Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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Federal Communications Commission
Office of Secretary

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

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GTE's REPLY

GTE Service Corporation on behalf of its affiliated domestic telephone operating, long distance and wireless companies ("GTE"), with reference to GTE's Petition for Reconsideration (the "Petition") addressed to the Report and Order[1] (the "*Report & Order*") seeking to implement the Telecommunications Act of 1996 (the "1996 Act")[2] and various parties' submissions in relation thereto submit the following Reply.

BACKGROUND

The Petition requests reconsideration of only those aspects of the *Report & Order* that adversely affect independent Local Exchange Carriers ("Independents").

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1 Report and Order, 11 FCC Rcd 17539 (1996) in this CC Docket No. 96-150 ("D.96-150").

2 All references to statutory sections or subsections are to 47 U.S.C. unless otherwise specified.

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These concern rule changes in the Commission's *Affiliate Transaction Rules*[3] adopted by the *Report & Order* seeking to implement section 260 and sections 271-276.

INTRODUCTION

The Petition expresses GTE's grave concerns that the effect of the *Report & Order* will be, in practice, to impose on Independents a massive and completely unjustified increase in administrative costs and burdens without satisfaction of the heavy burden of proof set out by the Commission.[4] If the rule changes are implemented as stated, GTE believes this would cost GTE more than a million dollars a year, of which $500,000 represents the estimate of Arthur Andersen reflected in the Arthur Andersen letter dated February 10, 1997 provided with the Petition.[5] This is in direct opposition to the intent of the Commission and the direction of the 1996 Act.

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[3] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities, CC Docket No. 86-111 ("D.86-111"), Report and Order, 2 FCC Rcd 1298 (1987) (the "*Joint Cost Order*"), *modified*, Order on Reconsideration, 2 FCC Rcd 6283 (1987) (the "*Joint Cost Reconsideration Order*"), *further recon.*, Order on Further Reconsideration, 3 FCC Rcd 6701 (1988) (the "*Joint Cost Further Reconsideration Order*"), *aff'd sub nom.* Southwestern Bell Corp. v. FCC, 896 F.2d 1378 (D.C. Cir. 1990). *See* 47 C.F.R. sections 64.901-903.

[4] "[A]ny commenter urging [the FCC] to adopt more detailed accounting safeguards than those in [its] current rules or those specifically mandated by the [1996] Act bears a heavy burden in demonstrating the necessity to adopt such safeguards." *Report & Order*, 11 FCC Rcd at 17551.

[5] Arthur Andersen says: "[W]e currently estimate that our audit fees will increase by approximately $500,000 in order to comply with Docket 96-150. Assuming that GTE performs the fair market value studies (or contracts with another consultant to perform the studies), we believe our fees would still increase by approximately $150,000 to $200,000 in order to cover the cost of testing the studies." In addition, GTE has in hand bids from consulting firms offering to do the required market studies (though with less detail than might be required) for amounts ranging from $150,000 to $400,000 for a single affiliate (GTEDS).

GTE maintains it is a mistake to increase regulatory burdens on Independents just when, as recognized by the Commission itself, the need for regulation is diminishing by virtue of price caps and competition. Thus, as observed by the *Report & Order* at paragraph 145 (*footnote omitted*): "Since the adoption of the affiliate transactions rules, we have adopted price cap regulation that gives the largest incumbent local exchange carriers efficiency incentives far stronger than those the valuation methods for affiliate services sought to preserve."[6] Moreover, the rule changes that will increase burdens are not adopted with any clear indication of *sunset*. So far as anyone can judge, these burdensome requirements will stay indefinitely.

An unintended effect of the *Report & Order* is to give better treatment to Bell Operating Companies ("BOCs") than to Independents. Thus, paragraph 137 of the *Report & Order* grants BOCs an effective dispensation ("a rebuttable presumption")

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[6] 11 FCC Rcd at 17605-06. Further, in addressing the deregulatory mandate of section 161(b)(2)(A), the FCC has reached the tentative conclusion that price caps -- with or without sharing -- together with increased competition justifies significant reductions in regulatory requirements under section 214. Implementation of Section 402(b)(2)(A) of the Telecommunications Act of 1996, CC Docket No. 97-11 ("D.97-11"), Notice of Proposed Rulemaking, 12 FCC Rcd 1111 (1997) (the "*D.97-11 Notice*"). "Although price-cap regulation that includes a sharing option preserves some of the incentives toward `gold-plating' that accompany rate-of-return regulation, we believe that all forms of price cap regulation nevertheless reduce these incentives.... Virtually all of the price-cap carriers have adopted the `no-sharing' X-factor. This fact seems to indicate strongly that, in general, the benefits associated with the no-sharing option exceed the benefits of adopting a sharing option and strategically overinvesting in facilities. Moreover, we expect that growth in competition for local exchange and interstate access will provide additional incentives for the price-cap LECs to increase their efficiency. Therefore, whether a price cap carrier elects a `sharing' or `no sharing' option, we tentatively conclude that additional regulation under Section 214 is not required to protect telephone service ratepayers adequately against potentially higher rates resulting from investment in unnecessary facilities." *D.97-11 Notice* , 11 FCC Rcd at 1129, *emphasis added, footnote omitted.*

from the *fifty percent condition* (that products or services furnished to a carrier by an unregulated affiliate may not be valued for regulatory purposes based on "*prevailing price*" unless external sales of that affiliate are greater than fifty percent).[7] This dispensation or "rebuttable presumption" is based on the fact that BOCs are bound by section 272 to charge the same price for the same service whether furnished to "affiliates [or] third parties."[8] As pointed out by the Petition, GTE is in substance already committed to the same kind of requirement by virtue of its Cost Allocation Manual ("CAM") and state requirements under which GTE commits that charges by affiliated vendors to the GTE telephone companies shall not exceed (and typically are less than) charges for the same products or services furnished to unaffiliated parties. Other Independents may already make such commitments and/or might be willing to accept such commitments for the sake of this rebuttable presumption that allows employment of the sensible *prevailing price* rule that the Commission has now re-adopted as indeed performing an important role. The Petition maintains that, rather than insisting on an arbitrary and rigid *fifty percent condition*, which is alien to the logic of prevailing price and would essentially remove it as a feasible option, the Commission should decide to treat the Independents at least as favorably as it treats the BOCs.

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[7] 11 FCC Rcd at 17601.

[8] "Because the rates for services subject to section 272 must be made generally available to both affiliates and third parties, we adopt a rebuttable presumption that these represent prevailing company prices. Accordingly, products and services subject to section 272 need not meet the 50 percent threshold in order for a BOC to record the transaction involving such products and services at prevailing price." *Report & Order* at paragraph 137.

DISCUSSION

1. Exhibit I shows graphically the Petition's suggested workable alternative approach to further safeguards, one that would not occasion an unjustifiable increase in administrative burdens and costs.

The Petition urged the Commission to reconsider features of the *Report & Order* that, in GTE's view, would unintentionally and unjustifiably increase regulatory burdens and costs. The Petition points out that two GTE affiliates sell more than $1.5 billion in products and services to the GTE telephone companies. They sell over $345 million to unaffiliated parties. The notion that $345 million in sales do not constitute, in the words of paragraph 134, a "substantial quantity of business"[9] is an outrageous reading of the English language. In any approach to the question, the Commission should recognize at the outset that transactions in these dimensions represent evidence of the legitimacy of pricing in market terms, and will be so considered by any court.

The Petition suggests that, if any further safeguards over and above GTE's commitment discussed *supra* are determined to be required, the Commission should consider the following alternative[10]: the *fifty percent condition* would not have to be met in any year in which (1) the total amount of unaffiliated party sales exceeds a specified amount (for GTE, $5 million); or (2) a specified number (twenty-five in the case of GTE) of unaffiliated customers each purchase in excess of $100,000 per year.[11] These two

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[9] 11 FCC Rcd at 17600.

[10] This alternative is shown graphically in Exhibit I attached hereto.

[11] These benchmarks, $5 million and twenty-five customers, would be appropriate for a firm the size of GTE. For a smaller firm, the Commission should consider different benchmarks to be worked out with the company involved. The benchmarks might be provided for in the firm's CAM.

conditions are consistent with the logic of the *prevailing price* rule in that they focus on the motivations of the unaffiliated purchasers, and in this way demonstrate the legitimacy of pricing in terms of market reaction. A third possibility is that the average annual growth rate of the affiliated vendor's external sales exceeds the industry average growth rate. Some combination of these elements are critical to giving meaning to the *prevailing price* rule.

2. GTE stresses the importance of extending the exception of *Report & Order* paragraph 148 to cover the provisioning of service by an Independent to members of its corporate family.

The *Report & Order* in paragraphs 147-148 gives some recognition to the need for permitting carriers to furnish to affiliates administrative service priced at fully allocated cost (including the allowed interstate return) without having to incur the wholly unnecessary cost of market evaluation.[12] The simple and workable fully allocated cost safeguard has represented adequate protection for the ratepayer for decades; the Commission should not make this a still more burdensome requirement now that the risks to ratepayers have been sharply reduced for all the reasons identified by the Commission in the *Report & Order* as well as in the *D.97-11 Notice.* For administrative transactions in either direction, the fully distributed cost safeguard is more than enough protection.

Further, the *Report & Order* at least recognizes that there is no need for valuation where service is furnished by a service-company type structure. GTE submits that the rule should be modified to permit transactions in either direction without

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[12] 11 FCC Rcd at 17607-08.

activating an effective valuation requirement. It is unfortunate when a consequence of intrusive regulation is to in effect dictate corporate structure. In the new competitive environment promoted by the 1996 Act and FCC policy, regulated firms should be able to structure their operations and the related corporate structure to maximize efficiency and to assure the highest level of service to customers at competitive rates -- not to come within political and administrative dictates. The industry should be moving in the direction of a world where the regulator consciously withdraws from dictating operational details, as has been all-too-common until now. GTE suggests the FCC should be leading the way to an affirmative policy that returns decisions of this character to the hands of company management.

As an illustration, GTE Telephone Operations through the GTE Telephone Operating Companies (the "GTOCs") furnishes administrative services to such nonregulated affiliates as GTE Data Services, charging for these services on a fully allocated cost basis. This includes such standard services as payroll and accounts payable. In this way, all the essential components of service to the public are performed within the corporate family on an efficient basis without unreasonably high profit levels. Any requirements that amount to compelling preparation of costly market valuations would be a significant burden as shown by the Arthur Andersen letter mentioned *supra*, and would artificially push the company toward a certain corporate structure. Creation of a service-corporation structure -- as employed by the BOCs and employed in other respects by GTE -- can be a reasonable option, but to date GTE management has not concluded this is the most efficient option. In making this sort of decision, management of GTE and other Independents should not be pressured by

arbitrary governmental rules and policies. A Commission rule that amounts to a requirement to prepare costly market valuations returns regulation to what Congress and the Commission are seeking to avoid, agency dictation of the specifics and even the details of how business should be done.[13]

Respectfully submitted,

GTE Service Corporation on behalf of its affiliated domestic telephone operating, long distance and wireless companies

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April 14, 1997

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[13] Concerns expressed by parties preoccupied with interexchange service (MCI, AT&T and TRA) miss the point. In fact, much of the administrative service furnished by the GTOCs to their affiliates are to competitive businesses not within the FCC's regulatory purview.

Proposed Further Safeguards

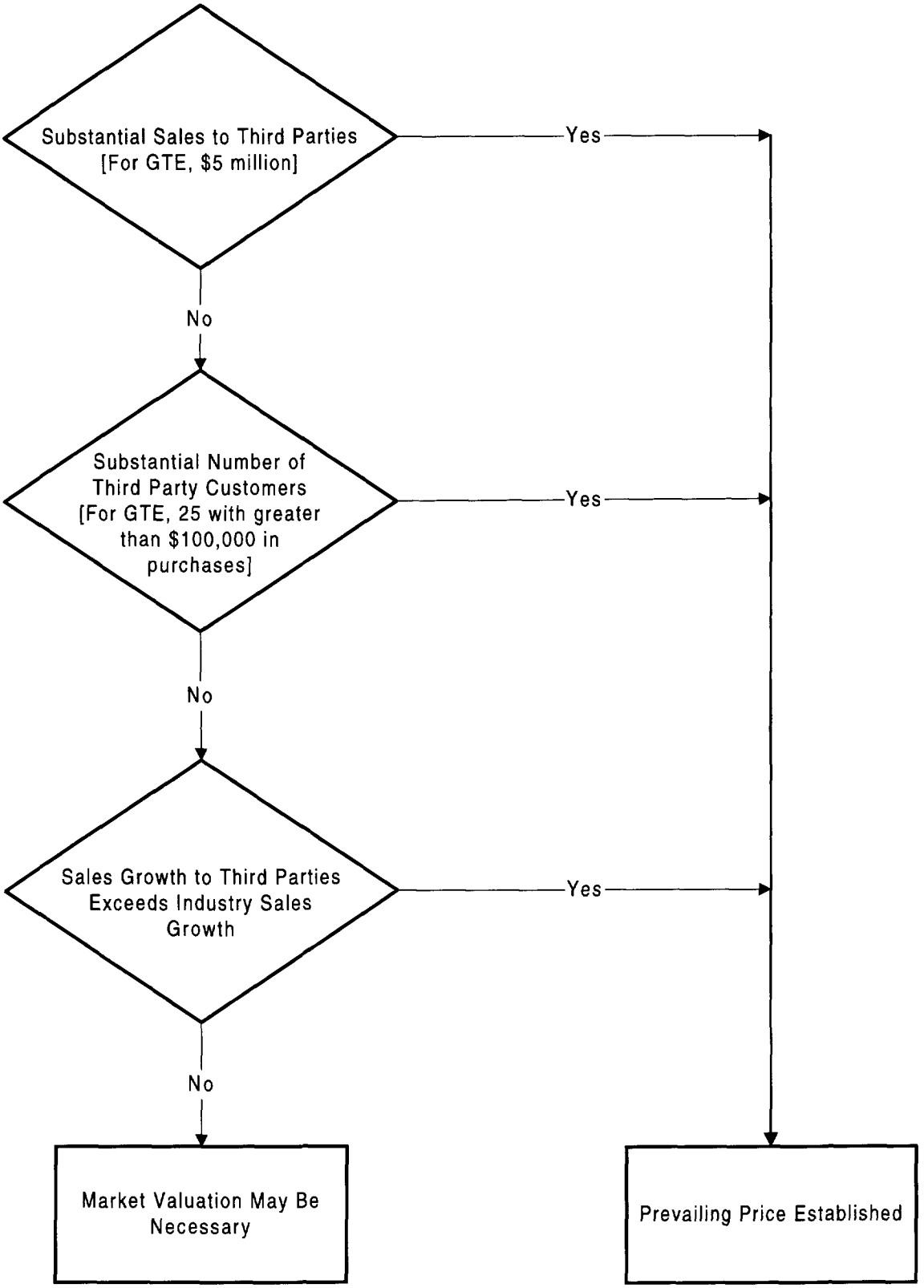

Exhibit I

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Certificate of Service

I, Ann D. Berkowitz, hereby certify that copies of the foregoing "GTE's Reply" have been mailed by first class United States mail, postage prepaid, on April 14, 1997 to all parties of record.

Ann D. Berkowitz