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Marie T. Breslin
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EX PARTE OR LATE FILED

August 9, 1996

EX PARTE

Mr. William Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554

Re: CS Docket No. 96-128, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996

Dear Mr. Caton:

Today, Carl Geppert, Selene Patterson, Michael Kellogg and Marie Breslin representing the RBOC Payphone Coalition met with John Muleta, Bob Spangler, Tom Zagorsky, Rose Crellin, Ken Ackerman and Thaddeus Machcinski of the Common Carrier Bureau to discuss the above captioned docket. A copy of the handouts distributed during the meeting is attached.

Please include this correspondence as part of the public record in the above-captioned proceeding. Please call me if you have any questions concerning the meeting.

Sincerely,

Marie Breslin

Attachments

cc: J. Muleta
B. Spangler
T. Zagorsky
R. Crellin
K. Ackerman
T. Machcinski

Accounting for Payphone Asset Reclassifications

Carl R. Geppert

August 7, 1996

Report of Arthur Andersen LLP
Accounting for Payphone Asset Reclassifications

This report responds to several issues raised regarding the accounting for payphone asset reclassifications contemplated in connection with the implementation of Section 276 as adopted by the Telecommunications Act of 1996 ("Act") and the Federal Communications Commission's ("FCC") Notice of Proposed Rulemaking in CC Docket No. 96-128, "Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996," (NPRM 96-128) released June 6, 1996. The following topics are discussed in this report:

- The categories of payphone assets to be reclassified from regulated to nonregulated activities.
- The applicability of prior regulatory proceedings to the reclassification of payphone assets under Section 276.
- The appropriateness of using net book value when reclassifying payphone assets under Section 276.
- The consistency of using net book value to reclassify payphone assets under Section 276 with the principles set out in the Democratic Central Committee decision.
- Our opinion related to the valuation of payphone assets to be reclassified from regulated to nonregulated activities.

PAYPHONE ASSETS TO BE RECLASSIFIED FROM REGULATED TO NONREGULATED ACTIVITIES

In response to the FCC's request for a listing of specific assets that will be transferred from regulated to nonregulated activities, attached as Exhibit A is a comprehensive list of Part 32 accounts that may contain assets dedicated to providing payphone service (in many cases, these accounts will only contain small portions of "dedicated" payphone service assets). The majority of payphone-related assets reside in account 2351, "Public Telephone Terminal Equipment." The balance of the accounts include amounts related to assets that are dedicated and/or allocated to the support of payphone operations.

THE APPLICABILITY OF REGULATORY PRECEDENT TO THE RECLASSIFICATION OF PAYPHONE ASSETS UNDER SECTION 276

The FCC has studied, on numerous occasions, the importance of using the appropriate method of reclassifying assets from regulated to nonregulated activities. These analyses strongly suggest the use net book value. The following list provides an overview of these proceedings:

- CC Docket No. 81-893: Addressed the criteria and procedures for the removal of embedded customer premises equipment (CPE) from regulated service. More specifically, this proceeding addressed the valuation of CPE when removing CPE from regulated service.
- CC Docket No. 86-111: Addressed separating the costs of regulated telephone service from the costs of the nonregulated activities of telephone companies and their affiliates. More specifically, this docket addressed the requirements of valuing central office equipment and outside plant when transferring these assets from regulated to nonregulated activities.
- RM 81-81: Declared that inmate payphones are CPE.
- NPRM - CC Docket No. 96-128: Discussed, among other issues, the FCC's tentative conclusions regarding the treatment of payphones as CPE and the valuation of assets to be transferred from regulated to nonregulated activities.

- NPRM - CC Docket No. 96-150: Discussed the implementation of accounting safeguards as mandated by the Act. More specifically, this notice addressed the transfer of assets from regulated to nonregulated activities for telecommunication services provided on an integrated basis (one of which is the provision of payphone services).

The above proceedings are all applicable to the reclassification of payphone assets under Section 276 for the following reasons:

1. As detailed in the NPRM to CC Docket No. 96-128[1], payphone assets should be treated as CPE and should follow the precedent set by CC Docket No. 81-893. The FCC reaffirmed its belief that payphone assets are CPE in RM 81-81.[2]
2. The arguments made for using net book value to reclassify CPE under CC Docket No. 81-893 are equally applicable to payphone business units today.
3. CC Docket No. 81-893 addresses "transfers" of assets from regulated activities to nonregulated activities. Similarly, payphone assets will be "transferred" from regulated activities to nonregulated activities.
4. CC Docket Nos. 81-893 and 86-111 discuss "mandatory" reclassifications of telephone equipment. Similarly, Section 276 mandates that the payphone business unit not be cross subsidized, which requires the payphone assets to be reclassified to nonregulated activities.

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[1] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, Notice of Proposed Rulemaking, FCC 96-254 (Rel. June 6, 1996), at 42.
[2] Petition for Declaratory Ruling by the Inmate Calling Services Providers Task Force, RM-8181, Declaratory Ruling, FCC 96-34 (Rel. Februrary 20, 1996), at 1.

THE APPROPRIATENESS OF USING NET BOOK VALUE TO RECLASSIFY PAYPHONE ASSETS FROM REGULATED TO NONREGULATED ACTIVITIES

The appropriateness of using net book value to reclassify payphone assets from regulated to nonregulated activities has been questioned in several comments to NPRM 96-128. The primary objection resides in the belief that net book value does not approximate economic or fair value. This opinion is unfounded in this proceeding for a number of reasons.

1. The use of net book value as a surrogate for economic value was debated and affirmed in CC Docket No. 81-893. More specifically, the FCC concluded, "that the definition of economic value proposed in the Notice of Inquiry should be adopted, and that net book value of the embedded CPE base should be used as a surrogate for economic value for purposes of ... valuing the equipment to be transferred to ATTIS."[3] The basis for this conclusion stemmed from the fact that "net book value is a commonly accepted measure of a company's worth, and it serves as a simple, objective rule for carrying out a valuation of the embedded base."[4] The alternative of appraising individual assets was believed to most likely cause delays, uncertainties and unnecessary costs.[5] The same obstacles exist today

2. The use of net book value as a surrogate for economic value was also debated and affirmed in CC Docket No. 86-111. As noted in NPRM 96-128, paragraph 170 of the Joint Cost Order states that "If reallocations of telecommunications plant (i.e., central office equipment and outside plant) from regulated to nonregulated operations are required, such plant will be transferred at undepreciated baseline cost plus an interest

[3] Procedures for Implementing the Detariffing of Customer Premises Equipment and Enhanced Services, CC Docket 81-893, Report and Order, FCC 83-551 (Rel. December 15, 1983), at 45.
[4] Id, at 47.
[5] Id, at 46.

charge to reflect the time value of money." Baseline cost, in this instance, would represent "the depreciated original cost at the time of the initial assignment or allocation of existing plant or the original cost of subsequently acquired new plant" (i.e., net book value). As discussed in our previous filings, the interest charge parameter noted above would not apply to the reclassification of payphone assets under Section 276 as payphone assets were properly classified as regulated per FCC Rules and Regulations prior to enactment of Section 276 and will be properly classified as nonregulated upon implementation of Section 276.

3. The use of net book value as a surrogate for economic value was endorsed by the FCC's tentative conclusion in NPRM 96-150. Although this notice does not specifically address the valuation of payphone assets, it does suggest using net book value (for asset reclassification purposes) for other services that will be provided on an integrated basis.[6]

4. Certain comments to NPRM 96-128 raised similar concerns to those raised by AT&T in CC Docket No. 81-893 regarding the possible distortion between net book value and economic value. Anticipating this concern, each RBOC Coalition member was asked whether the amounts shown on their external financial statements for the discontinuance of Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," ("Statement No. 71")[7] include any amounts related to dedicated payphone assets. All but one member (whose difference was

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[6] Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket 96-150, Notice of Proposed Rulemaking, FCC 96-309 (Rel. July 18, 1996), at 31.

[7] The intent of this adjustment is to reflect the difference between net book value for regulatory purposes and net book value for external financial reporting purposes. In other words, the adjustments are necessary to reflect any distortion between prescribed regulatory lives and true economic lives.

insignificant) did not have any amounts related to dedicated payphone assets in the Statement No. 71 adjustment.

5. Similarly, each RBOC Coalition member was asked whether they planned to change the depreciable lives of payphone equipment after reclassifying the payphone assets (accelerate or decelerate the depreciation schedules). In other words, did RBOC Coalition members believe that the prescribed regulatory lives distort the true economic lives of the payphone equipment? With the exception of one member (whose difference was insignificant), all believed that no changes were necessary.

6. Further, the estimated useful lives of the RBOC Coalition's payphone assets are similar to those expressed by several of the largest IPPs. In looking to the 1995 annual financial statements of Communications Central, Inc. (CCI) and Peoples Telephone Company, Inc. (Peoples)[8], CCI depreciates their telecommunications equipment over 10 years and Peoples depreciates their pay telephones over a 7-10 year period. These estimated useful lives are consistent with those currently used by the RBOC Coalition.

THE CONSISTENCY OF USING NET BOOK VALUE TO RECLASSIFY PAYPHONE ASSETS WITH THE PRINCIPLES SET OUT IN THE DEMOCRATIC CENTRAL COMMITTEE DECISION

CC Docket No. 81-893 has an extensive discussion about whether the detariffing of CPE in accordance with CC Docket No. 81-893 complies with the principles outlined in the Democratic Central Committee (DCC) decision.[9] Similarly, concerns have been raised as to whether the proposed guidelines in NPRM 96-128 (principally that of transferring payphone assets to the nonregulated entity at net book value) comply with the DCC decision principles.

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[8] Davel Communications Group, Inc. did not provide the depreciable lives of their payphone assets in their 1995 annual statement.

[9] Supra note 3, at 56-66.

Reclassifying payphone assets at net book value complies with the principles of the DCC decision.

1. The DCC decision related primarily to the sale of appreciable assets (i.e., assets that increase in value), specifically "obsolete railway terminals and repair shops."[10] Payphone assets are not appreciable assets and pose little risk of carrying an increasing market value. The fact that the majority of existing public payphones are "dumb" sets substantiates this point. In turn, the ratepayer is protected from foregoing a future "gain" on the sale of payphone assets.
2. As discussed above, a study of the net book values of the RBOC Coalition's payphone assets suggest that net book value is similar to economic or fair market value. This minimizes the possibility of recognizing a gain on the sale of payphone assets once the payphones have been reclassified to the nonregulated business unit (i.e., the ratepayer is further protected against possibly foregoing a future gain on the sale of payphone assets).
3. Considering the fact that net book value <u>currently</u> approximates economic or fair market value, any "gain" on the sale of payphone assets after the reclassification to the nonregulated entity would most likely be the result of the nonregulated entity's actions. In this case, the entitlement to the gain would rest with the nonregulated entity.

In summary, the same reasons outlined by the FCC in Paragraph 66 of CC Docket No. 81-893 as to why that decision complies with the principles of the DCC decision are equally applicable in CC Docket No. 96-128. First, it is not practical to assess the fair market value of

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[10]Supra note 3, at 56.

each payphone related asset.[11] Second, the fact that net book value approximates economic value protects the ratepayer from foregoing any future gains on the sale of payphone related assets.

OUR OPINION ON THE VALUATION OF PAYPHONE ASSETS TO BE RECLASSIFIED FROM REGULATED TO NONREGULATED ACTIVITIES

Despite concerns raised regarding the appropriate valuation methods for reclassifying payphone assets from regulated to nonregulated activities, we agree with the FCC's conclusion in paragraph 49 of NPRM 96-128 that the appropriate basis of valuation for the reclassification of payphone equipment to nonregulated status should be the assets' original cost, less associated reserves for accumulated depreciation, accumulated deferred income taxes and unamortized investment tax credits. This valuation, limited to the specific tangible assets reclassified to the BOC public communications businesses, is mandated by relevant FCC precedent, is supported by independent verification and is consistent with the principles outlined in the DCC decision. This is the most equitable approach, reflects the economic substance of the reclassification, and will allow BOC public communications businesses to compete on equal terms with the independent payphone providers.

ARTHUR ANDERSEN LLP

Carl R. Geppert

by
Carl R. Geppert

[11] See page 4, item 1.

Exhibit A

List of Payphone Related Asset Accounts

Account 2116 (Other Work Equipment)
This account includes the original cost of power operated equipment, general purpose tools and other items of work equipment.

Account 2122 (Furniture):
This account includes the original cost of furniture in offices, storerooms, shops, and all other quarters. They include some desks, chairs, tables, cabinets, display cases, credenzas, racks, etc.

Account 2123 (Office Equipment):
This account includes the original cost of office equipment in offices, shops and all other quarters. Office equipment shall be maintained by the following subaccounts:

- 2123.1 - Office Support Equipment
- 2123.2 - Company Communications Equipment

Account 2124 (General Purpose Computers):
This account includes the original cost of computers and peripheral devices which are designed to perform general administrative information processing activities. Administrative information processing includes, but it not limited to, activities such as the preparation of financial, statistical, or other business analytical reports; preparation of payroll customer bills, and cash management reports, and other records and reports not specifically designed for testing, diagnosis, maintenance or control of the telecommunications network facilities.

This account shall also include the original cost of initial operating system software for computers classifiable to this account whether acquired separately or in conjunction with associated hardware.

Account 2351 (Public Telephone Terminal Equipment):
This account includes the original cost of coinless, coin operated (including public and semi-public), credit card and pay telephones installed for use by the public. This account also includes the original cost of operating spares that are required to provide a continuity of service for public telephones.

Account 2362 (Other Terminal Equipment):
This account includes the original cost of other non-CPE terminal equipment not specifically provided for elsewhere and items such as specialized communications equipment provided to meet the needs of the disabled, over-voltage protection equipment, multiplexing equipment to deliver multiple channels to customers, etc.

Account 2682 (Leasehold Improvements):
This account includes the original cost of leasehold improvements made to telecommunications plant held under a capital or operating lease which is subject to amortization treatment. This account also includes improvements which will revert to the lessor.

CC DOCKET NO. 96-128

Payphone Asset Reclassification Meeting

August 9, 1996

Categories of Payphone Assets to be Reclassified

- Account 2351, "Public Telephone Terminal Equipment"
- General Support Assets
  - » Exhibit A erroneously excludes Motor Vehicle Assets
- Non-CPE Terminal Equipment (Account 2362)

Payphone Asset Reclassifications

- Dedicated assets (100% utilized in the provision of pay telephone service) to be directly assigned to nonregulated.
- Support/other assets to remain in existing Part 32 accounts
  - » Pay telephone cost allocations to be developed using new cost pools/cost apportionment studies

Basis of Valuation of Asset Reclassifications

- We agree with the Commission that Net Book Value of Tangible Assets is the most appropriate method
  - » Net book value is a fair approximation of fair market value
  - » Net book standard is consistent with FCC regulatory precedent
  - » Net book value is verifiable and will facilitate the timely reclassification of assets
  - » Consistent with GAAP

Discussion of Democratic Central Committee Principles

- Payphone assets to be reclassified, not sold
- Only tangible assets which exist on the books today should be considered
- Pay telephone equipment is not appreciating in value
- Ratepayers not burdened with extraordinary costs related to payphone operations
- Risk of ownership is being transferred to nonregulated operations