

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of

2000 Biennial Regulatory Review –
Comprehensive Review of the
Accounting Requirements for
Incumbent Local Exchange Carriers:
Phase 2 and Phase 3

CC Docket No. 00-199

PHASE 3 COMMENTS OF VERIZON¹

As Verizon and other parties demonstrated in their Phase 2 comments, the Commission should eliminate or substantially reduce its Part 32 accounting and automated reporting and management information system (“ARMIS”) reporting requirements immediately, not after additional “triggers” are met as proposed in Phase 3 of this rulemaking. These rules were designed to support intensive rate-of-return based regulation, and they are unnecessary and irrelevant in the current price cap regulatory regime. Their continued existence tilts the competitive playing field against the incumbent local exchange carriers, who are uniquely burdened by these costly and archaic reporting requirements. To the extent that the Commission does not reduce or eliminate these regulations in Phase 2, it should adopt a plan for their total elimination that would be triggered by the grant of pricing flexibility, which eliminates the lower formula adjustment, the last link to cost.

¹ The Verizon telephone companies (“Verizon”) are the affiliated local telephone companies of Verizon Communications Corp. These companies are listed in Attachment A.

I. There Is No Need For “Triggers” – The Commission Should Eliminate Its Part 32 Accounting And ARMIS Reporting Rules Immediately.

In Phase 2 of this proceeding, Verizon and other commenters made a compelling case that the Part 32 accounting system, which the incumbent local exchange carriers use for no other purpose than reporting data to the Commission, is an expensive and unnecessary burden in today’s competitive telecommunications environment. *See, e.g.*, Verizon Reply Comments, 2-4; USTA Reply Comments, 1-7; Qwest Reply Comments, 9-13. Section 11 of the Act requires the Commission to take a fresh look at its rules every two years and to eliminate any rules that are no longer “necessary.” *See* 47 U.S.C. §161(b). If the Part 32 system of accounts did not exist, it is extremely unlikely that the Commission could justify its imposition today. The Part 32 uniform system of accounts, together with the Part 64 rules for allocating costs between regulated and non-regulated activities, the Part 36 separations rules, the Part 69 access charge rules, and the Part 65 rate of return rules, were designed to allow the Commission to prescribe interstate access charges under a cost-based rate of return system. The Commission no longer uses this elaborate system to determine if rates are reasonable – it relies on price caps and the CALLS plan to determine the maximum rates that may be charged by the large incumbent local exchange carriers that are still subject to price controls. Similarly, there is no need for the carriers to report Part 32 costs through ARMIS – their financial reports to the Securities and Exchange Commission based on generally accepted accounting procedures (“GAAP”) already provide complete and accurate information about their financial condition.

The accounting and reporting requirements are not only burdensome and unnecessary – they are harmful. The Telecommunications Act of 1996 was designed to replace regulation with the discipline of a competitive market. Since the Act was passed, competition has increased

enormously, and the incumbent local exchange carriers face direct competition for both basic telephone service and advanced telecommunications services. Yet, the incumbent carriers alone are burdened with a costly accounting system and a requirement to publicly disclose detailed cost and revenue data. This asymmetrical burden distorts the market and prevents consumers from reaping the benefits of full and free competition. Maintaining unnecessary regulations on only one segment of the industry is contrary to the deregulatory purpose of the Telecommunications Act and cannot be justified simply because it has been around for a long time and “might come in handy.”

For these reasons, the Commission should not perpetuate the Part 32 accounting system and the ARMIS reports through a phased transition to deregulation. The Commission should eliminate these rules immediately.

II. If The Commission Adopts A Phased Approach To Elimination Of Its Accounting Rules, It Should Adopt Triggers That Reflect The Deregulation Of Rates Under Price Caps.

If the Commission decides, nonetheless, to adopt a phased approach to eliminate its accounting and reporting rules, it should adopt “triggers” that reflect the elimination of the last link to rate-of-return calculations under price caps. The Commission asks whether it should link deregulation to the sunset of the separate long distance affiliate requirements for the Bell operating companies under section 272 of the Act or to the grant of pricing flexibility in particular markets. *See* Notice of Proposed Rulemaking, FCC 00-364, CC Docket No. 00-199, (rel. October 18, 2000), ¶¶ 89-91, (“Notice”). While these events are related, directly or indirectly, to the growth in competition, they are not the best measures for identifying when there is no longer a need for a prescribed cost accounting system. Since the accounting rules were designed to assist

the Commission in determining the reasonableness of rates, they should be eliminated when they are no longer relevant to the Commission's system for price controls.

The upper pricing limits in the price cap formulas are based on prices and demand, not cost. Although costs are used in determining exogenous adjustments, these can be calculated based on GAAP accounts, and they do not require a separate set of books under Part 32.² The only unique use for Part 32 cost accounting under price caps is to generate an interstate rate of return to calculate the lower formula adjustment in the exceptional situation where a carrier seeks that relief. Under the Commission's pricing flexibility rules, a price cap carrier waives the opportunity to seek a lower formula adjustment on a holding company basis when it receives Phase 1 or Phase II pricing flexibility. *See* 47 C.F.R. §69.731. At that point, even the possibility of a need for a rate of return calculation is eliminated. Therefore, when a price cap carrier is granted pricing flexibility and loses the lower formula adjustment, it and its local exchange company affiliates should be exempted from the Part 32 accounting rules and the ARMIS reporting requirements.

Part 32 accounting, Part 64 cost allocations, and ARMIS reporting are not necessary for other regulatory purposes. The safeguards that the Commission has adopted to enforce sections 260 and 271-76 of the Act are primarily separate affiliate and nondiscrimination requirements. These are considered non-accounting safeguards. *See Implementation of the Non-Accounting Safeguards of Section 271 and 272*, 11 FCC Rcd 21905 (1996). The Commission has relied upon

² For example, the impact of tax law changes can be calculated using GAAP, and changes in the amount of universal service fund assessments are provided by the fund administrator. Cost adjustments due to changes in the separations manual are unlikely, given the proposal to freeze the separations factors. Changes in the uniform system of accounts (i.e., Part 32) would no longer require exogenous adjustments because there would be no Part 32.

its Part 64 cost allocation rules to ensure that carriers did not provide competitive services below cost by misallocating nonregulated costs to regulated accounts. While the LFAM exists, the Part 64 rules prevent a carrier from increasing its regulated rates by over-allocating costs to regulated accounts and suppressing its rate of return. Elimination of the LFAM removes this last link between cost allocations and rates for regulated interstate access services. Once the LFAM is eliminated, services that remain subject to price caps cannot be affected by a shift in costs from non-regulated to regulated accounts, because such shifts do not qualify for exogenous treatment. Services that are taken out of price caps are subject to competition and will remain reasonable regardless of how costs are allocated to those services. For these reasons, Part 64 cost allocation rules become irrelevant once the LFAM is eliminated, and Part 32 accounting is no longer needed as a prerequisite to Part 64.

Part 32 accounting also is not needed for jurisdictional separations purposes once a carrier has achieved pricing flexibility. The Commission no longer has a regulatory need to identify interstate costs if a carrier cannot take advantage of the lower formula adjustment. Most states have adopted price-based regulation in one form or another. States that still follow rate-of-return based regulation can use the proposed “frozen” separations factors to calculate the intrastate portion of a carrier’s total company costs.³

Part 32 also is not needed to administer the universal service fund. The Commission's proxy cost model is based on forward-looking costs, not the embedded costs in the Part 32 accounts. Although ARMIS data have been used in developing some of the cost inputs in the

³ GAAP will allow carriers to identify total company costs to which the frozen factors would be applied. Should the Commission decide not to adopt the Joint Board proposal to freeze the separations factors, separations studies can still be performed using GAAP accounts.

current model, the forward-looking nature of the model negates the need for updates based on embedded ARMIS costs. Moreover, GAAP accounts can be used to develop cost inputs, such as overhead costs and expense to investment ratios, either directly or through special studies. Although the current model is based on the costs of the incumbent local exchange carriers, support generated by the model is available to any “eligible telecommunications carrier” designated by a state commission, which may include competitive local exchange carriers and wireless carriers. The fund is administered in the same way for all carriers, and it does not require that any carrier who receives support maintain its financial data in Part 32 accounts. Given the rise in competition, data for any future update to the model inputs are likely to include the costs of new entrants that have only GAAP accounting data available. Part 32 accounts are not only unnecessary, but they are likely to become increasingly irrelevant as inputs to the model.

Nor is Part 32 needed to enforce the requirement in Section 254(k) that services in the definition of universal service bear no more than a reasonable share of joint and common costs. The Commission found that it dealt with this issue when it selected and adjusted overhead cost inputs for its proxy model. *See Federal-State Joint Board on Universal Service, 10th Report and Order*, 14 FCC Rcd 20156 (1999) ¶¶ 338, 387.

Part 32 accounting and ARMIS reporting also are not needed for other purposes, such as in addressing cost issues related to pole attachments, interconnection, collocation, or long term number portability. These costs can be developed from GAAP accounts using investment and expense accounts and cost studies, where necessary. The carriers are not likely to eliminate their current accounting systems immediately if the Part 32 rules were eliminated. As they replace their accounting systems over time, they will retain sufficient detail to respond to requests for cost data in these areas.

The Commission asks how it could assess the state of the network without the ARMIS infrastructure reports. *See Notice*, ¶ 98. This erroneously assumes that the large incumbent local exchange carriers alone constitute “the network.” Competitors have installed millions of miles of transmission facilities throughout the country, and wireless carriers are ubiquitous. Cable and satellite systems provide alternative telephone and broadband services to homes and businesses. The ARMIS reports provide only a partial, and increasingly distorted, picture of the deployment of telecommunications facilities. They are not only unnecessary, they are counter-productive. They will become increasingly misleading indicators of the amount of capacity and growth in the network as well as the types of services and technologies that are available to consumers.

III. Conclusion

For the foregoing reasons, the Part 32 accounting and ARMIS reporting requirements are obsolete and should be eliminated immediately. If the Commission decides to adopt a phased

approach to eliminate these rules, it should sunset them as carriers achieve pricing flexibility and remove services from price caps.

Respectfully submitted,

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THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.