method would decrease the allocation to nonregulated activities for that account from the previous year, the carrier must obtain a waiver to make the reallocation. At the end of the year, the carriers compare their forecasts with actual usage. If the actual usage of nonregulated activities is greater, they must adjust the allocation to nonregulated services based on that actual usage.

33. We tentatively conclude that applying our Part 64 rules to telemessaging will safeguard against the subsidies prohibited by Section 260(a)(1). Section 260 appears to allow telemessaging service to be provided on an integrated basis, at least for most incumbent local exchange carriers. However, we tentatively conclude, as we do in our companion item, *BOC In-Region NPRM,* that telemessaging is an information service. We also tentatively conclude in that *NPRM,* that our authority under Sections 271 and 272 over interLATA information services applies to intrastate, interLATA information services provided by BOCs or their affiliates. BOC provision of telemessaging service on an interLATA basis would therefore be subject to the separate affiliate and other requirements of Section 272. We invite comment on these tentative conclusions.

b. Scope of Commission's Authority

34. Section 260 of the Act imposes additional safeguards regarding the provision of telemessaging services, not only on the BOCs, but on all incumbent on whether, in light of our tentatilocal exchange carriers. We seek commenve conclusion that Sections 271 and 272 give the Commission jurisdiction over intrastate interLATA information services including telemessaging, Section 260 should also be read to give us jurisdiction over intrastate information services in implementing and enforcing Section 260. We note, however, that unlike Sections 271 and 272, the scope of Section 260 is not limited to interLATA services, nor is it limited to the BOCs. We seek comment, therefore, on whether any such intrastate jurisdiction would extend only to the BOCs, as only BOCs are covered by Sections 271 and 272, or to all incumbent local exchange carriers.

35. We further seek comment on what role States might have in implementing Section 260(a)(1)'s prohibition against subsidization of ''telemessaging service directly or indirectly from * * * telephone exchange service or * * * exchange access.'' Prior to the enactment of the 1996 Act, we did not preempt States from using their own cost allocation procedures for intrastate purposes. We ask commenters to address whether we must change this policy in order to effectuate Section 260.

36. To ensure a complete record, if Section 260 does not itself apply to intrastate services, we also seek comment on whether we have authority to preempt State regulation with respect to the accounting matters addressed by Section 260 pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority. We tentatively conclude that if Section 260 does not apply to intrastate services and if we have authority to preempt pursuant to *Louisiana PSC,* we should refrain from exercising that authority in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular whether preemption pursuant to *Louisiana PSC* in this area would be necessary to achieve the intent behind Section 260(a)(1) or whether less intrusive measures would be sufficient.

2. Section 271—InterLATA Telecommunications Services

a. Incidental InterLATA Services

37. Section 271(h) states that ''[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market.'' Section

271(g) lists specific incidental interLATA services that he BOCs and their affiliates may provide after the date of enactment of the 1996 Act. Those services are:

The interLATA provision by a Bell operating company or its affiliate—

(1)(A) of audio programming, video programming, or other programming services to subscribers to such services of such company or affiliate;

(B) of the capability for interaction by such subscribers to select or respond to such audio programming, video programming, or other programming services;

(C) to distributors of audio programming or video programming that such company or affiliate owns or controls, or is licensed by the copyright owner of such programming (or by an assignee of such owner) to distribute; or

(D) of alarm monitoring services;

(2) of two-way interactive video services or Internet services over dedicated facilities to or for elementary and secondary schools as defined in section 254(h)(5);

(3) of commercial mobile services in accordance with section 332(c) of this Act and with the regulations prescribed by the Commission pursuant to paragraph (8) of such section;

(4) of a service that permits a customer that is located in one LATA to retrieve stored information from, or file information for storage in, information storage facilities of such company that are located in another LATA;

(5) of signaling information used in connection with the provision of telephone exchange services or exchange access by a local exchange carrier; or

(6) of network control signaling information to, and receipt of such signaling information from, common carriers offering interLATA services at any location within the area in which such Bell operating company provides telephone exchange services or exchange access.

Section 271(h) states that ''[t]he provision of [Section 271(g)] are to be narrowly construed. The interLATA services provided under subparagraph (A), (B), or (C) of [Section 271(g)(1)] are limited to those interLATA transmissions incidental to the provision by a Bell operating company or its affiliate of video, audio, and other programming services that the company or its affiliate is engaged in providing to the public.''

38. Section 271(h) states that ''[t]he Commission shall ensure that the provision of services authorized under [Section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market.'' We invite comment on whether our present cost allocation rules in Part 64 are adequate to prevent the adverse effects proscribed by Section 271(h) or whether alternative solutions, if any, would be more appropriate. We ask commenters asserting that the rules require modifications to describe in detail the modifications they believe necessary, to explain how these modifications or additions to our Part 64 rules would better enable the Commission to fulfill its obligations under Section 271(h), and to identify the category of ratepayers or competitive markets the proposed modifications or additions would protect.

b. Integrated Provision of InterLATA Services

39. We note that BOCs are permitted to provide certain regulated, interLATA telecommunications services on an integrated basis, including out-of-region services and certain types of incidental services. In our *BOC Out-of-Region Order,* 61 FR 35964 (July 9, 1996), we determined that the BOCs must provide out-of-region interstate, interexchange services (including interLATA and intraLATA services) through separate affiliates, at least on an interim basis, in order to qualify for nondominant regulatory treatment in the provision of those services. Under that *Order,* however, a BOC could still choose to provide these services on an integrated basis, subject to dominant carrier regulation. To ensure against improper subsidization in the event of such operations, we tentatively conclude that we should apply our cost allocation rules to regulated services other than local exchange and exchange access services provided on an integrated basis. We seek comment on this tentative conclusion and on whether we should develop modified cost allocation rules for these other regulated services that the BOCs may provide on an integrated basis to prevent allocation of the costs of these other regulated services to local exchange and exchange access customers and, if so, what these modifications should be. One possible solution would be to require BOCs to create a separate category for regulated services other than local exchange and exchange access services within their internal cost allocation systems. This category would be in addition to the regulated and nonregulated categories our existing rules require and would parallel the approach we took with respect to video dialtone. Alternatively, we could require BOCs to classify any regulated services other than local exchange and exchange access services they provide on an integrated basis as nonregulated activities for Title II accounting purposes. This would parallel the approach we took in the *BOC out-of-Region Order* and would result in the carriers' allocating the costs of these services to the nonregulated category. We invite comment on the relative costs and benefits of these approaches.

40. In our *Interexchange Notice,* 61 FR 14717 (April 3, 1996), we addressed whether we should modify or eliminate the separation requirements independent local exchange carriers must currently meet in order to qualify for non-dominant treatment when they offer interstate, interexchange services originating outside the areas in which they control local access facilities. We also sought comment on whether, if we modified or eliminated these separation requirements for non-dominant treatment of independent local exchange carriers, we should apply the same requirements to BOC provision of out-of-region interstate, interexchange services. If independent local exchange carriers are allowed to, and choose to, provide out-of-region interstate interexchange services on an integrated basis, we seek comment on whether our regulatory treatment for such incumbent local exchange carriers should be similar to the regulatory treatment we adopt for the BOCs.

c. Other Matters

41. Section 272(e)(3) requires that ''[a] Bell operating company * * * impute to itself (if using [exchange] access for its provision of its own services), an amount for access that is *no less than* the amount charged to any unaffiliated interexchange carriers for such service.'' In our *BOC In-Region NPRM,* we seek comment on how to determine the imputed exchange access charges under Section 272(e)(3). We now invite comment on how the BOCs should account for these imputed access charges. One possible approach would be for the BOCs to record these imputed exchange access charges as an expense that would be directly assigned to nonregulated activities with a credit to the regulated exchange access revenue account. We seek comment on this approach as well as suggested alternatives.

42. Section 272(e)(4) states that ''[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) * * * may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on

the same terms and conditions, and so long as the costs are appropriately allocated.'' Although Sections 272(e)(3) and (e)(4) do not address activities performed on an integrated basis, we invite comment on whether and, if so, how these requirements should affect our rules for allocating costs between activities regulated under Title II and nonregulated activities for those BOCs that provide interLATA services on an integrated basis. We request comment on whether, in view of Section 272(e)(4), we may require BOCs that provide interLATA or intraLATA facilities or services on an integrated basis to provide them to their own internal operation only at the same rates as those facilities or services are made available to all carriers. When those rates differ for different carriers, we seek comment on which rate should be the one that applies to BOC affiliate transactions. We also invite comment on whether we should adopt specific accounting procedures to address the difference, if any, between those rates and ''the costs [that would be] appropriately allocated'' for the underlying facilities or services.

d. Scope of Commission's Authority

43. In the *BOC In-Region NPRM,* we tentatively conclude that this Commission has jurisdiction under Sections 271 and 272 over both interstate and intrastate interLATA services and interLATA information services. That tentative conclusion leads us also to conclude tentatively that we have jurisdiction with respect to accounting matters under those same sections of the 1996 Act. We base our tentative conclusions in the *BOC In-Region NPRM* and in this Notice on the following analysis. Sections 271 and 272 by their terms address BOC provision of ''interLATA'' services and information services. Many States contain more than one LATA, and thus, interLATA traffic may be either interstate or intrastate. Accordingly, we must determine whether Sections 271 and 272, and our authority pursuant to those sections, apply only to interstate interLATA services and interLATA information services, or to both interstate and intrastate interLATA services and interLATA information services.

44.The MFJ, when it was in effect, governed BOC provision of both interstate and intrastate services. The 1996 Act provides:

> Any conduct or activity that was, before the date of enactment of this Act, subject to any restriction or obligation imposed by the [MFJ] shall, on and after such date, be subject to the restrictions and obligations imposed by the Communications Act of 1934 as amended by this Act and shall not be subject to the restrictions and the obligations imposed by [the MFJ].

This section supersedes the MFJ, and explains that the Communications Act is to serve as its replacement. In the *BOC In-Region NPRM,* we find that Sections 271 and 272 of the Act were intended to replace the MFJ as to both interstate and intrastate interLATA services and interLATA information services.

45. Although Sections 271 and 272 make no explicit reference to interstate and intrastate services, they do refer to a different geographic boundary—the LATA, as originally defined by the MFJ and now by the 1996 Act. In the *BOC In-Region NPRM,* we tentatively conclude that the interLATA/intraLATA distinction appears to have supplanted the traditional interstate/intrastate distinction for purposes of these sections.

46. As to interLATA services, the MFJ prohibited the BOCs and their affiliates from providing any interLATA services, interstate or intrastate, unless specifically authorized by the MFJ or a waiver thereunder. Reading Sections 271 and 272 as applying to all interLATA services fits well with the structure of the statute as a whole. Sections 251 and 252 of the Act establish rules and procedures for competitive entry into local exchange markets. In the *Interconnection NPRM,* 61 FR 18311, we tentatively concluded that Congress intended these sections to apply to both interstate and intrastate aspects of interconnection. These new obligations imposed on BOCs (as well as other incumbent local exchange carriers), and enacted at the same time as Sections 271 and 272, clearly are part of the process for entry into the interLATA marketplace. Indeed, BOCs are permitted to provide in-region interLATA services only after they have met the requirements of Section 271, including a competitive checklist requiring compliance with certain provisions in Sections 251 and 252.

47. In the *BOC In-Region NPRM,* we note also that the structure of Sections 271 and 272 themselves indicates that these sections were intended to address both interstate and intrastate interLATA services. For instance, BOCs are directed to apply for interLATA entry on a state-by-state basis, and the Commission is directed to consult with the relevant State Commission before making any determination with respect to an application in order to verify the BOC's compliance with the requirements for providing in-region interLATA services. As we believe it did in Sections 251 and 252, Congress appears to have put in place rules to govern both interstate and intrastate services, and to have provided a role for both the Commission and the States in implementing those rules.

48. We also note in the *BOC In-Region NPRM* that, by contrast, reading Sections 271 and 272 as limited to the provision of interstate services would mean that the BOCs would have been permitted to provide in-region, intrastate, interLATA services upon enactment and without any guidance from Congress as to entry requirements or safeguards, subject only to any pre-existing State rules on interexchange entry. Any such rules, presumably, would not have been directed at BOC entry, which had for many years been prohibited. Concerns about BOC control of bottleneck facilities over the provision of in-region interLATA services are equally important for both interstate and intrastate services. Thus, the reasons for imposing the procedures and safeguards of Sections 271 and 272 apply equally to the BOCs' provision of both intrastate and interstate, in-region, interLATA services. We found it implausible that Congress could have intended to lift the MFJ's ban on BOC provision of interLATA services without making any provision for orderly entry into intrastate interLATA services, which constitute approximately 30 percent of interLATA traffic. Based on the preceding analysis, we tentatively conclude that our authority under Sections 271 and 272 applies to both intrastate and interstate interLATA services and interstate and intrastate interLATA information services provided by the BOCs or their affiliates. We also stated our belief that Section 2(b) of the Communications Act did not require a contrary result because Congress enacted Sections 271 and 272 after Section 2(b) and squarely addressed the issues presented here. We reach the same tentative conclusion here as to accounting safeguards and seek comment on it.

49. We also invite comment on what role States might play in implementing the accounting safeguards provisions of Sections 271 and 272, given this tentative conclusion. We ask commenters to address whether we must change our policy, adopted prior to the enactment of the 1996 Act, of not preempting States from using their own cost allocation procedures for intrastate purposes. We also invite comment on whether, in enacting the accounting safeguards provisions of Sections 271 and 272, Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation

procedures in their regulation of ''charges . . . for or in connection with intrastate communications service[s].''

50. To the extent commenters disagree with the above analysis, we also seek comment on whether we have authority to preempt state regulation with respect to the accounting matters addressed by Sections 271 and 272 pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority. We tentatively conclude that if Sections 271 and 272 do not provide authority over intrastate interLATA services and intrastate interLATA information services and if we have authority to preempt pursuant to *Louisiana PSC,* we should refrain from exercising it in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular, whether preemption in this area would be necessary to achieve the intent behind the accounting safeguards provisions of Sections 271 and 272, or whether less intrusive measures would be sufficient.

3. Section 275—Alarm Monitoring Services

51. Section 275(e) defines ''alarm monitoring service'' as ''a service that uses a device located at a residence, place of business, or other fixed premises (1) to receive signals from other devices located at or about such premises regarding a possible threat at such premises to life, safety, or property, from burglary, fire, vandalism, bodily injury, or other emergency, and (2) to transmit a signal regarding such threat by means of transmission facilities of a local exchange carrier or one of its affiliates to a remote monitoring center to alert a person . . .'' about the emergency. Section 275(a)(1) delays entry by the BOCs not already providing alarm monitoring services until five years from the date of enactment of the 1996 Act. If a BOC or BOC affiliate provided alarm monitoring services as of November 30, 1995, it may continue to do so, but cannot expand its alarm monitoring business by acquiring ''any equity interest in, or obtain financial control of, any unaffiliated alarm monitoring service entity'' during the five-year period.

52. Section 275(b)(2) specifies that an incumbent local exchange carrier engaged in the provision of alarm monitoring services ''not subsidize its alarm monitoring services either directly or indirectly from telephone exchange service operations.'' As with the prohibition against subsidizing telemessaging services, this prohibition against subsidizing alarm monitoring services specifically applies to incumbent local exchange carriers.

53. We currently require carriers to treat alarm monitoring services as nonregulated activities for Title II accounting purposes. Accordingly, the Part 64 cost allocation rules require incumbent local exchange carriers to allocate the costs of those services to nonregulated activities. We invite comment on whether our present rules are necessary or sufficient to prevent subsidization of alarm monitoring services as defined in Section 275(e). Commenters asserting that our existing rules would not meet this objective should identify with specificity any deficiency in our rules, explain the nature of the deficiency, and describe, in detail, how the rules can be modified to remove that deficiency. We ask commenters asserting that rules are not necessary to identify which rules are not necessary and why they are not necessary.

54. Alarm monitoring, as defined in Section 275(e), appears to fall within the definition of ''information service'' in Section 3(20) of the Act. Alarm monitoring services, however, are specifically exempted from the separate affiliate and nondiscrimination requirements of Section 272. We seek comment on the extent of our authority, if any, under Section 275 over intrastate alarm monitoring services.

55. We further seek comment on what role States might have in implementing Section 275(b)(2)'s prohibition against subsidization of ''alarm monitoring services either directly or indirectly from . . . telephone exchange service operations.'' We ask commenters to address whether we must change our policy, adopted prior to the enactment of the 1996 Act, of not preempting States from using their own cost allocation procedures for intrastate purposes. We also invite comment on whether, in enacting Section 275(b)(2), Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures for alarm monitoring services in the States' regulation of ''charges . . . for or in connection with intrastate communications service[s].''

56. We also seek comment on whether, if Section 275 does not itself preempt, we have authority to preempt State regulation with respect to the accounting matters addressed by Section 275(b)(2) pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority. We tentatively conclude that even if Section 275 does not itself preempt and if we have that authority pursuant to *Louisiana PSC,* we should refrain from exercising it in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We ask the commenters to address, in particular, whether preemption in this area would be necessary to achieve the intent behind Section 275(b)(2) or whether less intrusive measures would be sufficient.

4. Section 276—Payphone Services

57. Section 276(a)(1) states that ''any Bell operating company that provides payphone service shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations.'' This prohibition against subsidization is an integral part of Congress's plan ''to promote competition among payphone providers and promote the widespread deployment of payphone services to the benefit of the general public.'' To implement the prohibition, Section 276(b)(1)(C) directs the Commission to prescribe nonstructural safeguards for BOC payphone service that, ''at a minimum, include the nonstructural safeguards equal to those adopted in the Computer Inquiry-III (CC Docket No. 90–623) proceeding.'' The Act defines the term ''payphone service'' as ''the provision of public or semi-public pay telephones, the provision of inmate telephone service in correctional institutions, and any ancillary services.''

58. We tentatively conclude that we should apply accounting safeguards identical to those safeguards adopted in Computer Inquiry-III to prevent the subsidization of payphone services by BOC telephone exchange service or exchange access operations. We seek comment on this tentative conclusion. Commenters asserting that additional accounting safeguards are necessary to fulfill our responsibilities under Sections 276(a)(1) and (b)(1)(C) should identify the alternative safeguards and explain why they would better prevent the subsidies referred to in Section 276(a)(1).

59. All of the BOCs provide payphone service. In the past, we have treated payphone service as a regulated activity with applicable Part 32 plant, expense, and revenue accounts. This classification appears inconsistent with the mandate in Section 276(b)(1)(C) that we prescribe nonstructural safeguards for payphone service because this past treatment allows payphone investment and expenses to be recorded as costs of the regulated service. We tentatively conclude that the new rules required by

that section should reclassify payphone service as a nonregulated activity so that its costs should be separated from the telephone exchange service and exchange access operations that would continue to be regulated activities. Under this approach, the BOCs would continue to use the Commission's Part 32 accounts to record their payphone service activities, but would classify their payphone investment, expenses and revenues as nonregulated for Title II accounting purposes. We seek comment on this tentative conclusion and overall approach and, in particular, ask whether this proposal would comply with the 1996 Act's mandate to prescribe nonstructural accounting safeguards for the BOCs' payphone services at least equal to those adopted in the Computer Inquire-III proceeding. We also invite comment on whether this approach would prevent the subsidization of ''payphone service'' as defined in Section 276(d) by BOC telephone exchange service or exchange access operations.

60. Section 276 does not prescribe or direct the Commission to prescribe accounting safeguards to govern the provision of payphone service by incumbent local exchange carriers other than the BOCs. We seek comment on whether we can and should require these other incumbent local exchange carriers to reclassify their payphone service operations as a nonregulated activity for Title II accounting purposes.

61. Section 276(c) states that ''[t]o the extend that any State requirements are inconsistent with the Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements.'' Thus, it is clear that the statute itself preempts any State regulations that may be inconsistent with our own. We invite comment on what role States might have in implementing Section 276(a)(1)'s prohibition against subsidization of ''payphone service directly or indirectly from * * * telephone exchange service operations or * * * exchange access operations,'' given this clear statutory language and, in particular, whether in enacting Section 276(c), Congress intended to eliminate our ability to allow the States to depart from the Federal cost allocation procedures in their regulation of ''charges * * * for or in connection with intrastate communications service[s].''

III. Safeguards For Separated Operations

A. General

62. Section 272(a)(2) of the 1996 Act allows BOCs to provide the following services only through a separate subsidiary: manufacturing of telecommunications equipment and customer premises equipment; origination of interLATA telecommunications services, other than incidental, out-of-region, and previously authorized services; and interLATA information services other than electronic publishing and alarm monitoring services. Section 273(d)(3) requires ''any entity which certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity * * * only [to] manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity for such class of equipment through a separate affiliate.'' Section 274(a) requires that BOCs providing electronic publishing must do so only through a ''separated affiliate'' or electronic publishing joint venture. These requirements for ''separate'' or ''separated'' affiliates or joint ventures implicitly assume that structural safeguards limit the carrier's ability to engage in subsidization.

63. In this section, we discuss the accounting safeguards needed to prevent subsidization where telephone operating companies do business with their nonregulated and regulated affiliates. In the *Joint Cost Order,* 52 FR 6557, we adopted rules to govern the way costs are recorded, for Title II accounting purposes, when a regulated carrier does business with nonregulated affiliates. The affiliate transactions rules are designed to protect interstate ratepayers from subsidizing the competitive ventures of incumbent local exchange carrier affiliates. The affiliate transactions rules do not require carriers or their affiliates to charge any particular prices for assets transferred or services provided; rather, the rules require carriers to use certain specified valuation methods in determining the amounts to record in their Part 32 accounts, regardless of the prices charged.

64. We tentatively conclude that, except where the 1996 Act imposes specific additional requirements, our current affiliate transactions rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services. We invite comment on this tentative conclusion. We have previously concluded that these rules provide effective safeguards against subsidization. Incumbent local exchange carriers have implemented internal accounting systems for affiliate transactions to help ensure their compliance with these rules. Redesigning these internal systems to accommodate a fundamentally different approach to affiliate transactions accounting systems would impose substantial costs on the carriers. We seek comment on these matters and, in particular, on whether the benefits of any fundamentally different approach to affiliate transactions would be outweighed by the costs that implementation of such a system might entail.

65. Although we do not propose an approach for affiliate transactions that is fundamentally different from our existing rules, we seek comment on whether we should modify our affiliate transactions rules in certain respects. The Commission and the telephone industry have had more than eight years experience with the cost allocation regime created by the *Joint Cost Order,* 52 FR 6557 (March 4, 1987). This experience has made us aware that amending certain aspects of the affiliate transactions rules might provide more optimal protection against subsidization. In 1993, we released an *Affiliate Transactions Notice,* 58 FR 62080 (November 24, 1993), proposing such rule changes, including changes in how subject carriers would value for Title II accounting purposes services they provide, or receive from, nonregulated affiliates. We invite comment on whether, in implementing the 1996 Act's provisions regarding subsidization, we should amend the current affiliate transactions rules to incorporate certain of the modifications proposed in the *Affiliate Transactions Notice.* We discuss these modifications below. We also invite comment on whether any additional changes to those rules might be necessary or appropriate to implement the requirements of the 1996 Act.

66. As a general matter, we solicit comment on how and to whom the affiliate transactions rules should be applied. For example, we could apply the accounting safeguards for affiliate transactions discussed in this NPRM only to those entities that engage in activities for which the 1996 Act requires the use of a separate or separated subsidiary. We could also extend application of these safeguards to those incumbent local exchange

carriers that engage in activities for which the 1996 Act allows, but does not require, the use of a separate subsidiary. We discuss these approaches below. Finally, we invite comment on whether we should also apply any modifications to our affiliate transactions rules that we make in this proceeding to all transactions between incumbent local exchange carriers and their affiliates.

B. Specific Services

1. Section 272—Manufacturing and InterLATA Services

a. Statutory Language

67. Section 272(a) prohibits a ''Bell operating company (including any affiliate) which is a local exchange carrier that is subject to the requirements of section 251(c)'' from ''provid[ing] any service described in [Section 272(a)(2)] unless it provides that service through one or more affiliates that (A) are separate from any operating company entity that is subject to the requirements of section 251(c); and (B) meet the requirements of [Section 272(b)].'' Section 272(a)(2) states that:

> [T]he services for which a separate affiliate is required by [Section 272(a)(1)] are: (A) [m]anufacturing activities (as defined in section 273(h); (B) [o]rigination of interLATA telecommunications services, other than (i) incidental interLATA services described in [Section 271(g)(1)–(3) and (5)–(6)]; (ii) out-of-region services described in section 271(b)(2); or (iii) previously authorized activities described in section 271(f); [and] (C) [i]nterLATA information services, other than electronic publishing (as defined in section 274(h)) and alarm monitoring services (as defined in section 275(e)).

Section 272(b)(2) requires each of these separate affiliates to ''maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate.'' Under Section 272(b)(5), each of these separate affiliates must ''conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection.'' Pursuant to Section 272(c)(2), BOCs must account for all transactions with these affiliates ''in accordance with accounting principles designated or approved by the Commission.''

b. Accounting Requirements of Sections 272 (b)(2) and (c)(2)

68. Section 272(b)(2) requires the separate affiliates prescribed under Section 272(a)(2) to ''maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [BOC] of which it is an affiliate.'' We invite comment on the steps we should take to implement this provision and, in particular, whether we should mandate that the separate affiliates required under Section 272(a)(2) maintain their books, records, and accounts in accordance with generally accepted accounting principles (''GAAP''). We ask the commenters to address whether it is necessary to adopt any additional accounting, bookkeeping, or record keeping requirements for these affiliates and, if so, what those additional requirements should be.

69. Pursuant to Section 272(c)(2), BOCs must account for all transactions with their separate affiliates required under Section 272(a)(2) ''in accordance with accounting principles designated or approved by the Commission.'' We invite comment on how we should implement this provision. To ensure that the amounts recorded in Part 32 accounts are based on reliable financial data, the *Affilitate Transactions Notice* proposed that, except as otherwise ordered by this Commission, all accounting related to affiliate transactions must comply with GAAP. We invite comment on whether requiring such accounting would assist us in fulfilling our statutory obligation to ensure that each affiliate required under Section 272(a)(2) will ''conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis'' and, if so, whether we should adopt such a requirement.

c. ''Arm's Length'' Requirement of Section 272(b)(5)

70. Section 272(b)(5) of the 1996 Act requires that transactions between the BOC and its affiliate engaged in the manufacturing activities, origination of interLATA telecommunications services, and interLATA information services described in Section 272(a)(2) be conducted on ''an arm's length'' basis. In the *Computer II Final Decision*, 45 FR 24694, we required AT&T to provide enhanced services and customer premises equipment only through a ''separate corporate entity'' that would ''deal with any affiliated manufacturing entity only on an *arm's length*'' basis. We stated that ''the transfer of any products'' between this separate corporate entity and ''any affiliated equipment manufacturer must be done at a price that is compensatory.'' We also stated that, ''[t]o police this requirement, we [would] require that any transaction between the enhanced services subsidiary and any other affiliate which involves the transfer (either directly or by accounting or other record entries) of money, personnel, resources or other assets be recorded in auditable form.'' We invite comment on whether we should adopt similar requirements to implement Section 272(b)(5). We also invite comment on whether a requirement that prices be compensatory would be consistent with the Congressional intent behind Section 272(b)(5) and, in particular, any intent that ratepayers of regulated services benefit from the economies of scope from BOC manufacturing, origination of interLATA telecommunications services, and interLATA information services activities.

71. In *Computer III*, we reexamined our regulatory regime for the provision of enhanced services and replaced the *Computer II* requirements with a series of nonstructural safeguards. These safeguards included the Part 64 cost allocation rules and the affiliate transactions rules that we developed in the *Joint Cost Order.* The latter prescribe how incumbent local exchange carriers other than average schedule companies must value their affiliate transactions for Title II accounting purposes. These rules direct subject carriers to use different methods for valuing assets transferred and services provided. For asset transfers, the rules require that they us one of four methods: (1) tariffed rates; (2) prevailing company prices; (3) net book cost; and (4) estimated fair market value. Carriers must record each asset transferred to an affiliate pursuant to tariff at the tariffed rate. If an affiliate that sells a non-tariffed asset to its regulated carrier also sells the same kind of asset to third parties at a generally available price, the carrier must record the asset transfer at that prevailing company price. All other asset transfers must be recorded at the higher of net book cost and estimated fair market value when the carrier is the buyer (*i.e.*, from the affiliate). The United States Court of Appeals for the District of Columbia Circuit affirmed the valuation methods for asset transfers, finding them ''reasonably designed to prevent systematic abuse of ratepayers.''

72. The affiliate transactions rules authorize three valuation methods for determining the amounts carriers should record in their Part 32 accounts for services they provide to or obtain from affiliates: (1) tariffed rates; (2) prevailing company prices; and (3) fully distributed costs. Carriers must record services provided to an affiliate pursuant to tariff at the tariffed rate. If an affiliate provides a non-tariffed service to its regulated carrier that it also provides to third parties, the carrier

must record the transaction at the prevailing company price. All other affiliate services must be recorded at the service provider's fully distributed costs.

73. As stated above, the Commission has released an *Affiliate Transactions Notice* that proposes certain rule changes to provide greater protection against subsidization. We discuss certain of these proposed changes below. We solicit comment concerning whether our affiliate transactions rules, with the proposed changes, would be necessary or sufficient to ensure compliance with the ''arm's length'' requirement of Section 272(b)(5).

74. We also seek comment on whether and, if so, how we should amend our rules to address Section 272(b)(5)'s requirement that all transactions be ''reduced to writing and available for public inspection.'' We ask the commenters to address in particular whether Internet access to information about these transactions would be sufficient to comply with this requirement ''for public inspection.'' We also invite commenters to suggest any other methods we could implement to comply with Section 272(b)(5). We seek further comment about whether we need to adopt safeguards to protect any sensitive or confidential information that these publicly available documents may contain.

75. We note that Section 272(e)(1) requires a ''Bell operating company and an affiliate that is subject to the requirements of section 251(c)'' to ''fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access service within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates.'' We interpret ''transactions'' under Section 272(b)(5) to include requests by an affiliate to its BOC for telephone exchange service or exchange access. We seek comment on this interpretation. We also seek comment on whether we should require information about such transactions to be made publicly available and, if so, whether we need to adopt safeguards to protect any sensitive or confidential information related to such transactions.

i. Identical Valuation Methods for Assets and Services

76. In the *Joint Cost Order,* we did not prescribe uniform valuation methods for all affiliate transactions. In particular, if an asset transfer was neither tariffed nor subject to prevailing company prices, we required carriers to record the transfer at the higher of net book cost and estimated fair market value when it is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the purchaser. In contrast, the Commission required carriers to record all non-tariffed services other than those having prevailing company prices at the providers' fully distributed costs.

77. If we apply our affiliate transactions rules, with the changes proposed in this Notice, to transactions between the BOC and its affiliates engaged in the manufacturing, origination of interLATA telecommunications services and interLATA information services described in Section 272(a)(2) of the 1996 Act, we believe we should consider prescribing uniform valuation methods for all affiliate transactions. In the *Affiliate Transactions Notice,* we tentatively concluded that our treatment of the provision of services that are neither tariffed nor subject to prevailing company prices may reward a carrier's imprudent acts of buying services for more than, and selling services for less than, fair market value. By requiring carriers to record services they sell to nonregulated affiliates at the carriers' fully distributed costs even when those costs are less than what non-affiliates would pay the carriers, the rules motivate carriers to sell services for less than fair market value. Similarly, by permitting carriers to record services purchased from nonregulated affiliates at the affiliates' fully distributed costs, even when those costs exceed what the carriers would pay non-affiliates, the rules motivate carriers to pay more than fair market value for services. If these increased costs are reflected in rates for regulated telecommunications services, ratepayers may be harmed. Ratepayers and service providers not affiliated with carriers may also be harmed if the valuation methods for affiliate transactions induce carriers and their affiliates to ''use services that are not competitive to subsidize services that are subject to competition,'' thereby putting service providers not affiliated with the carrier at a competitive disadvantage.

78. Because of the concerns identified in the preceding paragraph, we believe that the current rules regarding the valuation of affiliate services may not be consistent with the requirement of Section 272(b)(5) for ''transactions * * * on an arm's length basis.'' Requiring that affiliate transactions that do not involve tariffed assets or services be recorded at the higher of cost and estimated fair market value when the carrier is the seller or transferor, and at the lower of cost and estimated fair market value when the carrier is the buyer or transferee appears more likely to achieve these statutory objectives. We propose to continue to define the applicable cost benchmarks as net book cost for asset transfers and fully distributed costs for service transfers. Our proposed rule, viewed in light of other changes detailed below, would form part of a rational and streamlined approach to affiliate transactions. This proposed rule would also reduce the incentive to record an affiliate transaction as a provision of a service, rather than an asset transfer, especially in the context of procurement activities. We seek comment on whether these modifications would better meet the objectives of Section 272. We also ask commenters to discuss whether, and under what circumstances, we should allow carriers and their affiliates to use any alternative valuation methods. We also seek comment on how the elimination of a sharing obligation from our price cap rules would affect the validity of our tentative conclusion in the *Affiliate Transactions Notice* that our treatment of the provision of services that are neither tariffed nor subject to prevailing company prices may reward a carrier's imprudent acts of buying services for more than, and selling services for less than, fair market value.

79. Section 272(e)(3) requires that ''[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) * * * shall charge the affiliate described in subsection (a) or impute to itself (if using the access for its provision of its own services), an amount for access that is no less than the amount charged to any unaffiliated interexchange carriers for such service.'' Section 272(e)(4) states that ''[a] Bell operating company and an affiliate that is subject to the requirements of section 251(c) * * * may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated.'' We invite comment on how these requirements should affect our rules for implementing the ''arm's length'' requirement of Section 272(b)(5). We also invite comment on whether we should adopt specific accounting procedures to address the difference, if any, between the rates charged by BOCs when they provide interLATA or intraLATA facilities or services on a separated basis and ''the costs [that would be] appropriately allocated'' for the underlying facilities or services.

ii. Prevailing Company Prices

80. The prevailing price method describes the use of the price at which a company offers an asset or service to the general public to establish the value of the affiliate transaction. Generally, when a carrier transfers assets or provides services to an affiliate or the affiliate transfers assets or provides services to the carrier and either the carrier or affiliate conducts similar transactions with the non-affiliates, the transfer or service price with non-affiliates should become the benchmark price for defining the value of the transaction. Although the prevailing price appears to represent the price that would be paid in an arm's length transaction, prevailing price in affiliate transactions may not reflect fair market value primarily because of the different nature of affiliate and non-affiliate transactions. In competitive markets, companies devote significant resources to retaining and attracting customers including sales presentations, advertising campaigns, discounts for volume purchases, or long-term commitments. Most affiliate transactions, however, take place in an entirely different environment. Sales between affiliates generally do not require extensive marketing efforts and involve lower transactional costs than sales to non-affiliates. We invite comment on whether affiliate transactions conducted ''on an arms's length basis'' will necessarily entail the same marketing efforts and transactional costs as sales to non-affiliates. We also invite comment on what, if any, effect any differences in those efforts and costs should have on our decision regarding the use of the prevailing price method for recording affiliate transactions between BOCs and their affiliates engaged in manufacturing, interLATA telecommunications origination and interLATA information services as described in Section 272(a)(2).

81. Our experience with the prevailing price method has revealed the difficulty of defining what constitutes a prevailing price. When a nonregulated affiliate transfers assets or provides services to the carrier and non-affiliates, the question becomes what percentage of an affiliate's overall business must be provided to non-affiliates in order to establish a prevailing company price. If the percentage of third-party business is small, there may not be enough participants in the market to ensure that the price equals the price the carrier and the affiliate would have negotiated ''on an arm's length basis.'' In such situations, using prevailing prices to value asset transfers could permit affiliates to charge inflated prices to the BOC. This would allow nonregulated affiliates to receive added revenue that could permit the nonregulated affiliate to price other competitive assets and services lower to the detriment of fair competition. An additional problem in determining a prevailing price arises because of the nature of the products and services that an affiliate may transfer. ''[R]egulatory requirements that [BOCs] buy equipment competitively crumble quickly when the product being purchased is technically complex and readily differentiated.''

82. We, therefore, seek comment on the benefits of our proposal to amend our affiliate transactions rules to eliminate the valuation of affiliate transactions based on prevailing prices for transactions between a BOC and its affiliates engaged in the manufacturing, interLATA telecommunications origination and interLATA information services described in Section 272(a)(2). Under this proposal, transactions from the carrier to the nonregulated affiliate would be recorded at tariffed rates, if applicable, or at the higher of fair market value or fully distributed cost. Transactions from the nonregulated affiliate to the carrier would be recorded at the lower of fully distributed cost or fair market value.

iii. Estimates of Fair Market Value

83. In prior portions of this NPRM, we propose to adopt identical valuation methodologies for assets and services which would require the carrier to record most affiliate transactions at the higher of net book cost and estimated fair market value when the carrier is the seller, and at the lower of net book cost and estimated fair market value when the carrier is the buyer. These proposals implicitly assume that there is an observable fair market value for any assets and services that a carrier and its nonregulated affiliates might provide each other, and that reasonable efforts will enable the carrier to discover that value. We believe that the procedures carriers use in estimating fair market value should vary with the circumstances of the transaction and consequently that we should not specify the methodologies that carriers must follow to estimate fair market value. We instead propose to require carriers to make good faith determinations of the fair market value, where such a valuation is required under the affiliate transactions rules. While this methodology will limit appraisals to transactions, such as building sales and other transfers of major assets, for which nonregulated companies obtain appraisals in the normal course of business, we believe a more stringent approach would impose unnecessary burdens and costs on the BOCs and other incumbent local exchange carriers. We believe that a good faith requirement would help ensure that affiliates covered by Section 272 ''conduct all transactions with the [BOC] of which it is an affiliate on an arm's length basis.''

84. While we propose not to prescribe methodologies for estimating fair market value, we seek comment on whether we should set criteria for determining what constitutes a good faith estimate of fair market value. For example, if a transaction is subject to reasonable independent valuation methods, we believe that carriers should continue to ascertain fair market value by applying these methods to demonstrate their good faith. If companies making certain purchases routinely solicit competitive bids, survey potential suppliers, or obtain independent appraisals, companies should continue to employ these methods to determine fair market value. Thus, carriers could support affiliate transactions involving real estate transfers by means of independent appraisals.

85. In situations involving transactions that are not easily valued, we seek comment on whether we should still require carriers to support their valuations by reasonable and appropriate methods. For example, for some assets or services a carrier might determine that an independent appraisal would be difficult, if not impossible, to obtain or be prohibitively expensive. In this case, a good faith attempt to ascertain fair market value might include supporting the transaction with computations or studies that utilize methods and principles that an independent appraiser would apply. This could mean, if possible, obtaining comparable sales information, computing values by applying a responsible capitalization rate on cash flow, or determining replacement value. We note that nothing discussed in this Notice would exempt carriers from their statutory obligation under Section 220(c) to justify their accounting entries. We invite comment on our proposal to allow good faith attempts to determine fair market value in affiliate transactions.

iv. Tariffed-based Valuation

86. Finally, we seek comment about the status of tariff-based valuation if incumbent local exchange carriers are not required to provide interconnection and collocation services and network elements pursuant to tariffs. Under Section 252, it may be that the BOC

would submit agreements adopted by negotiations or arbitration to State commissions for approval or rejection without ever filing a tariff. Alternatively, the BOCs may file statements of generally available terms pursuant to Section 252(f) that would state the terms on which these LECs would provide services to all customers who desire them. We seek comment on whether, and the extent to which, our affiliate transactions rules should be amended to substitute rates appearing in such publicly filed agreements and statements for tariffed rates where affiliates could subscribe to services under such generally available terms. We also seek comment on whether such amendments would be consistent with, or required by, Sections 272(e)(3) and 272(e)(4).

v. Return Component for Allowable Costs

87. In the *Joint Cost Proceeding,* the Commission determined that fully distributed costs should include a return on investment, but no ''profit'' in excess of the return then prescribed for the carrier's interstate regulated activities. Consequently, carriers that utilize fully distributed cost to value affiliate transactions include in their cost computations a component for rate of return. We believe we should consider allowing all carriers providing directly, or indirectly through an affiliate, the services that are the subject of Section 272 to use a uniform rate of return to value affiliate transactions. Adopting numerous rates of return would impose a significant compliance burden on the industry. In addition, the use of various rates of return could favor certain telecommunications service providers and disadvantage others. Moreover, allowing carriers to determine their own rate of return would increase the likelihood that an affiliate will fail to ''conduct all transactions with the [BOC] of which it is an affiliate an arm's length basis[,]'' as required by Section 272(b)(5). From a regulatory standpoint, the Commission would have a difficult, if not impossible, burden if it had to engage in numerous prescription proceedings and then monitor compliance with each.

88. The Commission has prescribed a unitary, overall rate of return for those incumbent local exchange carriers still subject to rate-of-return regulation to use in computing interstate revenue requirements, unless a carrier can show that such use would be confiscatory. The current prescribed rate of return on interstate services is 11.25 percent. Because the rate-of-return represcription will not affect either the price cap indices or the sharing zones for carriers subject to price cap regulation, the impact of any represcription of this rate of return on price cap LECs would be limited. In addition to affecting cost calculations for affiliate transactions, as we propose above, a represcription may change the amounts that price cap LECs receive from the universal service fund or pay for long-term support of NECA's common line pool and the amounts those LECs pay the telecommunications relay services fund to give persons with hearing or speech impairments full access to the voice communications network. We seek comment on whether we should require the BOCs to use the prescribed interstate rate of return for valuing their transactions with their affiliates engaged in the manufacturing activities, in-region telecommunications services origination and interLATA information services described in Section 272(a)(2).

d. Application to InterLATA Telecommunications Affiliates

89. We propose to apply our affiliate transactions rules to transactions between a BOC and any affiliates it establishes under Section 272(a) Under that provision, a BOC, including any affiliate, ''which is a local exchange carrier that is subject to the requirements of section 251(c)'' may not provide in-region interLATA telecommunications services, interLATA information services, or manufacturing unless it provides those services through one or more affiliate. Any transactions between a BOC and its interLATA information services or manufacturing affiliates would be subject to our existing affiliate transactions rules, because neither interLATA information services nor manufacturing are regulated activities under Title II. InterLATA telecommunications services, however, are regulated under Title II, and, absent a Commission requirement to the contrary, the affiliates that offer those services would therefore classify interLATA telecommunications services as regulated for Title II accounting purposes. Our existing affiliate transactions rules are solely designed for transactions between regulated carriers and their nonregulated affiliates. To help protect against improper subsidization, we have already determined that out-of-region interstate, interexchange services provided by BOC affiliates should be treated as nonregulated for accounting purposes. Thus, our affiliate transactions rules apply to transactions between the BOCs and those affiliates. Because BOC in-region interLATA telecommunications services also present a potential for improper subsidization, we tentatively conclude that we should apply our affiliate transactions rules to transactions between each BOC and any interLATA telecommunications services affiliate it establishes under Section 272(a). We invite comment on this tentative conclusion. We also invite comment on whether and how we should adapt our affiliate transactions rules if applied to such transactions and, in particular, whether we should adopt special valuation methodologies for these transactions to recognize the regulated status of the affiliates on both sides of the transactions.

90. Section 272 does not prohibit a BOC from providing manufacturing and interLATA information services described in Section 272(a)(2) through the same affiliate by which it provides origination of interLATA telecommunications services described in the same section. It also does not prohibit that affiliate from engaging in other activities not regulated under Title II. We seek comment on whether in this context we should apply our cost allocation rules to prevent subsidization of nonregulated activities, including manufacturing and interLATA information services, by subscribers to interLATA telecommunication services. In particular, we seek comment on what, if any, authority Section 254(k) extends to our application of our cost allocation rules to affiliates engaged in regulated and nonregulated activities.

e. Application to Joint Marketing

91. Although Section 272(b)(3) requires [the affiliate] to ''have separate officers, directors, and employees from the Bell operating company of which it is an affiliate,'' Section 272(g)(2) allows the BOC to ''market or sell interLATA service provided by an affiliate required by [Section 272] . . . [after] such company is authorized to provide interLATA services in such State under section 271(d).'' In our companion *BOC In-Region NPRM,* we seek comment on whether an affiliate may share marketing personnel with a BOC, and if so, what corporate and financial arrangements are necessary to comply with sections 272(b)(3), 272(b)(5) and 272(g)(2). If an affiliate may share marketing personnel with a BOC, we tentatively conclude that we should apply our cost allocation and affiliate transactions rules, as we propose to modify them in this Notice, to any joint marketing on interLATA and local exchange services. We seek comment whether and the extent to which any

additional accounting safeguards may be necessary.

f. Audit Requirements

92. Section 272(d) states that companies required to maintain a separate affiliate under Section 272 ''shall obtain and pay for a Federal/State audit every 2 years conducted by an independent auditor to determine whether such company complied with this section and the regulations promulgated under this section, and particularly whether such company has complied with the separate accounting requirements under [Section 272(b)].'' The independent auditor ''shall submit the results of the audit to the Commission and to the State commission of each State in which the company audited provides service, which shall make such results available for public inspection.'' Interested persons may then submit comment on the final audit report.

93. We tentatively conclude that the independent auditor's report should be filed with the Commission and each relevant State commission and should include a discussion of: (1) the scope of the work conducted, with a description of how the affiliate's or joint venture's books were examined and the extent of the examination; (2) the auditor's conclusion whether examination of the books has revealed compliance or non-compliance with the affiliate transactions rules and any non-discrimination requirements in the Commission rules; (3) any limitations imposed on the auditor in the course of its review by the affiliate or joint venture or other circumstances that might affect the auditor's opinion; and (4) a statement by the auditor that the carrier's cost allocation methodologies conform to the Communications Act of 1934, as amended, and the Commission's rules and that the carrier has accurately applied the methodologies described in those rules. We seek comment on the necessity or desirability of using such an approach to satisfy the requirements of Section 272(d). We also seek comment on whether the independent auditor's report should address whether the carrier has complied with Sections 272(e)(3) and 272(e)(4).

g. Scope of Commission's Authority

94. Section 272 of the 1996 Act, by its terms, covers transactions between a BOC and its affiliates engaged in the manufacturing activities, origination of interLATA telecommunications services, and interLATA information services described in Section 272(a)(2). As we have done in the *BOC In-Region NPRM*, we believe that each of these activities requires a different analysis. We state elsewhere in this Notice our tentative conclusions and analysis regarding telemessaging, interLATA telecommunications services, and manufacturing activities. We also tentatively conclude that we should apply our analysis for telemessaging to other interLATA information services covered by Section 272. We seek comment on this tentative conclusion.

2. Section 273—Manufacturing by Certifying Entities

a. Statutory Language

95. Section 273(d) of the 1996 Act requires certain standard-setting organizations to maintain separate affiliates in order to engage in certain types of manufacturing. Under Section 273(d)(3), when such a standard-setting organization certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity, the certifying entity ''shall only manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity * * * through a separate affiliate.'' [N]otwithstanding [Section 273(d)(3)],'' Section 273(d)(1)(B) prohibits ''Bell Communications Research, Inc., or any successor entity or affiliate'' from ''engag[ing] in manufacturing telecommunications equipment or customer premises equipment as long as it is an affiliate of more than 1 otherwise unaffiliated [BOC] or successor or assign of any such company.''

96. Section 273(d)(3)(B) requires the separate affiliate to ''maintain books, records, and accounts separate from those of the entity that certifies such equipment, consistent with generally acceptable accounting principles[,]'' and to ''have segregated facilities and separate employees'' from the certifying entity. Section 273(g) permits ''[t]he Commission [to] prescribe such additional rules and regulations as the Commission determines necessary to carry out the provisions of this section, and otherwise to prevent discrimination and cross-subsidization in a [BOC's] dealings with its affiliates and with third parties.''

b. Comparison of Sections 273 and 272

97. Both Sections 272 and 273 require the use of a separate affiliate to engage in different specified activities. We have already proposed accounting safeguards to govern transactions between a BOC and its affiliate engaged in the manufacturing, origination of interLATA telecommunications services and interLATA information services described in Section 272(a)(2). Section 273 requires a standard-setting organization that certifies telecommunications equipment or customer premises equipment manufactured by an unaffiliated entity to ''only manufacture a particular class of telecommunications equipment or customer premises equipment for which it is undertaking or has undertaken, during the previous eighteen months, certification activity * * * through a separate affiliate.'' Section 273(d)(3)(B) requires that the separate affiliate of the standard-setting organization ''maintain books, records, and accounts separate from those of the entity that certifies such equipment, consistent with generally acceptable accounting principles[,]'' and to ''have segregated facilities and separate employees'' from the certifying entity. As a threshold question, we seek comment on whether and, if so, how Section 273's different statutory language requires or permits different accounting treatment from that required or permitted for BOCs under Section 272. Specifically, we seek comment whether we should apply our affiliate transactions rules, as we propose to modify them, to transactions between a certifying entity and the affiliate it must maintain under Section 273(d). We note that our existing rules would not cover transactions between a certifying entity and its affiliate where that certifying entity is not also a regulated carrier. We, therefore, seek comment on whether, and to what extent, we should modify our affiliate transactions rules to govern such transactions.

98. In addition to the accounting safeguards for BOC entry into manufacturing set forth in Section 272 as discussed above, we note that Section 273(g) specifically authorizes ''[t]he Commission [to] prescribe such additional rules and regulations as the Commission determines necessary * * * to prevent cross-subsidization in a [BOC's] dealings with its affiliates and with third parties.'' We tentatively conclude that application of our affiliate transactions rules, as we propose to modify them, to BOCs engaged in activities under Section 273 would be sufficient to satisfy this provision of the 1996 Act. We seek comment on this tentative conclusion.

c. Scope of Commission's Authority

99. Section 273 provides that a BOC may manufacture and provide telecommunications equipment and

customer premises equipment if the Commission authorizes that BOC to provide interLATA services under Section 271(d). Section 273 also sets out safeguards for BOC manufacturing activities. We tentatively conclude that the provisions of this section apply to all BOC manufacturing activities, irrespective of any jurisdictional distinction. First, much like Sections 271 and 272, Section 273 sets the conditions for BOC entry into manufacturing. Thus, as with Sections 271 and 272, we believe that Section 273 was meant to supersede the MFJ, and to replace it for both interstate and intrastate activities, to the extent that such a jurisdiction division makes sense in the context of manufacturing. Section 273 conditions entry into manufacturing on the BOC's obtaining Commission approval for interLATA entry under Section 272. This relationship between Sections 272 and 273 further suggests that they should both be read to have the same jurisdictional reach.

100. Moreover, we tentatively conclude that although Section 2(b) of the Communication Acts limits the Commission's authority over ''charges, classifications, practices, services, facilities, or regulation for or in connection with intrastate communications service,'' we tentatively conclude the manufacturing activities addressed by Section 273 are not within the scope of Section 2(b). Even if Section 2(b) applies with respect to BOC manufacturing under Section 273, we tentatively find that such manufacturing activities plainly cannot be segregated into interstate and intrastate portions. We invite comment on what role States might have in implementing Section 273's accounting safeguards provisions, assuming the correctness of these beliefs, and, in particular, whether in enacting Section 273, Congress intended to eliminate our ability to allow the States to depart from the federal cost allocation procedures in their regulation of ''charges * * * for or in connection with intrastate communications service[s].'' We ask the commenters also to address whether preemption in this area would be necessary to achieve the intent behind Section 273 or whether less intrusive measures would be sufficient.

3. Section 274—Electronic Publishing

101. Section 274 of the 1996 Act prescribes the terms under which a BOC may offer electronic publishing. Section 274(a) permits a BOC or its affiliate to provide electronic publishing over its or its affiliate's basic telephone service only through a ''separated affiliate'' or an ''electronic publishing joint venture.'' Section 274(i)(9) defines ''separated affiliate'' as ''a corporation under common ownership or control with a Bell operating company that does not own or control a Bell operating company and is not owned or controlled by a Bell operating company and that engages in the provision of electronic publishing which is disseminated by means of such Bell operating company's or any of its affiliate's basic telephone service.'' Section 274(i)(8), in turn defines ''own'' as having ''a direct or indirect equity interest (or the equivalent thereof) of more than 10 percent of an entity, or the right to more than 10 percent of the gross revenues of an entity under a revenue sharing or royalty agreement.'' Section 274(i)(4) states that ''control'' has the meaning that it has in 17 CFR 240.12b–2, the regulations promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) or any successor provision to such section.'' Section 274(i)(5) defines an ''electronic publishing joint venture'' as '' a joint venture owned by a Bell operating company or affiliate that engages in the provision of electronic publishing which is disseminated by means of such Bell operating company's or any of its affiliates' basic telephone service.''

102. Under Section 274(b), the ''separated affiliate'' or joint venture ''shall be operated independently from the [BOC].'' The ''separated affiliate'' or joint venture and the BOC with which it is affiliated must ''carry out transactions (i) in a manner consistent with such independence, (ii) pursuant to written contracts or tariffs that are filed with the Commission and made publicly available, and (iii) in a manner that is auditable in accordance with generally accepted auditing standards.'' The ''separated affiliate'' or joint venture must also ''value any assets that are transferred directly or indirectly from the [BOC] to a separated affiliate or joint venture, and record any transactions by which such assets are transferred, in accordance with such regulations as may be prescribed by the Commission or a State commission to prevent improper cross-subsidies.''

103. Section 274(c)(2) discusses the joint activities permitted under Section 274. Section 274(c)(2)(A) provides that ''[a] Bell operating company may provide inbound telemarketing or referral services related to the provision of electronic publishing for a separated affiliate, electronic publishing joint venture, affiliate, or unaffiliated electronic publisher, provided that if such services are provided to a separated affiliate, electronic publishing joint venture, or affiliate, such services shall be made available to all electronic publishers on request, on nondiscriminatory terms.'' Section 274(c)(2)(B) states that ''[a] Bell operating company may engage in nondiscriminatory teaming or business arrangements to engage in electronic publishing with any separated affiliate or with any other electronic publisher if (i) the Bell operating company only provides facilities, services, and basic telephone service information as authorized by [Section 274], and (ii) the Bell operating company does not own such teaming or business arrangement.'' Lastly, Section 274(c)(2)(C) permits ''[a] Bell operating company or affiliate [to] participat[e] on a nonexclusive basis in electronic publishing joint ventures with entities that are not a Bell operating company, affiliate, or separated affiliate to provide electronic publishing services, if the Bell operating company or affiliate has not more than a 50 percent direct or indirect equity interest (or the equivalent thereof) or the right to more than 50 percent of the gross revenues under a revenue sharing arrangement or royalty agreement in any electronic publishing joint venture.'' Under Section 274(c)(2)(C), ''[o]fficers and employees of a Bell operating company or affiliate participating in an electronic publishing joint venture may not have more than 50 percent of the voting control over the electronic publishing joint venture.'' ''In the case of joint ventures with small, local electronic publishers, the Commission for good cause shown may authorize the Bell operating company or affiliate to have a larger equity interest, revenue share, or voting control but not to exceed 80 percent.'' A BOC participating in an electronic publishing joint venture ''may provide promotion, marketing, sales, or advertising personnel and services to such joint venture.''

104. Section 274(d) requires a ''Bell operating company under common ownership or control with a separated affiliate or electronic publishing joint * * * [to] provide network access and interconnections for basic telephone service to electronic publishers at just and reasonable rates that are tariffed (so long as rates for such services are subject to regulation).'' Those rates cannot be ''higher on a per-unit basis than those charges for such services to any other electronic publisher or any separated affiliate engaged in electronic publishing.''

a. Comparison of Sections 274 and 272

105. The language of Section 274's structural and transactional

requirements differs from the structural and transactional requirements of Section 272. We invite comment on whether the distinction between a ''separated affiliate'' under Section 274 and a ''separate affiliate'' under Section 272 requires or permits different accounting treatment for affiliate transactions pursuant to Sections 272 and 274. Specifically, we seek comment whether we should apply our affiliate transactions rules, as we propose to modify them, to transactions between a BOC and its electronic publishing joint venture or ''separated affiliate.'' We seek comment on whether application of these rules would provide adequate accounting safeguards for the joint activities permitted under Section 274(c)(2). Because Section 274 allows a BOC to provide electronic publishing through either a ''separated affiliate'' or a joint venture, we also seek comment on whether we should distinguish, for Title II accounting purposes, between transactions involving a BOC and its ''separated affiliate'' and those involving a BOC and its electronic publishing joint venture.

b. Audit Requirements

106. Section 274(b)(8) requires electronic publishing ''separated affiliates'' or joint ventures and the BOC with which they are affiliated to have performed an annual compliance review ''conducted by an independent entity for the purpose of determining compliance during the preceding calendar year with any provision of [Section 274].'' The results of such a review must be maintained by the ''separated affiliate'' or the joint venture for a five-year period. We seek comment regarding how such compliance reviews should be conducted. We ask commenters to address specifically what matters the annual compliance review should encompass. We propose to require the independent entity to prepare and file with the Commission reports describing: (1) the scope of its compliance review, with a description of how the affiliate's or joint venture's books were examined and the extent of the examination; (2) the independent entity's conclusion whether examination of the books has revealed compliance or non-compliance with the affiliate transactions rules and any other non-discrimination requirements imposed by Commission rules; (3) any limitations imposed on the independent entity in the course of its review by the affiliate or joint venture or other circumstances that might affect the entity's opinion; and (4) statements by the independent entity as to whether the carrier's accounting and affiliate transactions methodologies conform to the Communications Act of 1934, as amended, and the Commission's rules and whether the carrier has accurately applied the methodologies. We seek comment on the necessity or desirability of this approach.

107. Section 274(b)(9) states a separated affiliate or joint venture and the BOC with which it is affiliated shall ''within 90 days of receiving a review described in [Section 274(b)(8)], file a report of any exceptions and corrective action with the Commission and allow any person to inspect and copy such review subject to reasonable safeguards to protect any proprietary information contained in such report from being used for purposes other than to enforce or pursue remedies under [Section 274].'' We seek comment regarding what ''reasonable safeguards'' may be necessary to protect proprietary information in the compliance review report ''from being used for purposes other than to enforce or pursue remedies under [Section 274].''

c. Section 274(f)'s Reporting Requirement

108. Section 274(f) requires ''[a]ny separated affiliate under [Section 274 to] file with the Commission annual reports in a form substantially equivalent to the Form 10–K required by regulations of the Securities and Exchange Commission.'' The Form 10–K contains a description of the company filing the report and its operations, financial statements with supporting financial data, and major legal and financial disclosures concerning the company. We tentatively conclude that, to minimize burdens on the filing companies, we should require the separated affiliate to file the Form 10–K with us as well as the Securities and Exchange Commission. We recognize, however, that not all separated affiliates providing electronic publishing services would be subject to the Security and Exchange Commission's Form 10–K requirement. With regard to these separated affiliates, we seek comment on what ''substantially equivalent to the Form 10–K'' means under Section 274(f).

d. Section 274 Transactional Requirements

109. Section 274(b)(1) requires the ''separated affiliate'' or joint venture to ''maintain books, records, and accounts and prepare separate financial statements.'' We invite comment on the steps we should take to implement this provision. We ask the commenters to address whether it is necessary for the Commission to adopt any additional accounting, bookkeeping, or record keeping requirements for these affiliates and joint ventures, and, if so, what those additional requirements should be.

110. Under Section 274(b), the ''separated affiliate'' or joint venture ''shall be operated independently from the [BOC].'' The ''separated affiliate'' or joint venture and the BOC with which it is affiliated must ''carry out transactions (i) in a manner consistent with such independence, (ii) pursuant to written contracts or tariffs that are filed with the Commission and made publicly available, and (iii) in a manner that is auditable in accordance with generally accepted auditing standards.'' We seek comment on the meaning of ''in a manner consistent with such independence.'' We also seek comment as to whether any regulations are necessary to implement Sections 274 (b)(3)(A) and (b)(3)(B).

111. We further seek comment on whether and, if so, how we should amend our rules to implement the requirement that transactions under Section 274(b)(3)(C) be ''auditable in accordance with generally accepted auditing standards.'' Generally accepted auditing standards refer to standards and guidelines promulgated by the American Institute of Certified Public Accountants that an independent auditor must follow when preparing for and conducting an audit of a company's financial statements. These standards generally require that the auditor review a company's internal controls and determine whether adequate documentation exists to verify that the company has recorded transactions on its books in a manner consistent with generally accepted accounting principles.

112. According to Section 274(b)(4), the ''separated affiliate'' or joint venture must also ''value any assets that are transferred directly or indirectly from the [BOC] to a separated affiliate or joint venture, and record any transactions by which such assets are transferred, in accordance with such regulations as may be prescribed by the Commission or a State commission to prevent improper cross-subsidies.'' We have proposed in this Notice to conform our valuation methods under the affiliate transactions rules for the provision of services to those governing asset transfers. Regardless of how we resolve that issue, because Section 274 specifically addresses asset transfers between a BOC and its ''separated affiliate'' or joint venture, we seek comment on whether in this case we should distinguish between the asset transfers and the provision of services in

the context of electronic publishing affiliate transactions.

e. Scope of Commission's Authority

113. Although electronic publishing is specifically included within the definition of information service in Section 3(20), it is specifically exempted from the separate affiliate and nondiscrimination requirements of Section 272. Section 274,which applies only to BOCs, requires the use of a ''separated affiliate'' or ''electronic publishing joint venture'' in order for a BOC to engage in the provision of electronic publishing services via basic telephone services.

114. Section 274 imposes a number of safeguards on the provision by BOCs of electronic publishing through a separated affiliate or electronic publishing joint venture. Unlike Sections 260 and 275, however, Section 274 specifically refers to State commission jurisdiction regarding one of these safeguards. Section 274(b)(4) provides that a separated affiliate or joint venture and the BOC with which it is affiliated shall:

> value any assets that are transferred directly or indirectly from the Bell operating company to a separated affiliate or joint venture, and record any transactions by which such assets are transferred, in accordance with such regulations as may be prescribed by the *Commission or a State commission* to prevent improper cross subsidies.

This explicit reference to State commission regulations indicates that the requirements of this section apply to both interstate and intrastate electronic publishing services, and at the same time suggests that the Commission may not have exclusive jurisdiction over all aspects of intrastate services pursuant to Section 274. In light of this subsection, we seek comment on the extent of our authority, if any, under Section 274 over intrastate electronic publishing services.

115. Section 274(e) also provides that any person claiming a violation of this section may file a complaint with the Commission, or may bring suit pursuant to Section 207. It also provides that an application for a cease and desist order may be made to the Commission, or in any district court. No reference is made to complaints being filed with State commissions. We seek comment on the extent to which the Commission has jurisdiction under Section 274 over intrastate electronic publishing, particularly in light of the specific provisions of Sections 274(b)(4) and 274(e). We ask that commenters clearly identify whether specific subsections of Section 274 confer intrastate authority with respect to accounting matters addressed by Section 274 on the Commission.

116. To ensure a complete record, we also seek comment on whether, apart from any intrastate jurisdiction conferred by Section 274 itself, we have authority to preempt State regulation with respect to the accounting matters addressed by Section 260 pursuant to *Louisiana PSC* and, if so, whether we should exercise that authority. We tentatively conclude that if Section 274 does not apply to intrastate services and if we have authority to preempt pursuant to *Louisiana PSC*, we should refrain from exercising it in this area and instead retain our prior policy of not preempting States from using their own cost allocation procedures for intrastate purposes. We invite comment on this tentative conclusion. We also invite comment on what role states might have in implementing Section 274's accounting safeguards provisions, given the above analysis. We ask commenters to address whether in enacting Section 274, Congress intended to foreclose the states from departing from the federal cost allocation procedures for electronic publishing in their regulation of ''charges . . . for or in connection with intrastate communications service[s].'' We also ask the commenters also to address whether preemption in this area would be necessary to achieve the intent behind Section 274 or whether less intrusive measures would be sufficient.

f. Miscellaneous

117. Section 274(d) also requires a ''Bell operating company under common ownership or control with a separated affiliate or electronic publishing joint venture . . . [to] provide network access and interconnections for basic telephone service to electronic publishers at just and reasonable rates that are tariffed (so long as rates for such services are subject to regulation) and that are not higher on a per-unit basis than those charges for such services to any other electronic publisher or any separated affiliate engaged in electronic publishing.'' We tentatively conclude that we should apply our affiliate transactions rules, as we propose to modify them, to the provision of ''network access and interconnections for basic telephone service'' by a BOC under common ownership or control to ensure compliance with Section 274(d). We seek comment on this tentative conclusion.

4. Separated Operations Under Sections 260, 271, 275 and 276

118. While Sections 260, 271, 275 and 276 of the 1996 Act define categories of services that BOCs and, in some cases, incumbent local exchange carriers may not necessarily have to offer through a separate affiliate, a BOC or other incumbent local exchange carrier might, even if not required to do so, choose to perform these activities through an affiliate. We note that these sections do not explicitly impose regulatory requirements for transactions between a regulated company and its nonregulated affiliate. Sections 260, 275 and 276 bar the subsidization of the competitive businesses permitted under those sections by subscribers of either exchange access services. Section 260(a)(1) states that ''[a]ny local exchange carrier subject to the requirements of section 251(c) . . . shall not subsidize its telemessaging service directly or indirectly from its telephone exchange service or its exchange access.'' Section 275(b)(2) prohibits the subsidization of alarm monitoring services ''either directly or indirectly from telephone exchange service operations.'' Section 276(a)(1) bars any BOC that provides payphone service from ''subsidiz[ing] its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations.'' We believe that application of our affiliate transactions rules, as we propose to modify them, to transactions between an incumbent local exchange carrier and any of its affiliates engaged in activities that Sections 260, 275 and 276 of the 1996 Act might permit or require the carrier to offer through a separate affiliate would be consistent with these statutory mandates. We therefore seek comment on whether we should apply the affiliate transactions rules, with the proposed modifications, to transactions between an incumbent local exchange carrier and any of its affiliates engaged in activities that Sections 260, 275 and 276 might permit or require the carrier to offer through a separate affiliate. It is important to note, that we tentatively conclude in a companion item, *BOC In-Region NPRM*, that telemessaging, as defined in Section 260, is an information service. BOC provision of telemessaging on an interLATA basis would therefore be subject to the separate affiliate and other requirements of Section 272.

119. We also ask commenters to identify any interLATA telecommunications services, other than the interLATA telecommunications services that Section 272 requires BOCs

to provide through a separate affiliate, that the BOCs may choose to provide on a separated basis and for which we should develop appropriate affiliate transactions rules. In the case of such services, the 1996 Act does not explicitly impose or require specific regulatory safeguards to prevent subsidies. All of these interLATA telecommunications services would currently be considered regulated services for Title II accounting purposes, and, absent a Commission requirement to the contrary, the affiliates that offer these services would therefore classify them as regulated for Title II accounting purposes. Our existing affiliate transactions rules are solely designed to govern transactions between regulated carriers and their nonregulated affiliates. Because interLATA telecommunications services present a potential for improper subsidization, we tentatively conclude that we should apply our affiliate transactions rules to transactions between each BOC and any interLATA telecommunications services affiliate it establishes. We invite comment on this tentative conclusion. We also invite comment on whether and how we should adapt our affiliate transactions rules if applied to such transactions and, in particular, whether we should adopt special valuation methodologies for these transactions to recognize the regulated status of the affiliates on both sides of the transactions.

IV. Other Matters

A. Price Caps

1. General

120. Our existing Part 64 cost allocation rules were developed when all local exchange carriers were subject to cost-based, rate-of-return regulation. Today, we rely upon price cap, rather than rate-of-return, regulation to ensure that rates for the interstate services of the largest incumbent local exchange carriers, including the BOCs, are reasonable. Many States also have moved away from the traditional rate-of-return regulation by establishing temporary rate freezes or other price cap-like plans. Several State plans that were implemented before the Commission adopted price caps helped to guide us in developing the federal plan. Under the Commission's plan, price cap indices limit the prices that incumbent local exchange carriers may charge for their regulated interstate services. The indices are adjusted each year in accordance with a formula that accounts for changes in inflation and industry-wide changes in productivity.

121. The rules we adopt to prevent the subsidies prohibited by Sections 260 and 271 through 276 of the 1996 will shaped by our price cap regulations. A ''pure'' price cap system would permanently eliminate sharing, claims for exogenous treatment, and the need for the Commission to consider adjustments to productivity factors. Under pure price cap regulation, there would be few incentives to subsidize nonregulated services with revenues from regulated telecommunications services and the need for accounting safeguards to ensure against subsidies would be greatly diminished, unless, of course, there are other ways in which the carrier's entitlement to any revenues is dependent upon the costs the carrier classifies as regulated.

2. Exogenous Costs and Part 64

122. Under our price cap rules for incumbent local exchange carriers, most changes in a carrier's costs of providing regulated services are treated as ''endogenous,'' which means they do not result in adjustments to the carrier's price cap indices. Certain cost changes, however, triggered by administrative, legislative, or judicial action that are beyond the control of the carriers may result in adjustments to those indices. The Commission concluded that failing to recognize these cost changes by adjusting price cap indices would either unjustly punish or reward the carrier. Price cap carriers may claim adjustments to their indices based on costs that are beyond the carriers' control if they are not otherwise accounted for in the price cap formula. Such costs are defined as ''exogenous.'' Accordingly, the Commission has found that those types of cost changes should be treated ''exogenously'' to ensure that price cap regulation does not lead to unreasonably high or unreasonably low rates.

123. Our price cap rules for incumbent local exchange carriers specify that ''[s]ubject to further order of the Commission, those exogenous cost changes shall include cost changes caused by * * * [t]he reallocation of investment from regulated to nonregulated activities pursuant to [Section 64.901 of the Commission's rules].'' Under a strict reading of this rule, cost reallocations due to changes in the Part 64 cost allocation process would result in exogenous treatment only to the extent amounts are reallocated ''from regulated to nonregulated activities.'' We seek comment on this interpretation and whether all such reallocations to nonregulated activities that may result from the provision of telemessaging service should trigger an adjustment to lower price cap indices. We also seek comment on the potential exogenous treatment of new investment in network plant, some of which will be used for telemessaging service. As noted above, this investment may later require reallocation under part 64 if the proportion of regulated usage to nonregulatred usage changes over time.

3. Part 64 and Sharing

124. Under our price cap rules, incumbent local exchange carriers can select the productivity factor they will use to determine annual adjustments to their price cap indices. If they choose not to select the highest productivity factor permitted under our rules, they are required to ''share.'' Under sharing, incumbent local exchange carriers earning in excess of prescribed earnings levels must refund a portion of the excess earnings in subsequent rate periods by reducing their price cap indices. Those earnings are equal to the incumbent local exchange carrier's interstate revenues less the regulated interstate costs. Improper cost allocation can increase the incumbent local exchange carrier's regulated interstate costs and, therefore, can reduce the carrier's sharing obligations. We note, however, that in their most recent annual tariff filings all but four price cap local exchange carriers elected the highest interim productivity factor we had prescribed,which exempts them from sharing obligations for the 1995–96 access year. We seek comment on whether our eliminating sharing obligations permanently for price cap carriers would eliminate the need for Part 64 processes in our regulation of these companies. We also seek comment on how the relationship of our cost allocation rules to price cap local exchange carriers should influence the outcome of this proceeding.

B. Section 254(k)

125. Section 254(k) prohibits a telecommunications carrier from ''us[ing] services that are not competitive to subsidize services that are subject to competition.'' Section 254(k) further states that ''[t]he Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.'' We seek comment on whether our proposals related to Sections 260 and 271 through

276 of the 1996 Act are sufficient to implement Section 254(k)'s requirements that carriers not ''use services that are not competitive to subsidize services that are subject to competition'' and that the Commission, ''with respect to interstate services,'' establish rules necessary to ensure that regulated universal services ''bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.''

V. Procedural Issues

A. Ex Parte Presentations

126. This is a non-restricted notice-and-comment rulemaking proceeding. *Ex parte* presentations are permitted, except during the Sunshine Agenda period, provided that they are disclosed as provided in the Commission's rules.

B. Regulatory Flexibility Analysis

127. Section 603 of the Regulatory Flexibility Act, as amended, requires an initial regulatory flexibility analysis in notice and comment rulemaking proceedings, unless we certify that ''the rule will not, if promulgated, have a significant economic impact on a significant number of small entities.'' The Regulatory Flexibility Act generally defines the term ''small entity'' as having the same meaning as ''small-business concern'' under the Small Business Act, which defines ''small-business concern'' as ''one which is independently owned and operated and which is not dominant in its field of operation * * *.'' This proceeding pertains to the Bell Operating Companies and other incumbent local exchange carriers which, because they are dominant in their field of operations, are by definition not small entities under the Regulatory Flexibility Act. We therefore certify, pursuant to Section 605(b) of the Regulatory Flexibility act, that the rules will not, if promulgated, have a significant economic impact on a substantial number of small entities. The Secretary shall send a copy of this NPRM, including this certification and statement, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of this certification will also be published in the Federal Register notice.

C. Paperwork Reduction Act

128. This NPRM contains either a proposed or modified information collection. The Commission, as part of its continuing effort to reduce paperwork burdens, invites the general public and the Office of Management and Budget (OMB) to comment on the information collections contained in this NPRM, as required by the Paperwork Reduction Act of 1995, Public Law No. 104–13. Public and agency comments are due on August 26, 1996 and reply comments are due on September 10, 1996; OMB comments are due September 30, 1996. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

129. Written comments by the public on the proposed or modified information collection are due on or before August 26, 1996 and reply comments on or before September 10, 1996. Written comments must be submitted by the Office of Management and Budget (OMB) on the proposed or modified information collections on or before [insert date 60 days after publication in the Federal Register.] In addition to filing comments with the Secretary, a copy of any comments on the information collection contained herein should be submitted to Dorothy Conway, Federal Communications Commission, Room 234, 1919 M Street, N.W., Washington, DC 20554, or via the Internet to dconway@fcc.gov and to Timothy Fain, OMB Desk Officer, 10236 NEOB, 725 17th Street, N.W., Washington, DC 20503 or via the Internet to fain__t@al.eop.gov.

D. Comment Filing Procedures

130. Pursuant to applicable procedures set forth Sections 1.415 and 1.419 of the Commission's rules, 47 CFR §§ 1.415 and 1.419, interested parties may file comments on or before August 26, 1996, and reply comments on or before September 10, 1996. To file formally in this proceeding, you must file an original and six copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments, you must file an original and eleven copies. Comments and reply comments should be sent to Office of the Secretary, Federal Communications Commission, 1919 M Street, N.W., Room 222, Washington, D.C. 20554, with a copy to Ernestine Creech of the Common Carrier Bureau's Accounting and Audits Division, 2000 L Street, N.W., Suite 257, Washington, D.C. 20554. Parties should also file one copy of any documents filed in this docket with the Commission's copy contractor, International Transcription Services, Inc. (''ITS''), 2100 M Street, N.W., Suite 140, Washington, D.C. 20037. Interested parties can reach ITS by telephone at (202) 857–3800. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, 1919 M Street, N.W., Room 239, Washington, D.C. 20554.

131. In order to facilitate review of comments and reply comments, both by parties and by Commission staff, we require that comments and reply comments include a short and concise summary of the substantive arguments raised in the pleading. Comments, exclusive of appendices and summaries of substantive arguments, shall be no longer than sixty (60) pages and reply comments no longer than thirty (30) pages.

132. Parties are also asked to submit comments and reply comments on diskette. Such diskette submissions would be in addition to and not a substitute for the formal filing requirements addressed above. Parties submitting diskettes should submit them to Ernestine Creech of the Common Carrier Bureau's Accounting and Audits Division, 2000 L Street, N.W., Suite 257, Washington, D.C. 20554. Such a submission should be on a 3.5 inch diskette formatted in a IBM compatible form using WordPerfect 5.1 for Windows software. The diskette should be submitted in ''read only'' mode. The diskette should be clearly labelled with the party's name, proceeding, type of pleading (comment or reply comments) and date of submission. The diskette should be accompanied by a cover letter.

E. Additional Information

133. For further information concerning this proceeding, contact John V. Giusti or Mark B. Ehrlich, Accounting and Audits Division, Common Carrier Bureau at (202) 418–0850.

VI. Ordering Clauses

134. Accordingly, it is ordered that, pursuant to Sections 260 and 271–276 of the 1996 Act and Sections 1, 2, 4, 201–205, 215, 218, 220 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151(a), 152(b), 154, 201–205, 215, 218, 220, 260 and 271–276, that Notice is hereby given of proposed amendments to Parts 32 and

64 of the Commission's rules, 47 CFR Part 32 and 64, as described in this Notice of proposed rulemaking.

135. It is further ordered that, the Secretary shall send a copy of this Notice of proposed rulemaking, including the regulatory flexibility certification, to the Chief Counsel for Advocacy of the Small Business Administration, in accordance with Section 603(a) of the Regulatory Flexibility Act, 5 U.S.C. §§ 601 *et seq*. (1981).

List of Subjects

47 CFR Part 32

Transactions with affiliates, Regulated accounts.

47 CFR Part 64

Allocation of costs, transactions with affiliates, cost allocation manuals, Independent audits.

Federal Communications Commission

William F. Caton,

Acting Secretary.

[FR Doc. 96–19563 Filed 7–31–96; 8:45 am]

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