RECEIVED

AUG 26 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

DOCKET FILE COPY ORIGINAL

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

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	
	)	

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

Its Attorneys:

Mary McDermott
Linda L. Kent
Charles D. Cosson
Keith Townsend

1401 H Street, NW, Suite 600
Washington, D.C. 20005
(202) 326-7248

August 26, 1996

No. of Copies rec'd 0+10

TABLE OF CONTENTS

SUMMARY

The Commission should forbear from applying the current accounting safeguards to incumbent exchange carriers. In those instances where the Commission determines that the current safeguards must be continued for incumbent exchange carriers, those rules should be streamlined to the extent possible to ensure fair and efficient competition and to meet the Commission's objectives that the rules be clear, consistent and predictable. It is inconceivable, given the goals of the 1996 Act and the acceleration of competition, that more stringent rules would be required. Any such proposals must bear a heavy burden to justify their imposition on incumbent exchange carriers.

Forbearance is justified. The Act contains specific and comprehensive safeguards which are self-executing. In addition, there currently exist a number of other "safeguards" which will continue to constrain anticompetitive behavior. The Commission's rules are superfluous and only serve to tilt the competitive advantage to competitors.

Price cap regulation, particularly without sharing, eliminates any incentive to misallocate costs and makes the current rules unnecessary.

Competition significantly reduces any opportunities for improper cross subsidization for carriers subject to rate of return regulation or any vestige thereof. Competition poses a particular challenge for small exchange carriers, the majority of which are under rate of return regulation. Their opportunities to cross subsidize to the extent necessary to affect such competitors as AT&T, MCI or Time Warner would have to be of such proportion that it could not be undetected. The loss of even one high volume customer would be disastrous to small exchange carriers.

However, if retained, the current rules must be streamlined. USTA proposes specific modifications in its attachment. These recommendations modify the shared forecast investment rules, modify the affiliate transaction valuation standards, simplify the Part 64 administrative process and modify the frequency of the independent audit.

Finally, if the current rules are retained they should not be more stringent. In particular, the Commission should not adopt a uniform valuation method for all affiliate transactions. USTA opposed a similar proposal three years ago. It makes even less sense today and should be rejected. The current safeguards need not be strengthened to address the Act's requirements for integrated and separated operations.

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

In the Matter of	)	
	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
	)	
Accounting Safeguards Under the Telecommunications Act of 1996	)	
	)	

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

The United States Telephone Association (USTA) respectfully submits its comments in the above-referenced proceeding. USTA is the principal trade association of the incumbent exchange carrier industry. Its members provide over 95 percent of the incumbent exchange carrier-provided access lines in the U.S. Unlike their competitors, USTA member companies are subject to the current Part 64 rules implemented almost ten years ago, including the accounting requirements for transactions among incumbent exchange carriers and their nonregulated affiliates.

In a Notice of Proposed Rulemaking (NPRM) released July 18, 1996, the Commission is considering rules to implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the Telecommunications Act of 1996 (Act). The Commission recognizes that any cost allocation rules must not eliminate legitimate economies of scope. The Commission requests comment on whether the existing accounting safeguards are sufficient, require some modification or should be eliminated. The Commission observes 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." NPRM at ¶ 12. USTA urges the Commission to carefully evaluate the continued application of the current accounting safeguards to incumbent exchange carriers and to eliminate unnecessary and inappropriate rules which will impede the development of fair competition or which do not provide measurable benefits to customers. In those instances where the Commission determines that the current safeguards must be continued for incumbent exchange carriers, those rules should be streamlined to the extent possible to ensure fair competition and to meet the Commission's objective that the rules be clear, consistent and predictable. Finally, it is inconceivable, given the goals of the 1996 Act to provide for a pro-competitive, de-regulatory national policy framework, and given the increase in competition since the accounting safeguards were adopted, which has intensified since the Act was signed into law, that more stringent rules would be required for incumbent exchange carriers. USTA concurs in the Commission's conclusion that any such proposals must bear a heavy burden to justify their imposition on incumbent exchange carriers.

I. IN A COMPETITIVE ENVIRONMENT, THE COMMISSION'S RULES REGARDING COST ALLOCATIONS AND AFFILIATE TRANSACTIONS ARE NOT NECESSARY.

In determining whether the Commission's current Part 64 and Part 32 rules relating to affiliate transactions and cost allocations are necessary, the Commission must first look to the Act itself. The Act specifies that only Section 260 applies to non-BOCs. Thus, none of the accounting safeguards necessary for the provision of any of the services discussed in Sections

271 through 276 should apply to non-BOC incumbent exchange carriers.

In addition, the Act contains specific safeguards and requirements which Congress intended to apply to the provision of certain services in order to prevent the possibility of anticompetitve conduct. Sections 251 and 252 include specific requirements for both the BOCs and other incumbent exchange carriers to ensure the development of competition, including obligations to provide interconnection, to offer unbundled access to network elements, to offer services for resale at wholesale rates and to provide collocation. Section 274 requires an annual, independent compliance audit be performed by the BOCs engaged in the provision of electronic publishing. Section 272 of the Act imposes a separate affiliate requirement and other safeguards upon BOC participation in various competitive markets. For example, Section 272(b) requires that if a BOC engages in manufacturing activities, originates certain interLATA telecommunications services, or provides interLATA information services, it must do so through a separate affiliate that: operates independently from the BOC; maintains separate books, records and accounts; has separate officers, directors and employees from the BOC; does not obtain credit that relies on the assets of the BOC for recourse; and, conducts all transactions with the BOC at arm's length. Section 272(c)(1) prohibits discrimination between a BOC affiliate and any other entity. Section 272(d) requires the BOCs to submit to a joint Federal/State biennial audit. These restrictions are comprehensive in scope and detailed in execution.[1] Additional

[1]The application of the Section 272 requirements is discussed in detail in USTA's comments filed August 15, 1996 in CC Docket No. 96-149, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended and Regulatory Treatment of LEC provision of Interexchange Services Originating in the LEC's Local Exchange Area. USTA incorporates those comments into the record in this proceeding.

safeguards are not required.

Second, the Commission should recognize that there are a number of safeguards which exist to deter improper cross subsidization in addition to those specified in the Act and in its current rules. As will be discussed more fully below, competition and price cap regulation provide the most effective constraints on the ability of incumbent exchange carriers to cross subsidize. Other existing incumbent exchange carrier safeguards include the following: financial and other reporting; ongoing tariff review; the Commission as well as state complaint processes; rules for jurisdictional allocation of costs; a carrier's internal and external audits and internal controls; Commission as well as state commission audits and review authority; competitor and customer access to public regulatory reports; competitor and customer involvement in tariffing, complaint mechanisms and enforcement; activities of other agencies such as the Federal Trade Commission, Securities and Exchange Commission, Financial Standards Accounting Board, Department of Justice, state attorneys general; and Federal and state statutes, including antitrust statutes. All of these mechanisms exert inexorable discipline and provide effective protection against improper subsidization. Therefore, it is unlikely that the Commission's Part 64 rules are now or will be in the future the principle binding constraint on the behavior of incumbent exchange carriers. The Commission's rules are superfluous and further tilt the competitive advantage in favor of competitors who are free to enter telecommunications markets without any restrictions.

To justify the continued imposition of the current cost allocation rules, the Commission lists four circumstances under which incumbent exchange carriers may have an incentive to misallocate costs to their regulated business: carriers under rate of return regulation, carriers under price cap regulation with sharing at either the interstate or state level, carriers under price caps that may be adjusted in the future, and whenever a carrier's entitlement to any revenues may be affected by the costs it classifies as regulated. NPRM at ¶ 6. As will be explained below, the Commission properly recognizes that incumbent exchange carriers under price cap regulation without any sharing obligations have no incentive to misallocate costs since the link between costs and rates does not exist. Therefore, even under the Commission's analysis, the current Part 64 and Part 32 affiliate transactions rules need not be applied to those carriers. Overall, however, the Commission's four circumstances do not justify the imposition of the current rules in a competitive environment. Competition in local exchange and exchange access is now or quickly will be sufficient on its own to preclude improper cross subsidization.

Finally, the plain language of Section 254(k) does not require the implementation of cost allocation rules. In determining the costs of providing the services included in the definition of universal service, the Federal-State Joint Board can ensure that such services do not bear more than a reasonable share of the joint and common costs of facilities used to provide those services without Part 64 requirements.

A. Incumbent Exchange Carriers Subject to Price Cap Regulation, Particularly Those that Elect the No Sharing Price Cap Option, Have No Incentive to Misallocate Costs.

As has been discussed in other dockets and has been acknowledged by the Commission, price cap regulation protects customers of regulated services without the need to allocate costs and allows those customers to benefit from investment in new technologies, including economies of scope.[2] The Commission itself has agreed that "...because price cap regulation severs the direct link between regulated costs and prices, a carrier is not able automatically to recoup misallocated, nonregulated costs by raising basic services rates, thus reducing the incentive for the BOCs to shift nonregulated costs to regulated services."[3] In a price cap regime, once the rates for price capped services are established, prices are regulated by the price cap formula, not by allocations of costs. Since the prices are capped, changes in cost allocations cannot affect prices. Thus, the incumbent exchange carrier may charge the capped price whether or not its accounting costs for the regulated service change. If the sharing obligation is removed, there are no vestiges of rate of return regulation for which the allocation of costs is relevant.[4] Because price caps eliminate the incentive for carriers to cross-subsidize, there is no need for the Commission to apply current rules to carriers operating under price cap regulation. The Commission should forbear from applying Part 64 to exchange carriers under price cap regulation or, in the alternative, forbear from applying Part 64 to those carriers under price cap

---

[2]Laurits R. Christensen, "Treatment of LEC Investment in Joint-Use Broadband Facilities Under a Price Cap Regime," July 16, 1996, USTA Ex Parte Filing, CC Docket Nos. 96-112 and 94-1, July 17, 1996. [Christensen]. See, also, Affidavit of J. Gregory Sidak, Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, USTA Comments, filed May 31, 1996; [Sidak] and Statement of Professor Jerry A. Hausman, Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended: and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 96-149, USTA Comments filed August 15, 1996. [Hausman]. USTA incorporates these items into the record of this proceeding.

[3]Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, 6 FCC Rcd 7571, 7596 (1991).

[4]Even with the sharing obligation, if prices are below the cap, there is no incentive to cross subsidize because rates cannot be increased as changes in costs occur.

regulation with no sharing obligation.

In addition, under price cap regulation, economies of scope are realized through the productivity offset. USTA's proposed total factor productivity (TFP) is based on total company Part 32 results. Thus, the customers of regulated services fully share in the economies of scope associated with the joint use of investment under such a formula.[5] Any attempt to misallocate costs from nonregulated to regulated would serve no purpose.

There is no need to defer the elimination of the cost allocation rules until sharing is permanently eliminated. Once an incumbent exchange carrier has elected the no sharing option, costs no longer impact rates.

With respect to future adjustments to the productivity factor, USTA's proposed productivity formula is based upon a moving-average that would eliminate the need for periodic review and revision. In its proceeding to review incumbent exchange carrier performance under price caps, the Commission tentatively concluded that a moving average productivity factor be adopted to permit automatic recalculation and to eliminate the need for periodic updates.[6]

Nor is there any need to defer the elimination of the cost allocation rules until exogenous treatment is eliminated permanently. Requests for exogenous treatment must satisfy specific criteria. The Commission has already limited exogenous cost treatment to accounting changes that result in an economic cost change defined as having an impact on the incumbent exchange

[5]Christensen at pp. 2-4.

[6]LEC Price Cap Performance Review, CC Docket No. 94-1, 4th Further Notice of Proposed Rulemaking, released September 27, 1995 at ¶ 96 and First Report and Order, released April 7, 1995 at ¶ 145.

carrier's discounted cash flow. In addition, the changes must be beyond the control of the carrier and must not be reflected in the inflation index. As a result, exogenous treatment is not routinely granted. Exogenous treatment which could result in misallocated costs would probably be denied if not fully justified.

The current rule, which treats as an exogenous adjustment the reallocation of shared Central Office Equipment and Outside Plant investment from regulated to nonregulated, is inconsistent with the Act and is inconsistent with the rationale underlying the original Part 64 exogenous change requirements. There should be no exogenous treatment for cost allocations. An over-allocation of common costs to nonregulated activities will provide a disincentive for incumbent exchange carriers to enter nonregulated markets as it places them at a competitive disadvantage. This certainly does not further the objectives of the Act to foster competition. The reallocation from regulated to nonregulated accounts referenced in the price cap rules was developed as a measure to deter carriers from initially under-forecasting the nonregulated operations' use of joint and common facilities. If the nonregulated forecast is too low, the regulated rate base is overstated. The exogenous treatment was to be applied to compensate the ratepayer for the misallocation into the rate base of shared network investment resulting from under-forecasted allocation factors. In a price cap environment, particularly with no sharing obligations or where results do not meet the sharing threshold, the allocated costs do not affect the rates, therefore no exogenous rate adjustment resulting from an error in the allocated costs should be required.

Further, the USTA TFP methodology reflects the economies of scale achieved through the provisioning of total services, both regulated and nonregulated, over a shared system.[7] To require an exogenous change in addition to capturing full economies of scale through the TFP would result in a double reduction of rates for the same investment.

Regarding embedded or new investment for telemessaging service, the application of the current exogenous treatment related to the reallocation of investment from regulated to nonregulated pursuant to Section 64.901 of the Commission's current rules is only required if the investment is part of the shared forecast investment where a true-up would be warranted.[8]

Price cap regulation and accounting safeguards are redundant. There is sufficient rationale to eliminate the Part 64 and Part 32 affiliate transaction requirements for carriers operating under price cap regulation, particularly those with no sharing obligation.

B. Competition Significantly Reduces any Opportunities for Improper Cross Subsidization for Carriers Subject to Rate of Return Regulation or Any Vestige Thereof.

Compared to regulation, competition is the more effective constraint on improper cross subsidization. The purpose of the 1996 Telecommunications Act was to encourage competition

---

[7]See, Price Cap Performance Review for Local Exchange Carriers, 10 FCC Rcd 8961 (1995) at ¶ 159.

[8]As defined in Section 260(c), telemessaging includes voice mail. Therefore, it is a nonregulated service subject to the provision of the Joint Cost Order. NPRM at ¶ 30. See, Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates, Order on Reconsideration, 2 FCC Rcd 6283 (1987) at ¶ 64. [Order on Reconsideration].

and to establish a deregulatory framework that would allow market forces, not regulation, to discipline the activities of the market participants. Many competitors are large, sophisticated businesses with a great deal of experience in using the Commission's rules to advance their competitive advantage. The Commission just released an order which will hasten the pace of competition in exchange and exchange access markets.[9] For the majority of non-BOC carriers, most of which are subject to rate of return regulation, competition poses a particular challenge given their smaller size and relative lack of resources. Of course, these carriers have always been free to enter the long distance market and many have done so as resellers, as facilities-based carriers and as competitive access providers. However, these smaller carriers are particularly vulnerable to competitive entry.

For example, small rural incumbent exchange carriers, on average, obtain approximately sixty percent of their revenues from federal and state access charges, while the BOCs average approximately thirty percent. Any regulatory decision which jeopardizes access revenues has an even greater impact on smaller carriers. Average monthly local service prices for small company customers are approximately $16.00, while the average price for larger companies is approximately $20.00. This difference reflects the difference in calling scopes (i.e., the number of customers accessible via a local call) which is usually much smaller in small, rural carrier serving areas. Larger carriers serve approximately 400 subscribers per square mile while smaller carriers only serve approximately 20 subscribers per square mile. These statistics show that small carriers may not survive the loss of even one high volume user. Thus, these carriers cannot

[9]Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Report and Order, released August 9, 1996.

be placed at a competitive disadvantage compared to such companies as AT&T, MCI and Time Warner.

The Commission recognized the potential burdens which regulation poses for small exchange carriers when it imposed the cost allocation rules. In the Joint Cost Order the Commission determined that small exchange carriers would not be required to implement and maintain cost allocation manuals or to conduct annual, independent audits.[10] In addition, the Commission determined that carriers utililizing average schedules should not be subject to any Part 64 rules.[11] The Commission correctly observed that in the case of average schedule companies, no attempt is made to measure the actual costs of providing regulated services. Thus, like those carriers under price cap regulation, costs have no impact on the interstate rates of average schedule companies. Congress also recognized that smaller carriers must be relieved from certain regulatory requirements.[12] The report accompanying the Telecommunications Act of 1996 explains that a "level playing field" must be established for smaller companies facing "competition from a telecommunications carrier that is a largely global or nationwide entity that has financial and technological resources that are significantly greater than [the smaller exchange carrier's] resources."[13] Given the substantial participants in the interexchange and other

---

[10]Separation of Costs of Regulated Telephone Service From Costs of Nonregulated Activities Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates, Report and Order, 2 FCC Rcd 1298, 1304 (1987) [Joint Cost Order].

[11]Order on Reconsideration at p. 6300.

[12]See, Section 252(f)(1) and (2).

[13]Telecommunications Act of 1996, Joint Explanatory Statement at p. 119.

telecommunications markets, there is no possibility that any of the carriers subject to rate of return regulation could harm competition through any improper cross subsidization.

Finally, the Commission itself notes that predation by either a BOC or other incumbent exchange carrier is unlikely to occur.[14] NPRM at ¶ 16. The magnitude of cross subsidy that would be necessary to drive such competitors as AT&T and MCI from the interexchange market, for example, would have to be of such proportion that it could not go undetected. Given the differences in resources, it is more likely that incumbent exchange carriers will be the victims of predation, not the perpetrators of predation. Further, an incumbent exchange carrier could not subsequently raise prices above competitive levels.

C. The Commission Should Forbear from Applying its Cost Allocation and Affiliate Transaction Rules.

Based on the forgoing, USTA urges the Commission to free incumbent exchange carriers from all its rules for accounting and affiliate transactions that are no longer necessary in a competitive marketplace. Section 10 of the 1996 Act provides the Commission with authority to forbear from regulation based upon a specified determination that rates will be just and reasonable and not unjustly or unreasonably discriminatory; that consumers will be protected and that the public interest will be served. Since the cost allocation rules do not impact rates, as explained above, and there is no detriment to consumers, the public interest would be served in eliminating these rules which impede the development of fair competition and the realization of

[14] See, Matsushita Elec. Indus. Co. V. Zenith Radio Corp., 475 U.S. 574, 589 (1986) (predation is "rarely tried, and even more rarely successful").

economic efficiency. As noted above, the Act imposes detailed and comprehensive safeguards which strike the appropriate balance between furthering fair and efficient competition and prohibiting anticompetitive conduct. In addition, as listed above, there are many other safeguards which currently exist in addition to the current Part 64 rules. With the acceleration of competition into local markets and the implementation of price cap regulation with the no sharing option, there is no need to continue to apply the current Part 64 and 32 affiliate transactions rules.

II. IF RETAINED, THE CURRENT COST ALLOCATION AND AFFILIATE TRANSACTION RULES SHOULD BE STREAMLINED.

If retained, the current cost allocation and affiliate transaction rules should be streamlined to meet the Commission's objectives in the proceeding. Less detailed accounting safeguards are sufficient to fulfill the new statutory mandates. In an attachment to these comments, USTA recommends specific rules changes to streamline the current rules to ensure that they are clear, consistent and predictable. USTA's recommended rules changes will greatly simplify the current allocations and will relieve some of the regulatory burden on the incumbent exchange carriers subject to these rules by reducing current filing requirements. In addition, USTA's recommendations will ensure consistency with the requirements of the Act. USTA urges the Commission to adopt the proposed rules changes in the absence of forbearance. A summary of the rules for which streamlining is needed is discussed below.

1. Modify the Shared Forecast Investment Rules.

Section 64.901(b)(4) specifies that shared Central Office Equipment and Outside Plant be allocated between regulated and nonregulated based on the highest peak three year forecast. USTA proposes that carriers apportion shared investment according to actual use or some other factor, based on an individual carrier's circumstances. The ARMIS Joint Forecast Reports 495A and 495B, required under Section 43.21(e) of the Commission's rules, should be eliminated. Under price cap regulation, the allocation of investment risk is no longer applicable.

2. Modify the Affiliate Transaction Valuation Standards.

The affiliate transaction rules should be modified in two ways. First, the asymmetry required for asset transfers should be eliminated and carriers should be required to transfer assets, in the absence of a tariff rate, at net book value or prevailing price. Second, the Commission should retain the hierarchy for services of tariff rate, prevailing price or cost for services, but eliminate the substantial prerequisite condition on the use of prevailing price (market rate).

3. Simplify the Part 64 Administrative Process.

The requirements of Section 64.903 regarding the Cost Allocation Manual filing should be simplified by eliminating the sixty day approval period, the quantification of cost pool and time reporting changes and the Common Carrier Bureau suspension provision.

4. Modify the Frequency of the Independent Audit.

The frequency of the independent audit required in Section 64.904 should be reduced from annual to biennial. This will provide adequate review of cost allocation practices while conserving Commission and carrier resources and reducing the cost of regulation. Section 272(d) of the Act requires a biennial, joint Federal/State audit. The Part 64 audit and the Section

272(d) audit should be conducted in alternate years to avoid duplication. The costs of such audits are not incurred by competitors and therefore place incumbent exchange carriers at a competitve disadvantage when such costs are imposed.

III. IF RETAINED, THE CURRENT COST ALLOCATION AND AFFILIATE TRANSACTION RULES NEED NOT BE MORE STRINGENT.

A. Proposals Which Call for More Detailed Accounting Safeguards Should Satisfy a Heavy Burden of Proof That They Are in the Public Interest.

The Commission properly notes that any proposals which call for more detailed accounting safeguards will bear a heavy burden of persuading the Commission that such proposals are necessary. USTA suggests that any such proposals must satisfy a public interest test and cost/benefit analysis with sufficient opportunity to comment before they could be adopted.

The Commission tentatively concludes, and USTA concurs, that there is no need for more stringent accounting safeguards. NPRM at ¶ 27. The Joint Cost rules were adopted to deter any possibility of improper cross subsidization of nonregulated ventures by regulated services.[15] The Joint Cost rules were adopted almost ten years ago, long before the adoption of price cap regulation and the rapid increase in competition. These rules established a hierarchy as to how the regulated carrier should book costs associated with affiliate transactions in its regulated accounts:

---

[15]The Commission specifically noted that it did not intend to regulate the price of nonregulated activities including, for example, the sale of nonregulated services by a carrier to a nonregulated affiliate. See, Joint Cost Order at ¶ 40.

1) Carriers book the tariffed rate of the asset or service sold to or purchased from an affiliate, or, in the absence of a tariffed rate

2) Carriers book the prevailing price of the asset or service sold to or purchased from an affiliate, basing prevailing price on a substantial number of similar transactions with nonaffiliated third parties, or, in the absence of a prevailing price

3) Carriers book the fully distributed cost of the service sold to or purchased from an affiliate, or, in the case of assets

4) Carriers book the higher of net book or fair market valuation for assets sold to affiliates, or the lower of net book or fair market valuation for assets purchased from affiliates.

In addition, larger incumbent exchange carriers are required to file cost allocation manuals reflecting the established rules and current affiliate and nonregulated transactions and must participate in external as well as Commission audits. USTA strongly agrees with the Commission that there would be substantial costs, far more than the amount estimated in CC Docket No. 93-251, involved to redesign internal systems if some other approach were to be adopted. NPRM at ¶ 28. The current rules were the subject of a lengthy and time-consuming proceeding that strained the resources of both incumbent exchange carriers and the Commission. It is unlikely that either the public interest would be served or that the benefits of another such proceeding and another mechanism would outweigh the costs.

B. The Commission Should Not Adopt a Uniform Valuation Method for All Affiliate Transactions.

The Commission suggests that the valuation of affiliate services may not be consistent with the requirements of Section 272(b)(5). NPRM at ¶ 78. The Commission proposes instead to prescribe a uniform valuation method for all affiliate transactions whereby 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. The use of prevailing price as a valuation standard would be eliminated. USTA opposed a similar proposal three years ago in CC Docket No. 93-251 and maintains that it is equally inappropriate now.[16] It certainly does not meet the Commission's stated objectives for considering proposed rules changes.

As USTA explained in its comments in CC Docket No. 93-251, a requirement that estimated fair market value be determined for every service is administratively costly and complex.[17] USTA estimated that it would cost an average of $40,000 to obtain an estimated fair market value for a particular affiliate transaction which would equate to approximately $91 million for Tier 1 carriers. Given the large volume of service transactions which would be affected, the cost is prohibitive.[18] Such unwarranted costs place incumbent exchange carriers and their affiliates at a competitive disadvantage by forcing them to implement expensive accounting systems to accommodate such a requirement. The Commission should not adopt rules which will result in arbitrary marketplace distortions which will have a particularly detrimental impact on incumbent exchange carriers by preventing them from utililizing economic prices.

In addition, the determination of estimated fair market value is problematic in that identifying comparable transactions in the market is difficult and is fundamentally subjective.

---

[16]Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, released October 20, 1993.

[17]USTA Comments filed December 10, 1993.

[18]The costs would be even greater today given the additional requirements imposed by the Act.

The Commission itself rejected such a proposal in the Joint Cost Order on Reconsideration. The Commission noted, "Several parties have argued that if a tariff or prevailing price is unavailable as a measure of value, we should look to the value of similar services in the marketplace. We believe that such a valuation standard is fraught with the potential for abuse, and would be difficult to monitor. In contrast, by requiring carriers and their affiliates to allocate costs pursuant to the cost allocation standards, we can ensure that an auditable measure of the cost of the service is available."[19]

Such a proposal cannot be justified as a protection against cross subsidy. In order to cross subsidize in a manner in which competitors will be affected, a carrier must be able to shift costs from nonregulated to regulated accounts, incorporate the increased costs into higher rates and maintain their customers at the higher prices. As noted above, the chances of successfully achieving such a scenario are practically nonexistent.

That is why this proposal makes even less sense today than it did three years ago. Price cap regulation with no sharing eliminates any link between costs and prices.[20] A new law which relies on a deregulatory framework designed to accelerate competition has been enacted and its impact on the pace of competition has already begun. AT&T is well underway in its efforts to offer local service in every state. The Commission adopted an order which facilitates three paths of entry into local telephone markets: facilities-based entry, purchasing of unbundled network

---

[19]Joint Cost Order on Reconsideration at p. 6297.

[20]In fact, in CC Docket No. 93-251, the Commission recommends that AT&T not be subject to the affiliate transaction rules because its price cap plan did not include sharing. ¶¶ 100-103.

elements from incumbent exchange carriers at below market levels and resale of incumbents' retail services at wholesale rates.[21] This proposal could not be justified three years ago and it cannot be justified today. The Commission should reject such a modification once and for all.

C. The Current Safeguards Need Not be Modified to Address the Act's Requirements for Integrated Operations.

1. Section 260 - Telemessaging Service.

The nondiscrimination safeguards specified in Section 260(a)(1) and (2) apply to any local exchange carrier subject to the requirements of Section 251(c). While, as the Commission notes, Section 251(c) applies to incumbent exchange carriers as defined in the Act, the Commission should also acknowledge that certain rural telephone companies are exempt from the requirements of Section 251(c) pursuant to Section 251(f). Thus, exempt carriers should not be subject to the requirements of Section 260(a).

For those carriers subject to Section 260, the current accounting and affiliate transactions rules need not be modified to meet the nondiscrimination requirements. Telemessaging is a nonregulated activity that is currently governed by Part 64. NPRM at ¶ 30. Shared telemessaging plant can be allocated pursuant to the Part 64 rules.

---

[21] See, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, released August 8, 1996.

For services provided on an integrated basis, when rates differ for different carriers, the rate should reflect the type of service provided. NPRM at ¶ 42. No additional accounting procedures are needed to address any difference in Section 272(e)(4) between the rate charged the affiliate and any underlying costs of the facilities and services because the same rate is charged to all entities. Thus, there is neither improper cross subsidy nor unreasonable discrimination.

3. Section 275 - Alarm Monitoring Services

The current Commission rules are sufficient to protect against cross subsidy pursuant to Section 275(b)(2) and 275(e) as applicable to the BOCs. NPRM at ¶¶ 52-53. No additional rules are required.

4. Section 276 - Payphone Services.

There is no need to alter the current Part 64 rules to protect against improper cross subsidy or unreasonable discrimination pursuant to Section 276(a)(1) and (2) as recommended in Section 276(b)(1)(C). However, that section of the Act clearly states that nonstructural safeguards only apply to BOC payphone services. USTA agrees with the tentative conclusion reached by the Commission in CC Docket No. 96-128 that there is no requirement for carriers to structurally separate their payphone operations.[22] In addition, USTA agrees that it is appropriate

---

[22] Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, Notice of Proposed Rulemaking, CC Docket No. 96-128, released June 6, 1996.