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Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell
CC Docket No. 98-81

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SUMMARY*

The comments and the Arthur Andersen Whitepaper provided overwhelming support for deregulatory relief from many accounting and cost allocation requirements –well beyond what was proposed in the NPRM--for mid-sized ILECs, as well as price cap ILECs.

An increase in any ILEC's sales of competitive products and services should not be used as a pretext to avoid accounting deregulation. The Commission should consider competition in its Section 11 analysis, but more competition should lead to less accounting regulation rather than more. To deny relief to the largest ILECs who are experiencing the most growth in local exchange competition because of the Commission's unfounded perception that the overall level of competitive products and services offered by the largest ILECs is higher than the mid-sized ILECs turns the Section 11 standard on its head.

MCI claims that Class B accounts "will limit the Commission in several ways." MCI adds other pretexts for retaining Class A accounts, including tariff investigations, Part 69 cost allocation and estimating the avoided costs of providing wholesale services.

In the current competitive environment, the Commission can maintain the necessary degree of oversight of all ILECs while reducing the administrative burden of its accounting regulations across-the-board. The SBC LECs and others demonstrated why Class A accounts are not necessary for purposes of identifying cost misallocations and preventing cross-subsidy, especially in the case of price cap ILECs. Functions such as the CAM process are just as effective under Class B accounts as they are under Class A accounts. The same is true of the other mechanisms raised by MCI, to the extent those mechanisms are still necessary.

* The abbreviations used in this Summary are defined in the body of these Reply Comments.

MCI has not shown that the Commission needs Class A accounts to perform its essential duties. On the contrary, Class A accounts and other detailed accounting regulation are not needed to prevent cross-subsidy or enforce Section 254(k) or other sections of the 1996 Act, to rule on pole attachment complaints, to conduct tariff investigations, to monitor the development of competition or any other essential Commission function.

Given that Class A accounts can be eliminated without impairing any essential Commission functions, it follows that the advantages of Class A accounts are outweighed by their burden, even if that burden were relatively light. But, the burden of the Commission's accounting regulation is significant, especially compared to the ILECs' competitors and other industries.

Contrary to MCI's contentions, the existence of the external financial books and their underlying details does not reduce the burden of maintaining Class A accounting details. Having Class A accounts requires significant additional accounting efforts. This additional burden is especially wasteful in view of the sufficiency of Class B accounts. In addition, the ILECs accounting systems are not static. They must be updated and replaced and continually reconciled to the external financial reporting records.

Other recent proceedings that have adopted or proposed more detailed or onerous accounting regulation, such as RAO 26 and CC Docket No. 97-212, need to be reconciled with Section 11 and this NPRM. Meaningful streamlining cannot be accomplished if more accounting requirements are adopted as others are being streamlined.

The mid-sized ILECs generally indicate that relief from accounting regulation should be limited to the mid-sized ILECs. None of the reasons advanced by the mid-sized ILECs justify such a limitation on the scope of the Section 11 relief. The impact on competition should be the

criteria for deregulation under Section 11, not an arbitrary size threshold that has no rational connection to the underlying justification for the regulation under examination. The SBC LECs question how the Commission could reasonably, and consistent with Section 11, reach different conclusions concerning the mid-sized and the largest ILECs.

The Commission should expand the horizons of its Section 11 review to include a comprehensive review of these accounting and cost allocation regulations as applied to those ILECs for which the requirements are least meaningful and justified -- the price cap ILECs.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
1998 Biennial Regulatory Review--	)	CC Docket No. 98-81
Review of Accounting and Cost	)	
Allocation Requirements	)	
	)	
United States Telephone Association	)	ASD File No. 98-64
Petition for Rulemaking	)	

REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL AND NEVADA BELL[1]

I. INTRODUCTION.

The comments filed on July 17, 1998 in this proceeding provided overwhelming support for deregulatory relief from many accounting and cost allocation requirements –well beyond what was proposed in the NPRM--for mid-sized ILECs, as well as price cap ILECs. Likewise, the Arthur Andersen Whitepaper filed on July 15, 1998 recommends, and provides good reasons for, a transition to a less regulatory form of accounting that is more like that used in competitive, nonregulated industries. Collectively, the comments and Arthur Andersen's Whitepaper demonstrate that the advantages of continuing to impose detailed Class A accounts and other accounting and CAM requirements are very minimal relative to the ongoing burden of the maximum level of current accounting regulation. It is clear that this high degree of regulation is no longer necessary in the public interest as a result of competition. In performing its Section 11 review, the Commission is required to consider "all regulations" and how they may affect "any

[1] Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell ("SBC LECs") are filing these Reply Comments pursuant to the Commission's Notice of Proposed Rulemaking ("NPRM") in the above-captioned proceeding released on June 17, 1998.

provider" in today's competitive market and, at a minimum, during 1998, the Commission should consider all of the rules and simplification proposals in the SBC LECs Comments, SBC's Section 11 Biennial Review Petition,[2] the Arthur Andersen Whitepaper and USTA's Comments. In light of the overwhelming record in the Comments and other Section 11 filings, no further evidence is needed to make a case for streamlining the accounting and cost allocation requirements across-the-board under Section 11's standard. Therefore, these Reply Comments will focus primarily on comments that seek to impede or limit deregulation, raised mainly by MCI.

II. MORE COMPETITION SHOULD MEAN LESS REGULATION.

MCI contends that

> The Commission's stated rationale for relaxing its accounting rules – that mid-sized LECs have typically conducted a lower volume of transactions involving competitive products and services – does not justify the proposed change in course.[3]

The SBC LECs agree that the NPRM does not contain the correct rationale for accounting deregulation under the Section 11 standard, but accounting deregulation is nonetheless justified for all ILECs.

Even if the relative volume of ILECs' competitive products and services were relevant to the Section 11 analysis, the SBC LECs and others have demonstrated that mid-sized ILECs have no less competitive or nonregulated activity than the largest ILECs, as reflected in the ARMIS data.[4] Even the mid-sized ILECs agree that the NPRM's assumption is not accurate.[5] And, in

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[2] SBC Petition for Section 11 Biennial Review filed May 8, 1998.

[3] MCI at 2.

[4] SBC LECs at 9-10 & Exhibit 2; Bell Atlantic, n. 4; GTE at 8 & n.13; USTA at 7-8.

[5] ITTA at 3-4.

the case of most ILECs, the level of nonregulated activity is not significant.[6] However, an increase in any ILEC's sales of competitive products and services should not be used as a pretext to avoid accounting deregulation, and it cannot be so used under a proper Section 11 analysis. Under Section 11, an increase in competition means less regulation, not more.

SBC agrees with MCI that the level of competitive or nonregulated activity is growing.[7] Competition is growing in all parts of the telecommunications business and it is this growth in competition that should drive accounting and other deregulation under Section 11. It is the growth in "meaningful economic competition between providers" that Section 11 considers to be the core criterion for relief from regulation.

To deny relief to the largest ILECs who are experiencing the most growth in local exchange competition because of the Commission's unfounded perception that the overall level of competitive products and services offered by the largest ILECs is higher than the mid-sized ILECs turns the Section 11 standard on its head, aside from ignoring the facts and other significant factors.

The Commission should consider competition in its Section 11 analysis, but more competition should lead to less accounting regulation rather than more.

Accounting deregulation is justified for all Class A ILECs, large and mid-sized. In the current competitive environment, the Commission can maintain the necessary degree of oversight of all ILECs while reducing the administrative burden of its accounting regulations

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[6] See, e.g., GTE at 8; US West at 9.

[7] MCI at 3.

across-the-board.[8] For example, even if all ILECs are permitted to convert to a Class B CAM and to simplify the CAM in other ways, the Commission can still maintain the necessary degree of oversight of cross-subsidy pursuant to the CAM rules, which do not depend on Class A for their effectiveness.[9] Given the adequacy of the Class B accounts to permit the Commission to perform those of its functions that continue to be essential, with respect to any size ILEC, the burden of Class A accounts far outweighs the relative benefits of more detailed Class A accounting regulation, especially in the case of price cap ILECs and those ILECs that are subject to the most competition from other service providers.

III. USE OF CLASS B ACCOUNTS WILL NOT IMPEDE PERFORMANCE OF THE COMMISSION'S ESSENTIAL REGULATORY FUNCTIONS.

MCI claims that Class B accounts "will limit the Commission in several ways."[10] While the NPRM focuses mainly on prevention of cross-subsidy,[11] MCI adds other more specific pretexts for retaining Class A accounts, including tariff investigations, Part 69 cost allocation and estimating the avoided costs of providing wholesale services pursuant to Section 252(d)(3).

The SBC LECs and others demonstrated why Class A accounts are not necessary for purposes of identifying cost misallocations and preventing cross-subsidy. First, in the case of price cap ILECs, price cap regulation severs the direct linkage between book costs and rates. To the extent there are indirect mechanisms such as the low-end adjustment, Class B accounting is

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[8] Given that the Commission can reduce the burden of its accounting rules across-the-board without impairing any of its regulatory processes, the relative cost of regulation should not be used as a factor to limit the companies to which deregulation will be available.

[9] SBC LECs at 12, 14-15, 19-20; Ameritech at 7; GTE at 10.

[10] MCI at 3.

[11] NPRM, ¶¶ 5-6 & nn. 10-16.

more than sufficient and the importance of CAM and other cost-based functions are significantly reduced. Second, functions such as the CAM process are just as effective under Class B accounts as they are under Class A accounts. For example, as Ameritech illustrated, a Class B CAM will contain the same types of homogenous groupings of costs as a Class A CAM, while permitting ILECs to adopt a simpler, more efficient chart of accounts.[12] Ameritech shows how the cost pools under each of the Class A Land and Support Asset ("L&S") accounts could be reorganized under a single Class B account (2110).[13] Where the same type of cost pool exists in multiple Class A L&S accounts, they are combined in the Class B CAM. For example, three of Ameritech's Class A L&S accounts have a "Distribution Services" cost pool, each of which is allocated in the same fashion. Combining those three pools does not have any impact on the accuracy of cost allocation.

Thus, the SBC LECs and other commenters have shown that the Commission's cross-subsidy concerns, including those that are based on Section 254(k) and other sections of the 1996 Act cited in the NPRM, are addressed by price cap regulation, and otherwise by procedures such as CAM, the effectiveness of which does not require Class A accounts.

Just as cost allocation and the CAM process do not justify retention of Class A accounts, the other mechanisms noted by MCI are no reason to refuse to streamline the accounting requirements. For example, MCI claims that without Class A accounts, the Commission would "lose a significant amount of cost and revenue detail that has proven invaluable in tariff

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[12] Ameritech at 7 & Attachment 4.

[13] Given that each ILEC's CAM is different, other ILECs' reorganization of their Class A CAMs under a Class B system may differ from Ameritech's example.

investigations."[14] The tariff process is no reason to retain Class A accounts. First, the Commission needs to conduct the biennial review of the tariff process, and as a result, eliminate tariff regulation of services that are subject to competition and further streamline all other tariff regulation.[15] Second, recording data in the Class A categories is not essential for purposes of the tariff process. In fact, ILECs typically submit special cost accounting studies to show the direct costs of tariffed services and these studies do not need Class A details, given that equivalent internal data is available. Even where tariff regulation is retained after the biennial review of tariff requirements, it does not need to rely on Class A accounts. ILECs' internal records will continue to contain cost and revenue detail, which the Commission can obtain in connection with any tariff investigations.[16]

If a mechanism such as the pole attachment rules or the tariff process occasionally use information from certain Class A accounts, it is not necessary to have ILECs continually book costs in the Class A categories in order to obtain the data if and when it is needed. A mechanism's previous reliance or sporadic use of Class A data should not be used as a pretext to deny accounting simplification. The mechanism should be reviewed to see whether it is essential and whether its reliance on Class A data is essential. Given that comparable data is available

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[14] MCI at 4.

[15] See, e.g., SBC Biennial Petition at 21-23. In fact, the Commission has initiated the biennial review of tariffing requirements. 1998 Biennial Regulatory Review—Part 62 of the Commission's Rules and Related Tariffing Requirements, CC Docket No. 98-131, Notice of Proposed Rulemaking, FCC 98-164, released July 24, 1998.

[16] The Commission recognizes the availability and sufficiency of internal ILEC data, at least in the case of mid-sized ILECs in 1998 Biennial Regulatory Review—Review of ARMIS Reporting Requirements, CC Docket No. 98-117, Notice of Proposed Rulemaking, FCC 98-147, released July 17, 1998, ¶ 8. There is no reason to find any difference in availability or sufficiency of internal data in the case of mid-sized ILECs compared to the largest ILECs.

from internal accounting data, Class A data is not essential. If specific data is deemed essential, the ILEC can be required to retain the equivalent data in internal or subsidiary records.

Another example used by MCI is Part 69 cost allocation. MCI points out that the Commission recently began using four Class A accounts in the Part 69 cost allocation process.[17] Reliance on 4 out of 261 Class A accounts is no reason to retain Class A accounts in their entirety. To the extent it continues to be necessary in the future, ILECs will be able to retain the necessary details as subsidiary records of their Class B accounts. Part 69 has traditionally used Class B accounts and, to the extent Part 69 continues, its reliance on a few Class A accounts should be reexamined to determine whether that reliance is essential.

MCI also claims that Class B accounts will limit the Commission and state regulators in estimating wholesale prices pursuant to Section 252(d).[18] This is not a limitation on the Commission since it has no jurisdiction over pricing of local services.[19] State regulators are free to use Class A accounts for these or other state regulatory purposes, although it is not necessary for state purposes either. However, if the state and federal jurisdictions each waits for the other to be the first to simplify accounting, it will never begin. In any event, the same types of marketing, billing, collection and other avoided costs can be obtained or estimated from other internal accounting records, without the necessity of perpetuating the Class A accounts that might contain the avoided costs.

MCI also argues that certain Class A accounting data is needed to monitor the

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[17] MCI at 4 & n.10.

[18] Id. at 3-4.

[19] Iowa Utilities Board v. FCC, 120 F. 3d 753 (8th Cir. 1997).

development of competition in local markets.[20] However, the Commission can monitor the development of competition by means that are far less onerous than detailed and continuous tracking of the data in all Class A accounts. Accounting data would be an ill-suited basis to monitor development of local competition. In fact, the Common Carrier Bureau recently proposed a Local Competition Survey for this very same purpose.[21] A periodic Local Competition Survey, which does not compromise the confidentiality of competitively sensitive data, would be a much better method of monitoring competition than perpetuation of detailed, onerous accounting and financial reporting requirements. Certainly, it should not be necessary for the Commission to have multiple, overlapping and redundant tools for monitoring local competition when one alone would be more than sufficient to accomplish the required task.

MCI has not shown that the Commission needs Class A accounts to perform its essential duties. On the contrary, Class A accounts are not needed to prevent cross-subsidy or enforce Section 254(k) or other sections of the 1996 Act, to rule on pole attachment complaints, to conduct tariff investigations, to monitor the development of competition or any other essential Commission function.

IV. CLASS A ACCOUNTS IMPOSE AN EXCESSIVE BURDEN RELATIVE TO THEIR MINIMAL BENEFITS.

Given that Class A accounts can be eliminated without impairing any essential Commission functions, it follows that the advantages of Class A accounts are outweighed by their burden, even if that burden were relatively light. But, as commenters and the Arthur

[20] MCI at 4-5.

[21] Public Notice, "Common Carrier Bureau Seeks Comment on Local Competition Survey," CCB-IAD File No. 98-102, DA 98-839, released May 8, 1998.

Andersen Whitepaper show, the burden of the Commission's accounting regulation is significant, especially compared to the ILECs' competitors and other industries.[22] This costly burden justifies a move toward less regulation of accounting and cost allocation rules, including the interim step of permitting use of Class B instead of Class A accounts.

MCI contends that the cost of continuing to use Class A accounts is minimal because ILECs already maintain their records in a lot more detail than Class A.[23] MCI does not take into consideration the difficulty of maintaining two sets of accounts. Arthur Andersen explains this difficulty in part as follows:

> [A]s financial results are reported to the SEC and shareholders on a GAAP basis considering the discontinuance of SFAS No. 71, separate external reporting records must be kept. The necessary tracking and reconciliation of differences between the above accounting records adds further cost and complexity to the carriers' accounting and reporting process.[24]

ILECs may have significantly more detail in their internal records, but it is a different type of detail.[25] The ILEC must maintain one set of books under Part 32 and a separate set of books and records for internal management and external financial purposes. The existence of the external financial books and their underlying details does not reduce the burden of maintaining Class A accounting details.[26]

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[22] See, e.g., Arthur Andersen Whitepaper at 13, 18-24, 30-37, 44-45.

[23] MCI at 5.

[24] Arthur Andersen Whitepaper at 18.

[25] US West at 10.

[26] Bell Atlantic at 7.

The burden of Class A accounts is that it does not produce information that is useful at all for management purposes.[27] That is, since Class A accounts requires a restrictive, structured chart of accounts, it lacks the flexibility to be used as a management tool. Therefore, having Part 32 Class A accounts requires significant additional accounting efforts. This additional burden is especially wasteful in view of the sufficiency of Class B accounts.

Further, a move to Class B accounts will facilitate the eventual elimination of all Part 32 accounting requirements so as to permit ILECs to use the same accounting as their competitors and other industries, relying solely on GAAP.

MCI also claims that the burden is minimal because ILECs have been using Class A accounts for over a decade and have automated their internal accounting systems.[28] However, the ILECs' accounting systems are not static. They must be updated and replaced and continually reconciled to the external financial reporting records. For example, GTE explains how it recently implemented a new general ledger system that it had to customize to meet Part 32 requirements.[29] As noted in the Arthur Andersen Whitepaper,

> One LEC reported that approximately 20%-25% of their total general ledger system implementation costs were attributable *exclusively* to customizing the system for Part 32, representing a large cost to the company. Another LEC noted that processing time is effectively *doubled* because of the level of information required by Part 32.[30]

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[27] See Arthur Andersen Whitepaper at 20-21.

[28] MCI at 5.

[29] GTE at 6-7.

[30] Arthur Andersen Whitepaper at 21.

The burden of maintaining Class A accounts also increases as the differences between Part 32 and external financial books become greater. Also, the Commission has frequently changed Part 32, requiring additional changes in accounting procedures. In any event, the length of time that Part 32 Class A accounts have been in place does not reduce the burden of continuing to be limited by a rigid set of accounts that is no longer essential for any of the Commission's regulatory purposes.

The internal accounting procedures and reports that ILECs use to manage their business do not look anything like Part 32 Class A accounts. Given that Part 32 Class A accounts are of very limited value in regulating price cap ILECs, in today's environment, the Commission should permit all ILECs to move toward using a chart of accounts that would serve both management and regulatory needs without imposing unnecessary burdens.

A number of other accounting and CAM requirements (identified in various parties' comments) also impose excessive burdens relative to the anticipated benefit of applying them to price cap ILECs, and thus, they too should be reviewed and streamlined pursuant to Section 11.

V. ACTION IN OTHER PROCEEDINGS NEEDS TO BE RECONCILED WITH THE BIENNIAL REVIEW.

The Section 11 review should cover all regulations, including those that have been adopted or proposed recently. Whenever the Commission adopts a new regulation, it should consider whether it would survive a Section 11 cost/benefit analysis.[31] Some commenters observe that recent proceedings have adopted or proposed more detailed or onerous accounting regulation.[32] These other proceedings need to be reconciled with Section 11 and this NPRM.

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[31] SBC Section 11 Biennial Review Petition at 5.

[32] Cincinnati Bell at 7-8; Sprint at 6.

Meaningful streamlining cannot be accomplished if more accounting requirements are adopted as others are being streamlined. For example, RAO 26 and CC Docket No. 97-212 represent moves toward more regulation of affiliate transactions and accounting for specific types of activities. To be consistent with Section 11, the Commission should vacate or suspend the RAO 26 requirements[33] and modify its proposed action in CC Docket No. 97-212 to be more consistent with the streamlining that should result from the biennial review.

VI. AT LEAST AS MUCH RELIEF IS JUSTIFIED FOR PRICE CAP ILECS AS FOR MID-SIZED ILECS.

In supporting the NPRM's deregulatory proposals for mid-sized ILECs and seeking much broader relief than that proposed in the NPRM, the mid-sized ILECs generally indicate that this relief should be limited to the mid-sized ILECs. The mid-sized ILECs' reasons vary. Some agree that the Commission should focus its resources on "90% of the industry."[34] Others assert, without any factual support, that the relative cost to the mid-sized ILEC is higher than the cost to the largest ILECs.[35] Cincinnati Bell simply claims mid-sized ILECs are unique.[36] In contrast, ITTA acknowledges that the NPRM's "volume of transactions" rationale is mistaken.[37] Instead, ITTA gives the example of a mid-sized company that is losing business to its competitors because the competitor is not subject to any of the onerous regulations that impede the mid-sized

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[33] See SBC LECs' Application for Review, ASD No. 98-65, filed June 5, 1998, at 1-6, 9.

[34] See, e.g., Sprint at 5.

[35] See, e.g., ALLTEL at 2.

[36] Cincinnati Bell at 2.

[37] ITTA at 3-4.

company's ability to compete.[38] The impact on competition, illustrated by ITTA's example, should be the criteria for deregulation under Section 11, not an arbitrary size threshold that has no rational connection to the underlying justification for the regulation under examination.[39] As the SBC LECs and others have demonstrated, Class A accounts and other Part 32 and Part 64 detailed requirements are no longer necessary to regulate price cap ILECs, and yet, the NPRM ironically excludes the mandatory price cap ILECs from the scope of its proposed deregulation.[40] None of the reasons advanced by the mid-sized ILECs justify such a limitation on the scope of the Section 11 relief. And, if the Commission ultimately concludes that continued detailed accounting regulation of the largest price-cap-regulated ILECs is required to prevent cross-subsidy, to comply with Sections 254(k) and 260 for any of the purposes raised by MCI, then the SBC LECs question how the Commission could reasonably, and consistent with Section 11, reach a different conclusion concerning the mid-sized ILECs.

VII. CONCLUSION.

Instead of limiting deregulatory relief from detailed accounting and cost allocation requirements to those ILECs that remain under rate-of-return regulation, the Commission should expand the horizons of its Section 11 review to include a comprehensive review of these regulations as applied to those ILECs for which the requirements are least meaningful and justified -- the price cap ILECs. As the Commission very recently explained, price cap regulation was adopted to replace rate-of-return regulation in large part because the latter

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[38] Id. at 3.

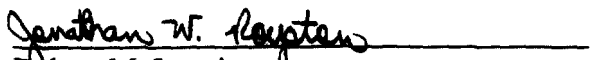
[39] See, e.g., SBC LECs at 8-17; BellSouth at 9-13.

[40] See BellSouth at 4, 6-7.

"required administratively burdensome cost allocation rules to enforce."[41] In light of Section 11, the left hand should now acknowledge what the right hand has done during the last eight years of price cap regulation and remove these administratively burdensome rate-of-return regulations.

Respectfully submitted,

SOUTHWESTERN BELL TELEPHONE COMPANY
PACIFIC BELL
NEVADA BELL



Robert M. Lynch
Durward D. Dupre
Darryl W. Howard
Jonathan W. Royston

One Bell Plaza, Room 3022
Dallas, Texas 75202
214-464-5534

Their Attorneys

August 3, 1998

[41] 1998 Biennial Regulatory Review – Part 61 of the Commission's Rules and Related Tariffing Requirements, CC Docket No. 98-131, Notice of Proposed Rulemaking, FCC 98-164, released July 24, 1998, n. 23.

CERTIFICATE OF SERVICE

I, Katie M. Turner, hereby certify that the foregoing, " CC DOCKET NO. 98-117, REPLY COMMENTS OF SOUTHWESTERN BELL TELEPHONE COMPANY, PACIFIC BELL AND NEVADA BELL IN THE MATTER OF 1998 BIENNIAL REGULATORY REVIEW – REVIEW OF ARMIS REPORTING REQUIREMENTS" in CC Docket No. 98-117 has been filed this 4th day of September, 1998 to the Parties of Record.

Katie M. Turner

Katie M. Turner

September 4, 1998

Chairman William Kennard
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, DC 20554

Tom Power
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, DC 20554

Commissioner Harold Furchtgott-Roth
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, DC 20554

Jim Casserly
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, DC 20554

Commissioner Michael Powell
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, DC 20554

Paul Gallant
Federal Communications Commission
1919 M Street, N.W.
Room 826
Washington, DC 20554

Commissioner Gloria Tristani
Federal Communications Commission
1919 M Street, N.W.
Room 826
Washington, DC 20554

Kyle Dixon
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, DC 20554

Commissioner Susan P. Ness
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, DC 20554

Kevin Martin
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, DC 20554

Larry Strickling
Federal Communications Commission
1919 M Street, N.W.
Room 500
Washington, DC 20554

Jane Jackson
Federal Communications Commission
1919 M Street, N.W.
Room 518
Washington, DC 20554

Richard Welch
Federal Communications Commission
1919 M Street, N.W.
Room 544
Washington, DC 20554

Kenneth Moran
Federal Communications Commission
2000 L Street, N.W.
Room 812
Washington, DC 20036

Jim Schlichting
Federal Communications Commission
1919 M Street, N.W.
Room 518
Washington, DC 20554

Lisa Gelb
Federal Communications Commission
2000 L Street, N.W.
Room 812
Washington, DC 20554

Warren Firschein
Federal Communications Commission
2000 L Street
Suite 200
Washington, DC 20554

ITS
1231 20th Street, N.W.
Ground Floor
Washington, DC 20036

David Solomon
Federal Communications Commission
1919 M Street, N.W.
Room 614
Washington, DC 20554

Linda Morrison
Federal Communications Commission
1919 M Street, N.W.
Room 622
Washington, DC 20554

Anthony Dale
Accounting Safeguards Division
Common Carrier Bureau
Federal Communications Commission
2000 L Street
Suite 201
Washington, DC 20554

Alan Buzacott
MCI Telecommunications Corporation
1801 Pennsylvania Ave., NW
Washington, DC 20006

Judy Sello
Mark C. Rosenblum
AT&T Corporation
295 North Maple Avenue
Room 3245I1
Basking Ridge, NJ 07920

Carolyn C. Hill
ALLTEL Communications Services Corp.
655 15th Street, N.W.
Suite 220
Washington, DC 20005

Leander R. Valent
Counsel for Ameritech
9525 West Bryn Mawr, Suite 600
Rosemont, IL 60018

Joseph DiBella
Attorney for the Bell Atlantic
Telephone Companies
1320 N. Court House Road
8th Floor
Arlington, VA 22201

M. Robert Sutherland
Stephen L. Earnest
BellSouth Corporation and
BellSouth Telecommunications, Inc.
1155 Peachtree Street, N.E.
Suite 1700
Atlanta, GA 30309-3610

Nancy Rue
Attorney for Cincinnati Bell
Telephone Company
FROST & JACOBS LLP
2500 PNC Center
201 East Fifth Street
Cincinnati, OH 45202

Michael J. Shortley, III
Attorney for the Frontier
Telephone Companies
180 South Clinton Avenue
Rochester, NY 14646

John F. Raposa
GTE Service Corporation
600 Hidden Ridge, HQE03J27
P.O. Box 152092
Irving, TX 75015-2092

Andre J. Lachance
GTE Service Corporation
1850 M Street, N.W.
Washington, DC 20036

Emily C. Hewitt
George N. Barclay
Michael J. Ettner
General Services Administration
1800 F Street, N.W., Room 4002
Washington, DC 20405

David W. Zesiger
Independent Telephone &
Telecommunications Alliance
1300 Connecticut Avenue
Suite 600
Washington, DC 20036

Jay C. Keithley
Sprint Local Telephone Companies
1850 M Street, N.W., 11th Floor
Washington, DC 20036-5807

Sandra K. Williams
Sprint Local Telephone Companies
P.O. Box 11315
Kansas City, MO 64112

James T. Hannon
US WEST, Inc.
1020 19th Street, N.W.
Suite 700
Washington, DC 20036

Lawrence E. Sarjeant
Linda L. Kent
Keith Townsend
John W. Hunter
United States Telephone Association
1401 H Street, N.W., Suite 600
Washington, DC 20005