

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554

|                                           |   |                      |
|-------------------------------------------|---|----------------------|
| In the Matter of                          | ) |                      |
|                                           | ) |                      |
| 1998 Biennial Regulatory Review --        | ) | CC Docket No. 98-137 |
| Review of Depreciation Requirements       | ) |                      |
| For Incumbent Local Exchange Carriers     | ) |                      |
|                                           | ) |                      |
| Ameritech Corporation Telephone Operating | ) |                      |
| Companies' Continuing Property Records    | ) |                      |
| Audit, <i>et al.</i>                      | ) | CC Docket No. 99-117 |
|                                           | ) |                      |
| GTE Telephone Operating Companies         | ) |                      |
| Release of Information Obtained During    | ) |                      |
| Joint Audit                               | ) | AAD File No. 98-26   |
|                                           | ) |                      |

**BELLSOUTH COMMENTS**

**BELLSOUTH CORPORATION**

M. Robert Sutherland  
Stephen L. Earnest

Its Attorneys  
Suite 1700  
1155 Peachtree Street, N. E.  
Atlanta, Georgia 30306-3610

404/249-2608 Telephone  
404/249-5664 Facsimile

Date: April 17, 2000

Comments of BellSouth Corp.  
CC Docket No. 98-137  
CC Docket No. 99-117  
AAD File No. 98-26  
April 17, 2000  
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## SUMMARY

Regulation of depreciation of Price Cap local exchange carriers (“LECs”) is outdated and unnecessary. This proceeding offers conditions under which the Commission may rid the industry of the unneeded regulatory oversight of depreciation while maintaining safeguards to adequately protect consumers and competition. Indeed, by adopting the conditions suggested in the *Notice*, any reason, real or perceived, for continuing prescription of depreciation rates, which is nothing more than a vestige of ratemaking regulation, is eliminated. Accordingly, the Commission should adopt the conditions suggested in the *Notice* and allow all Price Cap LECs that choose to follow those conditions freedom from depreciation regulation.

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**BELLSOUTH COMMENTS**

BellSouth Corporation, for itself and its affiliated companies (collectively “BellSouth”), submits the following comments in response to the *Further Notice of Proposed Rulemaking* released in the above-captioned proceeding.<sup>1</sup>

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<sup>1</sup> *In the Matter of 1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, *Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et al.*, CC Docket No. 99-117, *GTE Telephone Operating Companies Release of Information Obtained During Joint Audit*, AAD File No. 98-26, *Further Notice of Proposed Rulemaking*, FCC 00-119, released April 3, 2000 (“*Notice*”).

## INTRODUCTION

As discussed in the Background section of the *Notice*, the Commission recently issued an order in connection with its biennial review of depreciation.<sup>2</sup> In that order, the Commission refused to forbear from prescription of depreciation rates. However, it recognized “that it would be appropriate to grant a waiver of [its] depreciation prescription process for certain price cap incumbent LECs in certain instances.” *Depreciation Order*, ¶ 25. The *Depreciation Order* identified acceptance of four voluntary conditions as one way to demonstrate that a waiver of the depreciation rules is warranted. The Commission described these conditions at length in the *Notice*. The identified conditions are that an incumbent LEC:

(1) adjusts the net book costs on its regulatory books to the level currently reflected in its financial books by a below-the-line-write-off; (2) uses the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) foregoes the opportunity to seek recovery of the write-off through a low-end adjustment, or an above-cap filing; and (4) agrees to submit information concerning its depreciation accounts, including forecast additions and retirements for major network accounts and replacement plans for digital central offices.

*Depreciation Order*, ¶ 25

While the Commission listed these four specific conditions as making a waiver request ripe for approval, it also explicitly acknowledged that it would consider alternate proposals if such proposals provided “the same protections to guard against adverse impacts on consumers and competition as the conditions [listed above.]” *Depreciation Order* ¶ 25.

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<sup>2</sup> *In the Matter of 1998 Biennial Regulatory Review -- Review of Depreciation Requirements for Incumbent Local Exchange Carriers*, CC Docket No. 98-137, *Report and Order*, FCC 99-397, released December 30, 1999 (“*Depreciation Order*”).

On March 8, 2000, the Coalition for Affordable Local and Long Distance Service (“CALLS”) submitted a modified comprehensive plan aimed at obtaining access reform (“CALLS Plan”).<sup>3</sup> In connection with the CALLS Plan and in response to the *Depreciation Order*, participating incumbent local exchange carriers (“ILECs”) that are members of CALLS submitted a proposal to gain relief from depreciation regulation (“ILEC Depreciation Proposal”). This proposal suggested that the participating ILECs submit a joint request to the Commission seeking waiver of the depreciation rules pursuant to certain conditions similar to those listed above. Although the ILEC Depreciation Proposal modified the previously identified conditions, it nonetheless offered the same protections sought by the Commission in the *Depreciation Order*.

In the *Notice*, the Commission states that the participating ILECs make up almost an entire class of carriers. Therefore, the Commission established a rulemaking proceeding to address the regulatory relief for Price Cap LECs sought in the ILEC Depreciation Proposal. *Notice*, ¶ 3. This rulemaking, which is the subject of the *Notice*, requests comments on the condition set forth in the ILEC Depreciation Proposal. BellSouth strongly supports the Commission’s efforts in this rulemaking. Moreover, BellSouth contends that any rules established by this proceeding should be voluntary for any Price Cap LEC that chooses to opt into such rules, whether it is a member of the CALLS Plan or not. Likewise, if a Price Cap LEC that is a member of the CALLS Plan should choose not to opt into such rules, it should have the prerogative to do so. Thus, while the *Notice* focuses on conditions proposed by ILECs

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<sup>3</sup> CALLS submitted its original proposal in an *ex parte* on July 29, 1999. See *Access Charge Reform, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 and 96-45, *Notice of Proposed Rulemaking*, FCC 99-235, released September 15, 1999.

participating in CALLS, the rules established by this proceeding should not be limited or forced upon Price Cap LECs as a result of their participation in the CALLS Plan.<sup>4</sup>

**I. The Conditions in the ILEC Depreciation Proposal Provide the Same Protections as the Conditions Suggested in the *Depreciation Order***

The *Notice* identifies the conditions in the ILEC Depreciation Proposal as follows:

(1) use of the same depreciation factors and rates for both federal regulatory and financial accounting purposes; (2) submission of information concerning their depreciation accounts when significant changes to depreciation factors are made; and (3) use of a straight-line amortization over a five-year period to account for the difference between the reserve balances on their regulatory books and the corresponding balances on their financial books. The ILECs indicated that, under their proposal, the amortization expense for each year would be included in the calculation of regulated earnings (treated as an above-the-line expense) when reporting to the Commission. The ILECs would agree, however, that the amortization would have no effect on interstate price caps or their interstate rates and would commit not to seek recovery of the amortization expense through a low-end adjustment, an exogenous adjustment, or an above-cap filing. Also, under this proposal, the ILECs would commit not to seek recovery of the interstate amortization expense through any action at the state level, including any action on UNE rates.<sup>5</sup>

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<sup>4</sup> Indeed, if the CALLS Plan were not approved by the Commission, BellSouth, as other ILECs, would not be willing to forgo the recovery of the amortization amount discussed below.

<sup>5</sup> *Notice* ¶ 10. In a footnote, the *Notice* states that “[w]hile the commitment in the letter refers to interstate amortizations, we believe the ILECs intend to commit not to seek recovery, at the state level, of any portion of the amortization (*i.e.*, both state and interstate). We expressly seek comment from ILECs as to whether there is a firm commitment with regard to both state and interstate with respect to any recovery of any portion of the amortization.” *Notice* ¶ 10 n. 25. BellSouth maintains a separate set of books for their regulated state activities when state ratemaking treatment differs from federal rules. The Commission does not have jurisdiction over state regulated depreciation, *see Louisiana Public Service Commission v. FCC*, 476 U.S. 355 (1986), and therefore cannot mandate BellSouth’s accounting treatment of state activities. Neither BellSouth nor any other ILEC will be writing anything off the books on the intrastate side; there is nothing about the interstate adjustment that would affect any intrastate revenue requirement.

The *Notice* seeks comments on whether these conditions “adequately protect consumers from adverse rate impacts and otherwise meets the policy goals of the *Depreciation Order*.” *Notice*

¶ 12. Pursuant to the discussion herein, the conditions set forth in the ILEC Depreciation Proposal clearly address these concerns and goals of the Commission.

**A. Amortization of the Difference between Financial and Regulatory Depreciation Will Not Impact Customers or Competition**

The *Notice* points out the most significant difference between the conditions in the *Depreciation Order* and the ILEC Depreciation Proposal which is the write-off of the difference in reserves between Part 32 regulatory books and financial books. *Notice* ¶ 12. While both proposals would have carriers adjust their reserves for their Part 32 regulatory books to the level currently reflected on their financial books, the ILEC Depreciation Proposal amortizes this amount over a five-year period, with the amortization expense included in regulatory reporting as an “above-the-line” expense. The *Depreciation Order*, however, requires carriers to make a one-time below-the-line adjustment. The Commission’s concerns can be fully met by allowing carriers seeking relief to amortize this amount over five years as an above-the-line-expense instead of a one-time below-the-line write off. Amortization of the difference between the Part 32 books and the financial books as an above-the-line expense is consistent with past Commission action and is appropriate accounting.

**1. An Above-the-Line Amortization of the Reserve Adjustment is Justified and Consistent with Prior Commission Precedent**

The accounting matching principle requires that expenses should be matched to revenue related to those expenses. The purchase of equipment that will be used to generate revenue for several reporting periods, therefore, should not be expensed in the year purchased, but should be capitalized as an asset and expensed over the reporting periods it is used to produce revenue. Because it is impossible, in most cases, to directly match the expense of equipment to the revenue it produces, Generally Accepted Accounting Principles (“GAAP”) allows for the equipment to be assigned an estimated life over which the equipment will be used. Financial Accounting Standards Board (“FASB”), Concept Statement 6, Accrual Accounting and Related Concepts – Recognition, Matching, and Allocation, ¶ 149. The cost of the equipment is divided by its estimated life to determine an annual expense to be recorded in each respective reporting period. Accordingly, depreciation rates are a function of the life assigned to the equipment. All else being equal, as the estimated life is increased, the annual depreciation expense is decreased.

With the rapidly changing technology in today’s telecommunications, some assets have and will continue to become obsolete much sooner than the lives assigned by the Commission for regulatory purposes. Thus, the depreciation reserve for the regulatory books should be increased, thereby decreasing net book value. The adjustment should not be taken, however, through a below-the-line write off or in a single year. BellSouth agrees with the *Notice*, that the Commission should allow Price Cap LECs to determine the amount of the reserve adjustment and record one fifth of it each year as an above-the-line amortization expense that will

correspondingly reduce the regulated net book value. At the end of the five-year period, the reserve value recorded in regulatory books will equal the reserve value on the financial books.

The adjustment made as an above-the-line expense would not affect competition or consumers if relief from depreciation regulation is conditioned on a Price Cap LEC's committing not to seek a low-end adjustment, exogenous adjustment, or an above-cap filing related to the above-the-line reserve adjustment. Because Price Cap LECs are subject to price cap regulation, there is no other possible way the adjustment could affect prices. By forgoing these options, a Price Cap LEC would obviate any concerns the Commission may have regarding price increases. BellSouth supports the *Notice* that the Commission should revise its rules to incorporate this safeguard as a condition of relief from the Commission's capital recovery rules.

Moreover, amortization of such amounts above-the-line is consistent with past Commission actions. The Commission addressed the issue of depreciation reserve deficiencies for LECs in 1988. The Commission found that recovery of the reserve deficiency, i.e., amortization of the deficiency above the line, did not affect the LECs' recovery of depreciation expenses, but was "simply the timing of recovery of costs associated with carriers' use of capital to provide a communications service."<sup>6</sup> The Commission therefore allowed the amortization of the reserve deficiencies above-the-line *even in a rate of return regulated environment*.

Similarly, in 1988, AT&T complained that the rates prescribed by the Commission in 1985 had produced a depreciation reserve deficiency. AT&T petitioned the Commission to be allowed to adjust the depreciation reserve to the proper amount and to amortize that adjustment

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<sup>6</sup> *Amortization of Depreciation Reserve Imbalances of Local Exchange Carriers*, CC Docket No. 87-447, *Report and Order*, 3 FCC Rcd 984, ¶ 25 (1988).

above the line. Additionally, AT&T planned to write off from its financial books a significant portion of the assets that accounted for its reserve deficiency. The Commission determined that AT&T could amortize a reserve deficiency above-the-line and could write down the assets for financial book purposes.<sup>7</sup> The Commission held that “any write down by AT&T for financial reporting purposes has no effect on regulated investment amounts or prescribed depreciation expenses. Moreover, the plant subject to a write down has not been removed from service.”<sup>8</sup> The fact that these assets were written down for financial reporting purposes reflected the fact that with the increase in competition, the Commission could no longer guarantee a revenue stream sufficient to recover this investment. It in no way indicated that these assets were not in service or “used and useful” to ratepayers. Similar conclusions can be drawn about the assets of incumbent LECs now confronting increasing competition in their core service markets.

The *Depreciation Order* gave no reason for below-the-line treatment in seeking a waiver, and the Commission should abandon that notion in this rulemaking. The changes to adjust the regulatory reserve should be accounted for within regulatory earnings, *i.e.*, above-the-line. Making this adjustment below-the-line would not only be improper regulatory accounting treatment, but would artificially inflate reported LEC interstate earnings.

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<sup>7</sup> The write off for AT&T occurred over a period of non-contiguous years. Under the circumstances associated with the ILEC Depreciation Proposal, *i.e.*, the CALLS Plan, a five-year contiguous write off period for the full adjustment is appropriate.

<sup>8</sup> *Prescription of Revised Percentages of Depreciation Pursuant to the Communications Act of 1934, as amended for: AT&T Communications of California, Inc. et al.*, CC Docket No. Order, 4 FCC Rcd 1466, ¶ 16 (1989).

## 2. Recovery for the Difference in Depreciation Levels

Consistent with the ILEC Depreciation Proposal, the *Notice* seeks comments on the Price Cap LECs' commitment not to seek to recover through an exogenous cost adjustment,<sup>9</sup> low-end adjustment, or above cap filing the amortization expense incurred to adjust the depreciation reserve on its regulatory books to equal that on its financial books.<sup>10</sup> The CALLS Plan, if adopted, would establish a path for interstate access prices over the next five years. In that context, BellSouth believes that it is reasonable for a Price Cap LEC not to seek recovery of any interstate amortization expense incurred as a result of the amortization amount.

Moreover, given that the Commission's current cost standard for calculating UNE rates is based on forward looking costs, UNE rates would be unaffected by the interstate amortization expense.<sup>11</sup> Additionally, it is not the intent of the ILEC Depreciation Proposal for the amortization amount to have a burdensome impact on rural carriers by increasing loop costs, which in turn would decrease the federal high cost fund support. Indeed, BellSouth would

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<sup>9</sup> BellSouth notes that the Commission should order no exogenous adjustment to a Price Cap LEC's price cap indices upon completion of the write off. Because there is no price increase at the start of the adjustment, there should be no price decrease at the end of the adjustment.

<sup>10</sup> A Price Cap LEC would not be prohibited from filing a low-end adjustment or above-cap filing, but would be precluded from using the amortization of the reserve difference in determining the amount of relief available under such an adjustment. *Notice* ¶ 7 (“ . . . ILECs forego the opportunity to seek recovery of the *write-off* from interstate ratepayers through . . .”) (emphasis added).

<sup>11</sup> BellSouth reserves the right to price their UNEs based on actual costs if authorized as a result of the pending appellate review. See *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, *remand sub nom. Iowa Utils. Bd. v. FCC*, Case No. 96-3321 (and consolidated cases) (8<sup>th</sup> Cir. 1999). If unbundled network element prices are based on actual costs, BellSouth would exclude the interstate amortization expense from any such rate development.

support a system by which the amortization amount would have no impact on high cost fund calculations.

By modifying its rules to permit Price Cap LECs to set their own depreciation rates, the Commission would authorize the use of the proposed economic depreciation factors for all their reporting to the Commission. This would include any future cost estimates or studies, whether based on embedded or forward-looking cost, submitted by any of the companies. Indeed, there should be a presumption that the depreciation parameters used for both financial and regulatory reporting purposes are appropriate for any future cost study.

### **3. Reporting and Accounting for Reserve Amortization**

The *Notice* also seeks comments on whether “to include the amortization amount in the calculation of regulated earnings in the carriers’ reports to the Commission.” *Notice* ¶ 13. If included in the reports to the Commission, the *Notice* asks what protections will be needed “ensure that the carriers’ reported earnings...are not used in applications for rate increases under low-end adjustment, above cap price filings, or other mechanisms to justify rate increases.” *Notice* ¶ 13. BellSouth proposes that reporting of the amortization amount can be adequately accomplished by proper accounting. Such accounting treatment for the adjustment should be consistent with the Commission’s past treatment of amortization of reserve deficiencies. Thus the full amount of the reserve adjustment, *i.e.*, the difference between the Part 32 regulatory net books and the financial books, will be debited to Account 3100.9000, Accumulated Depreciation - Reserve Imbalance. The offsetting credit will be posted to the accumulated depreciation of the individual plant accounts, *i.e.*, Account 3100.XXXX – with Appropriate Field Reporting Code. Then, annually, for five years, 1/5th of the total reserve adjustment will be credited to Account

3100.9000 with a corresponding debit posted to the above-the-line expense Account 6561.2400, Amortization of Depreciation Reserve Imbalance. This accounting treatment allows for the adjustment of the net book value of the individual plant accounts for purposes of computing depreciation factors and rates but decreases total net book value over the amortization period as the expense is recognized. Moreover, the amount is easily identified within these accounts and will be adequate for reporting purposes.

**B. Carriers should be allowed to use the Same Factors for Regulatory and Financial Depreciation**

Consistent with the conditions identified in the *Depreciation Order* and the ILEC Depreciation Proposal in the *Notice*, the Commission should no longer prescribe capital recovery rates for participating Price Cap LECs but should allow them to use the same depreciation factors and rates for federal regulatory and financial accounting purposes.<sup>12</sup>

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<sup>12</sup> To insure that the same depreciation factors and rates for federal regulatory and financial accounting purposes continue to be used, the Commission must allow new accounting standards prescribed by the FASB relative to Depreciation to automatically take effect on the regulatory books coincident with the application of those standards on the company's financial books. As such, Section 32.16(a) of the Commission's rules would no longer apply for FASB approved Depreciation related changes to GAAP. Carriers would continue to report changes in accounting standards to the Commission as ordered in *Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I*, CC Docket No. 99-253, *Report and Order*, FCC 00-78, released March 8, 2000. (In para. 40, the Commission stated that information concerning changes in accounting standards can be obtained from the carriers' SEC Form 10-K and that carriers will submit a copy of their SEC Form 10-K annual report to the Commission.)

### **C. Reporting of Financial Information**

In order to maintain realistic ranges of depreciation rates for cost models, the *Depreciation Order* conditions required Price Cap LECs to provide information about plant accounts. The *Notice* seeks comments about the timing and scope of such information. BellSouth propose that Price Cap LECs report financial information related to assets, reserves and depreciation expense in the current (or streamlined) publicly filed ARMIS reports. Because there no longer would be a prescription of depreciation rates, no new reporting beyond what is in ARMIS should be necessary. Shifting responsibility for maintaining adequate reserves to the carrier, the public ARMIS information the Price Cap LECs will continue to report, and the data provided to the Commission regarding significant depreciation increases, taken together, make ongoing filing of additional information, such as theoretical reserves and forecasts, unnecessary.

### **II. The Commission Should Dismiss the Property Audits as Moot**

Finally, the *Notice* seeks comments on whether bringing the regulatory book balances to financial book levels would render the continuing property record (“CPR”), audits moot. While BellSouth, as well as the other ILECs, has vigorously objected to the methods used, and contested the conclusions drawn by the staff in these audits,<sup>13</sup> all issues raised by the audits will effectively be moot as a result of the Commission’s modification of its current depreciation rules pursuant to the *Notice* taken in conjunction with the pending CALLS Plan. Accordingly,

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<sup>13</sup> The Florida Public Service Commission recently completed an audit of BellSouth’s CPR in the state of Florida and found no significant findings. Division of Auditing and Financial Analysis Auditor’s Report, February 23, 2000.

assuming the Commission approves the CALLS plan, there is no basis for continuing the current audits of BellSouth or the other participating ILECs.<sup>14</sup>

In the staff report on property audits, the staff sought a write-off of investment and a reduction in access prices. The *Notice*, in conjunction with the CALLS Plan, resolves issues concerning carriers' net book investment values and access prices in a rational manner. While BellSouth strongly believes that the pending audits have produced no actionable results, there is no longer any reason to prolong that debate.

By increasing the regulatory depreciation reserve balance to match the depreciation reserve on the financial books, BellSouth will reduce its net regulatory investment. This reduction in net investment is significantly more than the retirement of the assets identified in its CPR audit. In addition, as a result of the CALLS Plan, switched access rates will be adjusted over time to an agreed upon rate of \$.0055 per minute for the participating ILECs. To reach that level, participating carriers will target the 6.5% price cap reduction and take additional reductions the first year in the switched trunking and local switching rates by as much as approximately 40%.<sup>15</sup>

With prospective rates set by the CALLS Plan, there can no longer be any doubt that prices are completely independent of investment levels reflected in BellSouth's permanent records of engineering equipment. It is pointless to continue the debate concerning the accuracy

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<sup>14</sup> For the same reasons, it would be unduly burdensome and wasteful to go forth with additional audits of plug-in equipment and outside plant, as once contemplated.

<sup>15</sup> See *In the Matter of Price Cap Performance Review for Local Exchange Carriers, et al.*, CC Docket No. 94-1, *et al.*, Memorandum in Support of the Revised Plan of the Coalition for Affordable Local and Long Distance Service, filed March 8, 2000, page 12.

of those records. Similarly, other CPR audits that have been initiated or contemplated should not be undertaken.<sup>16</sup>

### **III. Implementation**

Price Cap LECs that choose to opt into the rules promulgated by this proceeding, pursuant to the conditions described herein, should be allowed to begin setting their own rates beginning July 1, 2000, with the timing being consistent with the timing of the CALLS Plan. Accordingly, the Commission should make July 1, 2000 the effective date of any order establishing rules consistent with the *Notice*.

BellSouth proposes that if a Price Cap LEC chooses to opt into the rules promulgated by this proceeding, it should do so by sending a letter of notice of such election to the Commission. The Price Cap LEC should then be authorized to operate under these rules beginning one week from the date of its notice of election.

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<sup>16</sup> See Letter from Commission Chairman William E. Kennard to Congressman Thomas J. Bliley, dated September 8, 1998 (discussion of plans to audit plug-in equipment and outside plant).

## CONCLUSION

The Commission should approve the CALLS Plan as proposed and should implement the proposal set forth in the *Notice* to eliminate the prescription of depreciation rates for participating Price Cap LECs.

Respectfully submitted,

**BELLSOUTH CORPORATION**

By its Attorneys

/s/Stephen L. Earnest

M. Robert Sutherland

Stephen L. Earnest

Suite 1700

1155 Peachtree Street, N. E.

Atlanta, Georgia 30306-3610

(404) 249-2608

Date: April 17, 2000

## CERTIFICATE OF SERVICE

I do hereby certify that I have this 17th day of April, 2000, served the following parties to this action with a copy of the foregoing *COMMENTS OF BELLSOUTH CORPORATION*, reference CC Docket No. 98-137, CC Docket No. 99-117, and ASD File No. 98-26, by the Commission's Electronic Comment Filing System (ECFS), or by placing a true and correct copy of the same by Federal Express or in the United States Mail, addressed to the parties listed below.

Magalie Roman Salas\*  
Commission Secretary  
Office of the Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Suite TW-A325  
Washington, DC 20554

William E. Kennard, Chairman\*\*  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Room 8-B201  
Washington, DC 20554

Michael Powell, Commissioner\*\*  
Federal Communications Commission  
Room 8-A204  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Gloria Tristani, Commissioner\*\*  
Federal Communications Commission  
Room 8-C302  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Harold Furchgott-Roth\*\*  
Commissioner  
Federal Communications Commission  
Room 8-A302  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

International Transcription Service, Inc.\*\*  
1231 20<sup>th</sup> Street  
Washington, DC 20037

Debbie Byrd\*\*  
Accounting Safeguards Division  
Federal Communications Commission  
445 12<sup>th</sup> Street  
Washington, DC 20554

Susan Ness, Commissioner\*\*  
Federal Communications Commission  
Room 8-B115  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Ken Moran, Chief\*\*  
Accounting Safeguards Division  
Federal Communications Commission  
Room 6-B201  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

Carol Matthey\*\*  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, DC 20554

/s/Lenora Biera-Lewis  
Lenora Biera-Lewis

\* ***ECFS***  
\*\* ***FEDERAL EXPRESS***