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

In the Matter of	)	
	)	
2000 Biennial Regulatory Review --	)	CC Docket No. 00-199
Comprehensive Review of the	)	
Accounting Requirements and	)	
ARMIS Reporting Requirements for	)	
Incumbent Local Exchange Carriers:	)	
Phase 2 and 3	)	
	)	
Local Competition and Broadband	)	CC Docket No. 99-301
Reporting	)	

JOINT COMMENTS OF BELLSOUTH, SBC, VERIZON, QWEST, FRONTIER, and CBT

BELLSOUTH CORPORATION
By its Attorneys

Stephen L. Earnest
Richard M. Sbaratta
Suite 4300
675 West Peachtree Street, N. E.
Atlanta, Georgia 30375
(404) 335-0711

CINCINNATI BELL TELEPHONE COMPANY
By its Attorneys

Christopher J. Wilson
Associate General Counsel
201 East Fourth Street
Room 120-620
Cincinnati, Ohio 45202
(513) 397-6351

THE FRONTIER AND CITIZENS INCUMBENT LOCAL EXCHANGE CARRIERS
By its Attorneys

Gregg C. Sayre
Associate General Counsel – Eastern Region
180 South Clinton Avenue
Rochester, New York 14646-0700
(585) 777-7270

QWEST CORPORATION
By its Attorneys

James T. Hannon
Sharon J. Devine
James T. Hannon
Suite 700
1020 19th Street, N.W.
Washington, DC 20036
(303) 672-2860

SBC COMMUNICATIONS INC.
By its Attorneys

Juanita Harris
Gary L. Phillips
Paul K. Mancini
1401 I Street, N.W.
Suite 400
Washington, D.C. 20005
(202) 326-8910

-and-

VERIZON
By its attorneys

Ann H. Rakestraw
1515 North Courthouse Road
Suite 500
Arlington, VA 22201
(703) 351-3174

Michael E. Glover
Edward Shakin
Of Counsel

Date: April 8, 2002

TABLE OF CONTENTS

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

In the Matter of	)	
	)	
2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and 3	)	CC Docket No. 00-199
	)	
Local Competition and Broadband Reporting	)	CC Docket No. 99-301

JOINT COMMENTS OF BELLSOUTH, SBC, VERIZON, QWEST, FRONTIER, and CBT

BellSouth Corporation and its wholly owned affiliates ("BellSouth"), Southwestern Bell Communications, Inc., for itself and its wholly owned affiliates[1] ("SBC"), the Verizon telephone companies,[2] Qwest Corporation, ("Qwest") and The Frontier and Citizens Incumbent Local Exchange Carriers ("Frontier") and Cincinnati Bell Telephone Company ("CBT") (collectively, "Coalition") submits the following comments in response to the Further Notice of Proposed Rulemaking released in the above-captioned proceedings.[3]

1 SBC Communications Inc. ("SBC") files these Comments on behalf of its subsidiaries, Southwestern Bell Telephone Company ("SWBT"), Pacific Bell, Nevada Bell, Ameritech, and the Southern New England Telephone Company.

2 The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Corp., and are listed in Attachment A.

3 *In the Matter of 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, et al.*, CC Docket No. 00-199, *et al. Report and Order CC Docket Nos. 00-*

Introduction and Summary

In the *Phase 2 Order*, the Commission stated that its goal was to eliminate "unnecessary" regulation, as it recognized that "any unnecessary regulation places a corresponding, unnecessary burden on the carriers that are subject to it."[4] Indeed, under the terms of the Act, the Commission is statutorily required to "repeal or modify any regulation it determines to be no longer necessary in the public interest."[5] Pursuant to that goal, the Commission should eliminate accounting requirements of Part 32 without limitation, the affiliate transaction requirements of 47 C.F.R. § 32.27 and the continuing property records ("CPR") rules of 47 C.F.R. § 32.2000. Additionally, the Commission should eliminate the ARMIS reporting requirements. Rather than rely on the current outdated and burdensome accounting and reporting regulations, the Commission should instead limit any reporting to more targeted data collection mechanisms designed to elicit only the specific information necessary for the Commission's oversight functions. Even without Part 32 accounting and ARMIS reporting, carriers will continue to maintain information necessary for most regulatory purposes because of Generally Accepted Accounting Principles ("GAAP") and other business concerns.[6] Many of these changes should

---

199, 97-212, and 80-286 ("Phase 2 Order"); Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301 and 80-286 ("Notice"), 16 FCC Rcd 19911 (2001).

4 *Phase 2 Order* 16 FCC Rcd at 19913, ¶ 2.

5 47 U.S.C. § 161.

6 The ILECs would likely continue to maintain the basic framework of the uniform system of accounts ("USOA") in the near term due to embedded coding in systems. Thus, in the interim, the USOA listing of accounts rules, simplified affiliate transaction rules, and the ARMIS financial reports (43-01, 43-02, 43-03, 43-04) could be retained to assist the states during the transition period. The notification, approval, CPR rules, materiality limitations, jurisdictional differences accounts, and all other regulatory requirements regarding the chart of accounts, however, should be removed immediately while an orderly transition should be allowed for

become effective immediately, and the Commission should remove all Part 32 accounting and ARMIS reporting rules within a three year sunset period.

I. Accounting and Reporting Requirements Are No Longer Necessary Due to Regulatory Changes and Competition, and Should Sunset in Three Years

A. The Part 32 Accounting and ARMIS Reporting Requirements Are Not Necessary, and Should Be Eliminated

The Coalition is pleased with the Commission's recognition of the need for deregulation of the incumbent local exchange carriers' ("ILEC") accounting rules.[7] As the Commission acknowledged, with the development of competition, the original justification for these rules "may no longer be valid."[8] Indeed, elimination of these rules should not be seen as optional but as something that is the legal duty of the Commission. Specifically, both sections 10 and 11 of the Telecommunications Act of 1996 ("the Act") *require* the Commission to forbear from applying regulations that are not "necessary."[9] As the District of Columbia Court of Appeals has recently reaffirmed, section 11 "is clear that a regulation should be retained only insofar as it is necessary in, not merely consonant with, the public interest."[10]

---

depreciation reserve and deferred tax differences. As argued herein, there is no Federal need for such regulation.

7 *See Notice* 16 FCC Rcd at 19985, ¶ 206 ("In [the Commission's] view, the question is not whether further deregulation should occur, but rather when.")

8 *Id.*

9 *See* 47 U.S.C. § 160(a) (requiring the Commission to eliminate any regulation or provision of the Act if the Commission determines that: (1) enforcement is not necessary to ensure that the rates and practices of a telecommunications carrier or service are just, reasonable and not unjustly or unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest); 47 U.S.C. § 161 (b) (requiring Commission to "repeal or modify any regulation it determines to be no longer necessary in the public interest").

10 *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1050 (D.C. Cir. 2002).

The accounting and reporting rules, in particular, are ripe for repeal. Price cap regulation combined with pricing flexibility has completely eliminated any link between ILECs' recorded costs and the prices they charge for services. Thus, the accounting rules are not necessary for the regulation of rates. The accounting and reporting rules placed on ILECs were established at a time when prices were set on a cost plus basis and there was very little, if any, competition in the market. Since that time, the marketplace and the regulatory paradigms have shifted. Competition has increased, and the largest ILECs operate under a price cap system that does not require the same level of detailed accounting regulation. The Commission has eliminated the sharing and the lower formula adjustment mechanism ("LFAM"), that could have created potential incentives for price cap ILECs to shift costs.[11] Similarly, the Commission recently adopted the CALLS plan, which is "an integrated access reform/universal service plan that restructured access rates to remove implicit subsidies. Rates under CALLS are not based on the development and reporting of costs under any of the Commission's accounting and reporting rules."[12]

Moreover, elimination of federal regulatory accounting rules is in the public interest because the burden placed on the ILECs to comply with the rules far outweigh any benefits

---

[11] *See In the Matter of Price Cap Performance Review for Local Exchange Carriers and Access Charge Reform*, CC Docket Nos. 94-1 and 96-262, *Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262*, 12 FCC Rcd 16642, 16700, ¶148 (1997) ("*1997 Price Cap Review Order*"), *aff'd in part, rev'd in part, USTA v. FCC*, 188 F.3d 521 (D.C. Cir. 1999). *See also In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers, and Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1, 98-157 and CCB/CPD File No. 98-63, *Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd 14221, 14304 ¶ 162 ("*Pricing Flexibility Order*").

[12] Comments filed by USTA in CC Docket 00-199 on February 13, 2001 at 5 ("USTA Comments").

derived from complying with such rules. Compliance with ARMIS reporting and Part 32 accounting rules requires ILECs to invest a significant amount of administrative and financial resources, imposing unequal burdens on only one class of carriers. In a competitive market, regulation of only one class of competitors hinders competition, handicapping ILECs' ability to compete more effectively in the increasingly competitive local services and access markets, including broadband services. As Commissioner Martin stated,

> And at the FCC, we, too, need to critically reevaluate our rules to determine whether they are necessary in today's regulatory environment. For example, our accounting and auditing rules serve little purpose in a price-cap regulatory framework. . . . I supported our recent efforts to streamline these regulations and believe the Commission must continue to identify anachronistic regulations that may be stifling competition generally.[13]

The Commission should eliminate detailed Part 32 accounting procedures and ARMIS reporting requirements, because they are unnecessary and burdensome. In many instances, the rules require carriers to capture, maintain, and report data that is no longer useful for regulatory purposes and can be eliminated immediately. And even without the accounting and reporting rules, regulators will continue to be able to request and obtain information necessary for regulatory purposes, because carriers will continue to keep detailed accounting records pursuant to GAAP. If the Commission finds it necessary to have certain information reported on a more regular basis, it should obtain that information through the *Local Competition and Broadband Data Gathering Program Form,* 477 ("Form 477"), or other more targeted requests that allow the data to be collected from all carriers in a way that protects proprietary information.

---

13 Commissioner Kevin J. Martin, Remarks at the National Summit on Broadband Deployment (Oct. 26, 2001).

B. Sunsetting Unnecessary Regulations Is Preferable to Adopting Triggers

Micro-managing the accounting and reporting for a limited set of service providers makes no sense in today's competitive environment. The Commission can eliminate the accounting and reporting rules without pause because, as demonstrated below, information that is necessary for regulatory purposes can still be provided through other means on a more focused basis. Many of these rules can be eliminated immediately. For the remaining rules, the Commission should establish a date certain, no longer than three years, to sunset these rules. By allowing a three year window before eliminating the rules entirely, the Commission will provide time for states relying on current reporting to prepare for the change in Federal requirements.

A sunset rule is better than a system that relies on "triggers," because it is more uniform, easier to administer, and provides both carriers and regulators with certainty. Identifying triggers on a carrier-by-carrier basis would be more cumbersome and costly than a single sunset of the rules. This provides the carriers and states a clear picture of when a carrier will transition away from the rules. The Commission should eliminate some rules immediately, and sunset the rest within three years and allow an orderly transition for depreciation reserve and deferred tax differences.

II. The Commission Should Eliminate Part 32 Accounting Requirements and Allow Carriers to Maintain Their Regulatory Books in Accordance with GAAP for Federal Accounting Purposes

The *Notice* asks for comments on whether accounting and reporting requirements should sunset by a date certain, such as three or five years in the future. As the Commission has recognized, "the question is not whether further deregulation should occur, but rather when."[14] The Commission should eliminate Part 32 accounting rules within three years, and allow carriers

[14] *Notice*, 16 FCC Rcd at 19985, ¶ 206.

to keep their regulatory books pursuant to GAAP for Federal purposes.[15] This should include the elimination of the chart of accounts requirements discussed in the *Notice*, and just as importantly should include elimination of all Part 32 federal regulatory accounting requirements.[16] These rules are not necessary, because records kept pursuant to GAAP will be sufficient to satisfied Federal regulatory needs.

GAAP is universally recognized as the proper set of principles under which companies record financial data for management and reporting purposes, and is being used to satisfy many regulatory purposes.[17] Indeed, the Commission has already accepted GAAP as an appropriate means of maintaining regulatory books. The Commission has ordered that the regulated separate affiliates of ILECs are to use GAAP.[18] Moreover, CLECs, cable companies, wireless carriers, and others use GAAP for all accounting and financial reporting purposes.

Indeed, the USOA currently prescribed by the Commission is primarily based on GAAP. GAAP embraces a number of sources of established accounting principles in addition to

---

[15] The *Notice* also asks whether the "requirement to maintain either Class A or Class B accounts be replaced with a rule requiring adherence to generally accepted accounting principles ("GAAP")"*Id.* at 19986, ¶ 209. As discussed herein, the Commission should eliminate the regulations related to Part 32 and allow carriers to operate under GAAP; however, there is no need to implement a rule requiring carriers to adhere to GAAP. Every Coalition member must have its financial statements audited by a certified public accountant ("CPA"). Part of the auditor's obligation in issuing an opinion on the financial statements is to state whether they are in accordance with GAAP. Thus, carriers will adhere to GAAP if the Commission simply eliminates its rules.

[16] The Coalition discusses continuing property records ("CPR"), Part 32.2000, and affiliate transaction rules, Part 32.27, in detail below. Other Part 32 rules, for example, notification for adopting a new accounting standard, Part 32.16, and the materiality, limitations in Parts 32.26, and 32.2000, and the jurisdictional differences accounts, should also be eliminated.

[17] For example, the New York Public Service Commission ("PSC") has recently issued an order allowing Verizon's state regulatory financial reporting will transition to GAAP over a three year period.

[18] *In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, 11 FCC Rcd 17539, 17618, 17649, ¶¶ 170, 243 (1996) ("*Accounting Safeguards Order*").

pronouncements issued by the Financial Accounting Standards Board ("FASB") and the American Institute of Certified Public Accountants ("AICPA"), which are binding on both private and publicly traded companies. In addition to business needs that require ILECs to maintain detailed accounting records, several other federal statutes already require ILECs to maintain accurate records and publicly report financial information.[19] With all of these other incentives and requirements for ILECs to retain accurate and complete records, there is no need for the Commission to maintain accounting rules, especially when those rules impose burdensome obligations on only one class of carriers.

A. The Commission Should Phase Out Part 32 Chart of Account Regulations Entirely, Rather than Imposing Piecemeal Changes that Might Create Additional Burdens with Only Short-Term Benefits

The Commission should eliminate Part 32 chart of accounts requirements completely and allow each carrier to maintain their chart of accounts in accordance with GAAP. In the *Phase 2 Order*, the Commission eliminated some Class A accounts, modified others, and added new accounts. While the overall reduction in accounts is a positive step, the combination of changes that the Commission adopted in Phase 2 – especially the modifications of existing accounts, and the addition of new accounts – resulted in significant short term implementation costs. For example, Verizon has estimated that it would take at least four to six months to structure and conduct the studies necessary to allocate Account 6620 expenses between wholesale and retail subaccounts, costing close to $3.5 million in additional implementation costs, and over $2.5

[19] For example, all of the Coalition ILECs are public companies that report financial statements on an annual and quarterly basis to the Securities and Exchange Commission ("SEC"). Additionally, the Coalition members are all subject to the Foreign Corrupt Practices Act ("FCPA"), which requires every public company to make and keep "books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." 15 USC § 78m(b)(2)(A).

million per year in ongoing costs. If Class A ILECs instead made operational system changes to segregate the expenses into wholesale and retail, the burden would be even more onerous – BellSouth has estimated it would cost approximately $12.5 million and take 18 months to implement these changes.[20]

In this final Phase 3 proceeding, the Commission's goal should be to eliminate unnecessary rules altogether, rather than to tinker with outdated accounting and reporting rules. Additional "tweaking" as an interim step may make sense from a conceptual standpoint, but in reality, the costs associated with implementing piecemeal modifications may be great. If the goal is to eliminate these requirements altogether, those costs will be incurred for potentially limited, short-term benefits. Additionally, individual account adjustments to Class A accounts must also be avoided.[21]

B. In Addition to the Chart of Accounts, the Commission Should Eliminate All Other Part 32 Accounting Requirements

The Commission should eliminate all other Part 32 federal regulatory accounting requirements and allow business needs and GAAP to dictate practice and policy.[22] GAAP establishes that a company must disclose, both in notes to its financial statements as well as in the statements themselves, exactly how it applies accounting standards. A company's financial statements plus other reports, such as the company's 10K report filed with the SEC, provide

---

20 *See* Petition for Reconsideration filed by BellSouth, SBC, and Verizon on March 8, 2002 (cost of implementing wholesale/retail split of certain accounts will be enormous).

21 Although the large ILECs (via USTA) argued for a wholesale shift from the detailed Class A chart of accounts to the Class B chart of accounts, the Coalition now believes moving all carriers to Class B accounts would be unsatisfactory.

22 Although it was not mentioned in the *Notice*, the Commission should also revisit the depreciation rules. These rules should also be eliminated and the carriers should be allowed to set depreciation rates according to GAAP. To make the transition to GAAP, the carriers must be allowed to amortize over a reasonable period any excess reserve deficiency as an above the line expense to regulated earnings.

much of the information necessary for regulatory needs. Any other regulatory questions can be addressed through targeted data requests, rather than through the imposition of burdensome accounting requirements.

C. The CPR Rules Serve No Federal Purpose and Should Be Eliminated

1. The CPR Rules Are Not Necessary

The Coalition fully supports the Commission's tentative conclusion to eliminate the CPR rules, which provide little or no benefit in today's regulatory environment. This point was punctuated in a letter prepared by independent accountants in response to audits of the large ILECs' CPR conducted by the Commission's Accounting Safeguards Division, ("ASD").[23] In disputing the results of the audits, the group stated:

> Separate and apart from the fundamental problems with the FCC's CPR audit, the FCC's *Property Record Requirements themselves are an unnecessary requirement of the regulatory past and surpass the level of detail required to maintain a proper system of internal control for COE. The FCC should simplify its Rules and Regulations as they pertain to property records and expense limits so that the costs of compliance and internal controls do not exceed the benefits derived there from.*[24]

To the extent that accurate plant accounts play any continuing role in monitoring financial results, defining stranded investment or calculating low-end adjustments "[t]hese

---

[23] *See In the Matters of Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, Bell Atlantic (North) Telephone Companies' Continuing Property Records Audit, Bell Atlantic (South) Telephone Companies' Continuing Property Records Audit, BellSouth Telecommunications' Continuing Property Records Audit, Pacific Bell and Nevada Bell Telephone Companies' Continuing Property Records Audit, Southwestern Bell Telephone Company's Continuing Property Records Audit, US West Telephone Companies' Continuing Property Records Audit, Notice of Inquiry*, CC Docket No. 99-117, ASD File No. 99-22, 14 FCC Rcd 7019 (1999)("*CPR Audit NOI*").

[24] Letter from Carl R. Geppert, T.J. Mangold, and John W. Putman to Magalie R. Salas dated September 22, 1999 at 3, CC Docket No. 99-117, (emphasis added).

mechanisms are . . . mere relics of rate-of-service regulation and are no longer necessary in today's increasingly competitive environment."[25] Indeed, the CPR rules and Responsible Accounting Officer ("RAO") letters have long outlived their purpose and usefulness. They are a detailed set of rules that dictate very specific requirements that an ILEC must follow in recording its fixed plant. At the time of their adoption, carriers subject to the rules operated under a rate of return regulatory regime.[26] The Commission assumed that precise detailed documentation of costs that made up the plant asset rate base and contributed to the calculation of depreciation expense was necessary to protect ratepayers. Transition to price cap regulation, however, completely eliminated the need for such complex detailed rules. Such detailed rules that micromanage physical plant assets serve absolutely no purpose under price cap regulation. And they impose significant costs on the ILECs, both in terms of compliance and audit costs. The Coalition believes that the cost of compliance with the CPR rules and the funds expended on CPR audits far outweigh any benefits that could possibly result from these rules.

Although the move to price cap regulation is, by itself, reason enough to get rid of the CPR rules, other reasons, which are just as compelling, fully demonstrate that the CPR rules serve no purpose and should be eliminated. First, and foremost, the Commission has acknowledged that the primary purpose of the CPR rules is to "serve the interests of the state

---

[25] Separate statement of Commissioner Harold Furchgott-Roth, *In the Matter of GTE Telephone Operating Companies Release of Information Obtained During Joint Audit,* AAD 98-26, *Memorandum Opinion and Order,* 13 FCC Rcd 9179, 9183 (1998).

[26] The CPR systems and processes that the ILECs use were designed and implemented in the 1960s. Even at the time of implementation there was serious concern about the design. After the AT&T divestiture, the ILECs continued the AT&T practice and systems and the Commission essentially adopted its structure into the Part 31 and then the Part 32 rules. Subsequently, there has been a significant change in technology while the number of access lines and switches increased dramatically. Thus, the process that was inadequately designed to track a relatively small amount of electro-mechanical equipment is now tracking equipment in considerably larger amounts and greater variety, *e.g.*, electronic, digital, and optical equipment.

regulators."[27] However, as the Commission itself recognizes, state needs do not provide a basis to continue the CPR rules.[28]

Most states that argue for continuation of the CPR rules do so because they remain under rate of return regulation. They contend that the CPR rules provide assurance that costs for physical plant are accurately stated as inputs for rate base and depreciation calculations. As discussed above, GAAP is already sufficient to meet these needs.[29] In addition, the needs of a handful of states cannot be sufficient reason to impose a burdensome federal regulation.[30] Rate of return states have adequate authority to obtain whatever information they need to perform their regulatory duties; there is no valid federal purpose for continuing to apply the CPR to all ILECs.

Second, in addition to the fact that under price caps the CPR rules have no impact on prices ILECs charge subscribers, these rules do not materially impact any other price related

---

27 *Notice,* 16 FCC Rcd at 19987, ¶ 212.

28 *See id.* at 19985, ¶ 207 ("We believe that, if we cannot identify a federal need for a regulation, we are not justified in maintaining such a requirement at the federal level.").

29 The Coalition recognizes that it is important to continue to maintain accurate records of these investments, for business and accounting purposes. Moreover, in order to manage the business properly, the ILECs must know the physical assets that they have in place. It is vitally important for planning purposes to know the capacity of the current network, which requires a very thorough knowledge of the plant assets within the network. In fact, ILECs may well continue to use the physical plant systems they have in place even if the Commission eliminates the CPR rules. Accurately recorded investment, however, does not require the minutia of rules that are currently required by the Commission's Part 32 CPR rules, and the corresponding RAO Letters.

30 While rate of return regulation may still be used in some states, it is limited to a very few. Communications Daily, March 26, 2002 (noting that in only seven states do the dominant ILECs for that state operate under rate-of-return regulation).

function, such as universal service fund calculations and unbundled network element ("UNE") prices.[31]

Elimination of the CPR rules is necessary in order to allow ILECs the flexibility to change their systems where change is necessitated. Large interexchange carriers ("IXC") are a prime example of how deregulation of the CPR rules will not harm regulatory needs. IXCs still maintain CPRs for physical plant assets in accordance with the CPR rules although the Commission has eliminated the CPR rules for IXCs. Freedom from the draconian rules, however, has allowed the IXCs to evolve their physical plant practices over the years to achieve efficiencies that ILECs have not enjoyed. The CPR rules impose an impediment to the evolution of ILEC property record keeping and should be eliminated.

2. There are Significant Burdens Associated with the CPR Rules

The *Notice* also seeks comment on the costs and burdens of maintaining CPR rules. In an effort to obtain efficiency savings in the accounting and reporting process and to obtain meaningful management information, packaged system software has been developed for general ledger and related feeder systems such as the fixed asset systems. Unfortunately, the efficiency savings resulting from such changes are diminished because ILECs are required to expend additional resources to customize these packaged systems to comply with the CPR rules. Likewise, processing time is increased because of the level of information required by Part 32. In addition to diminished savings, the on-going functionality of the new systems is greatly reduced due to the detailed elements of data that must be added in order to comply with Part 32.

---

[31] The ILECs that were subject to CPR audits in 1998 filed comments in the *CPR Audit NOI* that explain in detail that the CPR do not affect these calculations. That is because the investments recorded in the accounts are based on the amounts actually paid to procure and install equipment, and carriers do not use the CPR in order to calculate these amounts.

The Commission's pre-notification rules are also problematic. For example, the current rules require the ILECs to notify the Commission of any proposed changes to the CPR, and wait for a Commission response before these changes may be implemented. Experience has shown that this regulatory review adds an unreasonable amount of time to process.[32] Because of this delay the carriers subject to these draconian Part 32 CPR rules have been hesitant to initiate changes to their property records when a major project would require immediate action for implementation. As a result, ILECs have maintained antiquated property systems and processes rather than subject themselves to the Commission's lengthy regulatory requirement needed for a change. The ILECs seek the ability to continuously redefine property units and record elements consistent with asset management best practices within the telecommunications industry. A comprehensive overhaul project once started would be complex and require flexibility and rapid execution. The expectation of regulatory delays and possible design alterations, potentially adding many months to the process, is a significant deterrent to beginning such a process at all.

III. The Commission Should Eliminate ARMIS Reporting Requirements, and Require Any "Necessary" Data To Be Reported Through Form 477 or Specific Information Requests

In the *Notice*, the Commission asks whether it should go further than changes in the *Phase 2 Order* and eliminate ARMIS reporting requirements entirely.[33] The answer to that question is yes. ARMIS is incredibly burdensome and, because it applies only to a few carriers,

---

32 In 1999, SBC requested to change its basic property units list to add one item. The process, which entailed SBC and its vendors providing a tremendous amount of detailed explanations to the Commission's staff, took nearly a year. A non-regulated company would have only to develop and justify its own business case before its own management, as SBC had already done before going to the Commission. SBC lost a year of potential efficiencies as a result of this regulatory delay.

33 *Phase 2 Order* 16 FCC Rcd at 19914-15, 19961-77, ¶¶ 5, 128-78.

is of limited regulatory use. If the Commission finds any information currently reported in ARMIS to be "necessary" for federal regulatory purposes, it should require this data to be reported on Form 477, which requires reporting by all carriers and has a mechanism for protecting proprietary information.

Current ARMIS reports encompass two very distinct sets of information: the ARMIS 43-01 through 43-04 reports contain financial information while 43-05 through 43-08 are focused on network and service quality information. Because of the distinct nature of these two sets of ARMIS reports, the issues associated with them are quite different and are discussed separately.

A. The Network Reports (ARMIS Reports 43-05 through 43-08) Should Be Eliminated

1. ARMIS Reports 43-05 and 43-06 Are Unnecessary

The Coalition members have long advocated the elimination of both the ARMIS 43-05, Service Quality Report, and the 43-06, Customer Satisfaction Report.[34] These reports were originally implemented to monitor price cap ILECs as they transitioned from rate of return regulation to price cap regulation, and that transition, and thus the need for the reports, is long over. Moreover, most states have their own service quality reporting. Therefore, there is no federal need for continuing this reporting.

2. ARMIS Reports 43-07 and 43-08

The Commission should eliminate ARMIS reports 43-07 and 43-08. Report 43-07, Infrastructure Report, provides information regarding an ILEC's switching equipment, transmission facilities, call set-up times, and additions and book costs. Most of this information

---

[34] *See* Comments and Reply Comments filed by USTA and BellSouth *In the Matter of 2000 Biennial Regulatory Review Telecommunications Service Quality Reporting Requirements*, CC Docket No. 00-229.

is antiquated and is of no value to the Commission. Reporting such information as the availability of touch-tone services or deployment of local switches equipped with SS7 is of no relevance in the current market. Likewise, Report 43-08, Operating Data Report, is equally obsolete and should be eliminated. This report provides information regarding outside plant statistics including the number of poles and trench kilometers of conduit, switched access lines by technology, access lines in service, and call volumes. Monitoring network infrastructure through these ARMIS reports is no longer needed in today's competitive environment. If the ILECs do not provide the services demanded by their customers, or provide inadequate services, their customers will obtain service from a competitor. Even in areas where competition is not yet prevalent, ILECs try to increase their profitability by marketing new services to existing customers. ILECs, therefore, have every incentive to invest in infrastructure if that investment will provide products and services to market to their customers, or will create more satisfied loyal customers.

If the Commission finds that it is still "necessary" for federal regulatory purposes to have continued reporting of certain ARMIS information, it should have carriers report that information through Form 477 or through specific information requests. In addition, the Commission should not impose special reporting and accounting burdens on ILECs that do not apply to its competitors. If other carriers are not required to report certain information, the Commission should ask itself why such reporting is "necessary" for a handful of ILECs. In the increasingly competitive telecommunications marketplace, it is questionable whether receiving information from only a partial class of carriers is useful in formulating policy decisions. As the Commission recently stated, one of its key initiatives is promoting facilities based competition. A basic requirement for achieving facilities based competition is having multiple facilities based carriers providing services, not just ILECs. Therefore, rather than limit the carriers who would be required to report infrastructure information, all facilities based providers should be required to submit data on key items that will enable the Commission to evaluate a carrier's commitment to providing facilities based competition.

3. The Commission Must Not Require The Reporting of Additional Information Not Currently Reported in ARMIS or the Form 477

The *Notice* asks whether the Commission should require collection of "information on hybrid fiber-copper loop interface locations, number of customers served from these interface locations, xDSL customer terminations associated with hybrid-copper fiber loops, and xDSL customer terminations associated with non-hybrid loops" and "on whether to gather information on new technologies that indicate how carriers are upgrading the public switched network...."[35] The Commission should not require reporting of information this burdensome and competitively sensitive without explaining why the information is necessary. If the Commission wishes to pursue collection of this type of data, it should do so by seeking comment in the *Local Competition and Broadband Data Gathering Program* docket with the proper analysis and explanations of why the information is necessary. This would allow carriers to offer alternatives ways the Commission could achieve its objectives without unnecessarily burdening carriers. It also should ensure that any reporting occurs through Form 477, where confidential information can be protected as proprietary.

B. The Financial Reports (ARMIS Reports 43-01 through 43-04)

The ARMIS financial reports differ from network reports, because a large portion of the data contained in them is available from other standardized financial reporting vehicles such as

35 *Notice,* 16 FCC Rcd at 19987, ¶211.

the 10K. Despite the prevalence of price regulation at the Federal and state level, both the Commission and the states have argued that the reports provide useful information. The states have argued strenuously that they need ARMIS data to conduct their business efficiently and to avoid collecting their own data. However, as Attachment B indicates, the vast majority of states already require separate reporting of some type.

IV. Part 32 Accounting and ARMIS Reporting Requirements Are Not Needed for Universal Service, Pole and Conduit Attachments, or Monitoring Price Caps

Any information the Commission needs to administer universal service and ensure that pole attachment rates are reasonable can more efficiently be provided through other data collection mechanisms. These reports are not necessary for the regulators to be able to monitor rates under price cap plans, or for any other regulatory purposes claimed by the states.

A. Universal Service

Neither Class A accounts nor information from current ARMIS reports is necessary for the Commission to properly administer the Universal Service Fund ("USF").

Significantly, the amounts recorded in carriers' accounts do not drive the majority of inputs into the USF mechanism. For example, rather than looking to carriers' books of accounts, in order to determine the cost of carrier networks, other vehicles such as switching contracts, first installed costs, and job estimates have been used for USF purposes.

In addition, some of the Class A information that the Commission claims it needs for the USF has not been required in the USF report.[36] For example:

---

36 *See Phase 2 Order*, 16 FCC Rcd at 20004-05, App. E; *In the Matter of Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs,* CC Docket Nos. 96-45 and 97-160, *Tenth Report and Order,* 14 FCC Rcd 20156, 20417, App. D (1999).

- Appendix E of the *Phase 2 Order* shows that individual accounts 6121, 6122, 6123 and 6124 are needed; however the USF input order shows the Class B equivalent of 6120 as being used.
- Appendix E of the *Phase 2 Order* shows that individual accounts 6511 and 6512 are needed; however the USF input order shows the Class B equivalent of 6510.
- Appendix E of the *Phase 2 Order* shows that individual accounts 6531, 6532, 6533, 6534 and 6535 are needed; however the USF input order shows the Class B equivalent of 6530.

Information currently reported in ARMIS that is used to administer the USF can, and should, be collected through other means. Indeed, current rules already require carriers to report financial information for USF outside the ARMIS process.[37] A process unique to the USF insures that the data will be used for its intended purpose and that any future streamlining or elimination of data can be implemented without adversely affecting other processes.

Thus, a separate data request would be a much more effective way of obtaining the information required for the USF, rather than extracting the information from ARMIS. Furthermore, a USF data request would only be required when the USF model is updated – at most, annually.[38] To demonstrate, the Coalition developed a sample data request form that shows how today's USF inputs can be provided absent ARMIS and absent a chart of accounts. This report is included as Attachment C to the comments.[39]

B. Pole and Conduit Attachments

---

[37] *See, e.g.*, 47 C.F.R. § 36.611 (requires each ILEC to provide to National Exchange Carrier Association ("NECA") annual reports providing certain unseparated investment, depreciation, deferred tax, maintenance expense, and other information); 47 C.F.R. § 36.612 (applies to rural telephone companies who also supply data.)

[38] The data request could be once every 2 or 3 years depending on when model is updated.

[39] This sample report was developed simply to demonstrate how neither ARMIS nor Part 32 is required to administer today's USF and is not meant to indicate approval of the current USF model or model input.

The information necessary to monitor pole and conduit attachment costs are limited to a handful of items.[40] Accordingly, all the information can be provided through a report directly related to pole and conduit attachments, without ARMIS and without a mandated Part 32 chart of accounts.

The Coalition has developed a sample reporting form, provided as Attachment D, including definitions of each reportable item, that all carriers could prepare and report to the Commission relevant information related to pole and conduit attachments ("pole attachments"). Such a report would lessen ILECs' burdens and would benefit pole attachment users because all key data items would be in one place. If a separate pole attachment report were created, it could, and should, be used by all facilities-based telecommunications carriers providing pole attachments. Once ARMIS is eliminated, the new report should be provided annually at the company level, which is the same level as the current source of this information, ARMIS 43-02 and 43-08.

C. Price Cap Concerns

For price cap ILECs, rates are driven by changes in the price cap formula, which incorporates changes in productivity and inflation and other non-accounting factors, such as demand changes. The price cap system was intentionally designed to prevent cross-subsidy between services.

Part 32 accounting data and ARMIS reporting are not necessary to support accounting-related exogenous cost adjustments. Price cap ILECs can employ accounting records based on

---

40 *See* Letter from Paul Glist, Cole, Raywid & Braverman, L.L.P. on behalf of National Cable and Telecommunications Association to Ms. Magalie Roman Salas, Federal Communications Commission, CC Docket No. 01-199,September 5, 2001 (identifying accounts needed to monitor pole attachment costs).

GAAP requirements if Part 32 is no longer required. ILEC records to support interstate price cap tariff filings and jurisdictional separations requirements, can be maintained internally as long as those requirements exist. Because separations factors are now frozen, interstate amounts relative to total company amounts that support exogenous costs should remain relatively stable in the future. Therefore, the ARMIS reports filed in 2003 that contain 2002 data (based on year 2000 factors), should provide price cap ILECs and other parties with sufficient information to develop interstate factors used to confirm the reasonableness of exogenous costs and supporting amounts filed in the future. Additionally, exogenous cost changes are reviewed as part of the tariff filing process and are examined by the Commission and other parties. Thus, price-cap ILECs have an incentive to maintain sufficient detail and records used in calculating exogenous cost adjustments, regardless of whether the exogenous adjustment is an accounting-related exogenous adjustment or not.

D. State PSC Concerns are Unwarranted

The *Notice* identifies requests of state regulators for Class A accounts and ARMIS for the purpose of promoting local competition, developing appropriate prices for unbundled network elements ("UNE") and conducting local ratemaking proceedings. Class A accounts and ARMIS reports, as currently configured, however, are not necessary for any of these purposes. First, the Commission established the Local Competition and Broadband Report, Form 477, to help monitor local competition. States can use information from this report more effectively in assessing local competition than information provided through the ARMIS reports.

Second, UNE rates are based on forward-looking cost data, not books of accounts.[41] While some methodologies used to develop UNE costs may use historical accounting data as the starting point for forward looking projections, that does not mean that Class A accounts must be maintained in order to establish these rates. Indeed, because the historical costs are not included in UNE rates but are merely used as a basis to project forward looking costs, specific account classifications of the historical costs should not be necessary. Instead, ILECs can provide to the state commissions whatever historical data is necessary to establish forward-looking projections for UNE rates.

Third, carriers that are still under rate of return regulation will continue to face local ratemaking proceedings. These proceedings require information that is even more detailed than that provided in the chart of accounts or ARMIS. Typically, data requests are used. Rate of return carriers will need to maintain whatever their specific state commissions require. This information would need to be provided to the states regardless of whether or not the Commission eliminates Part 32 accounting and ARMIS reporting requirements.

V. Affiliate Transaction Rules Should be Eliminated for Price Cap Carriers

The *Notice* asks a series of questions regarding the continued necessity of the affiliate transaction rules considering, as the *Notice* recognizes, that the rules "were created at a time when all incumbent LECs were subject to rate-of-return regulation."[42] Revisiting these rules under the current regulatory climate is appropriate. When the Commission established these rules it stated its goal to be "to prevent cost shifting to ratepayers by means of improper transfer

41 *See* 47 C.F.R. § 51503(b). "An incumbent LEC's rate for each element it offers...shall be established... pursuant to the forward-looking economic cost-based pricing methodology...."

42 *Notice, 16 FCC* Rcd at 19988, ¶ 214.

pricing."[43] The concern was that such pricing would result in increased regulated revenue requirements to be recovered from ratepayers, and is clearly not relevant under the current price regulation model[44] now in effect at the Federal level and in most states. These rules should be eliminated for carriers that operate under price caps for Federal ratemaking.[45]

A. The Elimination of Affiliate Transaction Rules for Price Cap Carriers Will Not Harm Federal Ratemaking

Under Federal price cap regulation, removing the affiliate transactions rules will have no significant effect on regulated products/services pricing. The allocation or misallocation of costs associated with affiliate transactions has no bearing on the setting of prices for existing services under the price cap rules. For tariff filings involving price changes of existing services under price cap regulation, the ILEC must provide (as a part of its tariff filing) a demonstration that the price change is within the applicable price cap basket service band index limits and that the basket price cap index remains below the applicable basket actual price index after the price change. These limitations prevent extreme price shifts, such as greatly lowering prices for certain services, while at the same time raising prices for other services.

Affiliate transactions are recorded on the books of the regulated telephone company in a multitude of accounts. These accounts, however, are never incorporated directly or indirectly into the formulas used to govern the setting of prices under price caps. A change in the value of

---

43 *In the Matter of Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and their Affiliates*, CC Docket No. 86-111, *Report and Order,* 2 FCC Rcd 1298, 1328, ¶ 240 (1986) ("*Joint Cost Order*").

44 *See USTA Comments* at page 4 (explanation of how price cap regulation severs the link between costs and prices.)

45 Price cap regulation for the ILECs has been in place since January 1, 1991.

affiliate transactions recorded in the cost accounts will not, and cannot, have an impact on the prices resulting from the application of the price cap rules to existing services. In addition, the price cap baskets were originally designed to group similar or like services together, while at the same time preventing service prices in one particular basket from subsidizing the (lower) prices in another price cap basket.[46]

In order to speed up the introduction of new services to address competitive demand, the Commission streamlined the pricing of new price cap services in its *Pricing Flexibility Order*.[47] While the analysis of costs played a significant role in new service pricing under the original price cap plan, the Commission essentially removed costs from the approval process for non-loop based services in the interest of speeding competitive services to market, because the burdens associated with gaining price cap approval for these new services were actually discouraging their introduction. For new non-loop based services, ILECs can introduce them in tariffs filed on one day's notice. Under these revised requirements, new service tariffs normally include a short description and justification explaining the new service and its features, as well as the appropriate tariff page changes, however, no cost support is required. Consequently, the potential for cost "misallocations" resulting from a change in the affiliate transactions rules is not relevant to the adoption of the price for a new service.

The new services test and cost support continue to be required for new service tariff filings for loop-based services.[48] The Commission determined that because of the nature of loop-based services at that time it continued to be important to monitor the costs used to establish

---

[46] The current price cap baskets are as follows: Common Line, Traffic Sensitive, Trunking, Special Access, and Interexchange.

[47] *Pricing Flexibility Order*, 14 FCC Rcd 14221.

[48] *Id.*

the prices for these services. Therefore, any potential for changes in affiliate transactions costs to have an impact on the initial price of a new loop-based price cap service is minimized or eliminated by the Commission's ability to review the detailed cost support information. More importantly, competition for facilities and non-facilities based loop-based services has increased since the adoption of the *Pricing Flexibility Order*.

The Commission asks whether the affiliate transactions rules are still be necessary to protect against cost misallocations that can occur through a carrier availing itself of the LFAM.[49] The answer to that question is no. Once a price cap ILEC files for and is granted either Phase I or Phase II pricing flexibility it will be precluded from making a low-end adjustment throughout its entire service area.[50] As of April 1, 2002, three of the Coalition ILECs, BellSouth, Verizon, and SBC, had petitioned for and been granted pricing flexibility relief for their special access services and Frontier/Citizens had received pricing flexibility for its Rochester entity. Qwest has a pricing flexibility petition currently pending before the Commission. Accordingly, none of the ILECs that have been granted pricing flexibility have the ability to seek an LFAM. Other companies are expected to petition for pricing flexibility this year. Again, it is not adequate to retain rules simply because some companies (and the minority of access lines) continue to be subject to an LFAM. The Commission could easily adopt rules that exempt carriers that no longer can avail themselves of the LFAM from the affiliate transactions rules. Given the pace at which companies are giving up their right to the LFAM, the cost to all companies is much greater than any perceived risk.

---

49 *See Notice* 16 FCC Rcd at 19988, ¶ 214.

50 *Pricing Flexibility Order* 14 FCC Rcd at 14307, ¶ 167.

B. The Commission Should Not Impose Affiliate Transaction Requirements on Federal Price Cap Carriers in Order to Satisfy State Ratemaking Purposes

The *Notice* next asks "[w]hat impact, if any, would elimination of the [affiliate transaction] rules for price cap carriers have on state ratemaking processes?"[51] Similar to the situation at the Federal level, the current affiliate transactions rules have no impact on retail rates in states that have adopted price cap regulation. While details of state price cap plans vary, generally rates are regulated based on pre-determined pricing/inflation formulas. Since the different inputs and adjustment factors do not rely on historical costs, a change in affiliate transaction costs has no impact on retail rates. To illustrate this point, at Attachment E, the Coalition has provided several examples of price cap plans adopted by states in different parts of the country.

The Commission has also asked if affiliate transactions could have any potential impact on retail rates in states that retain rate-of-return regulation. If there is any impact, it is minimal because: (1) only seven states still have rate-of-return regulation for dominant incumbent ILEC; (2) infrequent rate cases mean current ongoing costs/data is less important. Most states require the filing of cost information annually to monitor the rates; and (3) affiliate transaction costs are only one of many costs that go into the ratemaking process. In addition, states retain considerable flexibility over the factors included in the final rate setting determination.

C. Wholesale UNE Rates

Any potential impact of affiliate transactions on UNE rates is difficult to quantify given the complexity of the transactions and the variability among companies. Unlike prices set under price cap rules, the methodologies used by some companies to develop certain components of

---

51 *Notice,* 16 FCC Rcd at 19988, ¶ 214.

UNE costs use historical accounting data as the starting point for forward looking projections. Expenses and their genesis vary between carriers. For example, some carriers outsource certain operations to affiliates while others provision those services within the carrier. Some carriers have affiliate originating expenses that impact the shared and common costs included in the development of the forward-looking costs used for setting UNE rates. As a result, for some carriers an adjustment in the amount of affiliate transactions recorded in shared and common costs can theoretically have an impact on UNE prices. Whether or not any potential impact is more than de minimis depends on a number of factors, including but not limited to:

- the type of business function outsourced and it's inclusion or exclusion in the underpinning of a UNE factor,
- how the transaction relates to a retail function of the carrier which is excluded in total (such as advertising of retail services or retail billing), and
- the size of the affiliate transaction compared to the total expenditure level in a particular Part 32 account.

The potential impact, if any, on the final UNE rates should not prevent the Commission from streamlining its affiliate transactions rules. The UNE rate setting process itself almost precludes a single factor from having a disproportionate impact on the final result. It is important to emphasize that even when some companies use historical cost in the development of certain components that impact the calculation of UNE costs, it is at most only the starting point. There are numerous other factors that go into the development of forward-looking UNE costs, *e.g.*, determination of forward-looking efficient network designs, projected growth rates, projected inflation rates, and projected productivity factors. In addition, state regulators exercise considerable influence over the factors themselves and the processes and procedures used to determine the UNE rates. Therefore, the element of UNE costs that could be influenced by affiliate transactions is but one of the many factors involved in the determination of forward looking UNE rates.

D. If the Commission Does Not Immediately Eliminate the Affiliate Transaction Rules, It Should Dramatically Simplify These Rules

If the Commission decides not to eliminate the affiliate transaction rules immediately, it can and should immediately adopt substantial modifications to the affiliate transaction rules. The simplification plan outlined below establishes a streamlined set of rules for affiliate transactions that could be implemented until the Commission is comfortable with complete elimination. If it adopts a transitional approach, the Coalition strongly urges the Commission to set a date certain, *e.g.*, three years after implementation, to revisit the issue of whether complete elimination of the affiliate transaction rules is appropriate.

1. Simplified Affiliate Transactions Plan

Today the affiliate transactions rules require carries to record affiliate transactions on their books based on a hierarchy of pricing methods. If no public rates are available, the ILEC must perform an Estimated Fair Market Value ("EFMV"), as well as a Fully Distributed Cost ("FDC") comparison, and record sales at the higher and purchases at the lower of this comparison. As the ILECs argued in Phase 2 and the Commission acknowledged by adopting some streamlining measures, the current affiliate transactions rules, and the EFMV/FDC comparison in particular, have turned out to be far more burdensome than anticipated.

Rather than the complex set of rules that exist today, the ILECs propose a simple three-class system that eliminates the comparison test but maintains adequate controls over the transaction values recorded. Essentially, the plan would require affiliate transactions to be recorded on the ILECs' books so they reflect the economic exchange of the transaction, just as transactions with external parties are recorded.

Under the plan each transaction would be categorized into a "class" based on the status of the service that is the subject of the transactions. The categorization would be consistent regardless of the direction of the transaction, *i.e.*, service provided to the ILEC or provided by the ILEC. There would be three classes of service:

First Class: Services subject to tariff regulations that are sold to affiliates would continue to be recorded at tariff rates.

Second Class: Services that are sold in the external, commercial market place would be recorded at the amount the services are sold to third parties, *i.e.*, the market price.

Third Class: Services that are provided only within the corporate family would be recorded on a cost-based transfer pricing method, FDC, using the Commission's existing rules.

2. The Simplified Affiliate Transactions Plan Reduces Current Burdens and Distortions, and Has a De Minimis Impact on Carriers' Booked Costs

Not only would this system be simpler to administer for all parties,[52] it would reduce some of the unintended consequences of the current rules. For example, by requiring transactions for commercial services to affiliates (Second Class services) be recorded differently than how they are recorded when sold to a third party, based on some artificial market coverage benchmark (currently 25%), today's rules create an inequity across all customers of that service. In addition, the Third Class of service recognizes that most, if not all, corporations with

---

[52] It is very cumbersome to follow the current rules. Not only is obtaining an EFMV of obscure services hard to do, it is very expensive. In addition, the carrier's affiliates must continually monitor sales to third parties to make sure that they exceed the prevailing price threshold. If third party sales drop below the threshold, currently 25% as set by the *Phase 2 Order*, the affiliate must then engage in FDC calculations.

subsidiaries/affiliates have transactions between these entities that occur solely for the efficient operation of the corporation. A move to this Plan would address the concerns regarding the EFMV and FDC comparison rules, as described more fully in section V.E., infra.

The major change between the current rules and the simplification plan is the elimination of the comparison between FDC and EFMV.[53] The pointless exercise of obtaining an EFMV is easily illustrated. The Coalition conducted an analysis of the affiliate transactions of the large carriers to demonstrate the impact of carrier affiliate purchases. Based on that analysis, the Coalition determined that in the year 2000, slightly over 4.5% of the large carriers' operating expenses included transactions where a carrier purchase of a service from an affiliate was subject to the EFMV/FDC rule. Of the transactions subject to this rule, only about 13% were recorded in the carrier's books using EFMV. The remaining purchases were recorded at FDC. Thus, only approximately 0.6% (13% of 4.5%) of large carriers' operating expenses were the result of service purchases that actually used the EFMV after the comparison was made.[54] Clearly, eliminating the EFMV comparison and relying only on FDC would have a de minimis impact. And certainly, would not be enough to have a measurable impact on, for example, UNE rates.

---

53 The current rules require a carrier to record sales at the higher and record purchases at the lower of this comparison.

54 For asset purchases, only 0.002% of the large carrier net total plant in service (plant in service net of depreciation) were the result of asset transfers that actually used the EFMV after the comparison was made.

E. Affiliate Transactions Rules – Other Issues

In addition to asking the global question of "whether affiliate transaction rules remain necessary," the Commission asked for comment on a number of discrete issues. These issues are addressed below.

1. Impact of Retention of the Affiliate Transactions Rules On Carriers

While the changes made by the Commission in the *Phase 2 Order* helped reduce the burden imposed by the affiliate transactions rules, a considerable amount of work is necessary for compliance with the remaining rules. Each large company member of the Coalition will spend on average approximately $3.5 to $4.0 million per year in time and labor to comply with the rules. In addition, compliance diverts energy and resources away from serving customers and can distort business decisions in an effort to avoid regulatory costs. The significant costs and burdens of complying with affiliate transaction rules, are costs that ILECs' competitors do not experience.

2. Relationship of Affiliate Transactions Rules and BOC 272 Affiliates

Elimination of the affiliate transactions rules would not impact transactions between a Bell operating company (BOC") and its 272 Affiliate (a non-regulated affiliate providing interLATA services after 271 approval). By statute, a BOC must conduct transactions with its 272 Affiliate on an "arms-length basis." Additionally, the BOC may not discriminate between the 272 Affiliate and any other entity in the provision or procurement of goods, services, facilities, and information.[55]

Affiliate transactions applicable to the BOC's relationship to a 272 affiliate have been fully addressed by the Commission in the *Accounting Safeguards Order* where it stated:

---

55 47 U.S.C. § 272(c).

> Section 272 *requires BOCs to charge their section 272 affiliates the same rates as unaffiliated third parties for facilities, services, and information.* 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 rates represent prevailing company prices.* Accordingly, *products and services subject to section 272 need not meet the 50 percent*[56] *threshold in order for a BOC to record the transaction involving such products and services at prevailing price.*[57]

Market based pricing ensures that BOCs will comply with the Act's "arms length" obligation for all transactions between the carrier and the 272 Affiliate. Accordingly, the affiliate transactions rules are not required for the BOC to comply with its "arms length" obligation.[58]

With one exception – joint marketing – all transactions between the BOC and the 272 Affiliate will be recorded at prevailing price. The prevailing price is established pursuant to the nondiscrimination obligation. This obligation provides all carriers access to the same services, at the same terms and conditions that the BOC provides to its 272 Affiliate. The nondiscrimination obligation acts essentially like a tariff.

The only transactions between the BOC and its 272 Affiliate that would not fall into the nondiscriminatory category are joint marketing services. Today, BOCs record joint marketing

---

56 *See Phase 2 Order*16 FCC at 19949, ¶ 93. The Commission lowered the threshold for determining prevailing price from 50 percent to 25 percent.

57 *Accounting Safeguard Order* 11 FCC Rcd at 17601¶ 137 (emphasis added).

58 Pursuant to 47 U.S.C. § 272(f)(1), the provisions of Section 272, except for Section 272(e) will "cease to apply with respect to...the interLATA telecommunications services of a Bell operating company 3 years after the date such Bell operating company...is authorized to provide interLATA telecommunications services under Section 271(d), unless the Commission extends such 3-year period by rule or order." When Section 272 sunsets, the offering of interLATA services may be done on an integrated basis within the BOC. Thus, there will no longer be a need for a Section 272 affiliate nor affiliate transaction rules.

transactions pursuant to the asymmetrical EFMV and FDC comparison rules.[59] Any potential cross-subsidization can easily be addressed without complex affiliate transaction rules by simply requiring the use of FDC for recording joint marketing when provided only to members of the corporate family or by allowing use of a market price if there are sales to unaffiliated parties.

3. Alternative proposals on the services exemption

The Commission seeks further comment on the initial USTA/BellSouth Phase 2 service exemption proposal.[60] Although the Coalition is pleased with the Commission's continued consideration of this proposal, at this late stage of the biennial review process the Commission should consider "more fundamental changes," such as the total elimination of the federal affiliate transaction rules, or the simplified approach outlined above.

The Commission did not adopt the USTA/BellSouth proposal in Phase 2 due to concerns about whether allowing the exemption on a service-by-service basis would increase the risk of cross-subsidization.[61] These concerns are misplaced; the Commission's own FDC rules prevent cost misallocation. Indeed, the Commission's concerns call into question the current process it requires to accomplish the FDC to EFMV comparison.

USTA/BellSouth's Phase 2 proposal was not to exempt the service from the mandated FDC calculation. It only proposed that an EFMV not be required for services that are not

---

59 *See Accounting Safeguard Order* 11 FCC Rcd at 17607, ¶ 147.

60 *Notice* , 16 FCC Rcd at 19989, ¶ 216.

61 *See Phase 2 Order* 16 FCC Rcd at 19951, ¶ 98 ("if an affiliate offers several services of which only one is provided within the corporate family and subject to the exception [no EFMV calculation required], the carrier would need to assign costs between the excepted service and the other services. Such allocations could shift costs between services offered outside the corporate family and services offered to the incumbent carrier.")

provided to the outside market. These services are typically services large corporations provide for themselves internally and it is difficult and costly to obtain an EFMV.[62]

a. FDC Addresses Cross-Subsidization Risks

The Commission has established specific guidelines for the calculation of FDC.[63] The Commission established the FDC rules based upon cost causation specifically to prevent cross-subsidization. All entities having transactions with the carrier, which are not sold externally and the cost of the service is the transaction base, must use these cost causative principles in determining the cost of the transaction and, therefore, the amount booked by the carrier. Under the Commission's cost causation principles all costs are apportioned, regardless of the customer (internal or external).

When applying FDC principles to the carrier's purchases, however, the carrier's recording of transactions cost is limited to those costs directly assigned or directly/indirectly attributable, including an equitable share of overhead, for the services the carrier itself receives. FDC principles prevent the carrier from recording costs associated with services it did not receive, *i.e.*, services provided to other affiliates or services sold commercially. As long as the

[62] *See* study performed by Theodore Barry and Associates, Analysis of Proposed Use of Estimated Fair Market Value, dated January 10, 1994, attached to BellSouth's comments filed on January 10, 1994 *In the Matter of Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions Between Carriers and Their Affiliates*, CC Docket 93-251 (regarding the costs of obtaining EFMV of internal services). Although the study is dated, the principles still apply. The costs of obtaining an EFMV study have, if anything, increased due to inflation. This is an area where productivity efficiencies would have little to do with decreasing costs.

[63] *See* 47 C.F.R. §64.901 (or Part 32.27(c)(3)). Those guidelines prescribe a cost causative apportionment method following a hierarchy: 1) direct assignment is to be used to the maximum extent possible; 2) then costs may be directly attributed on a specific cost causative link; 3) when direct assignment or direct attribution is not possible, an indirect attribution method may be deployed; 4) if there is no cost causative link between a set of costs and a specified economic event, then general allocators may be used.

carrier journalizes no more than the cost of the service received, there is no cross-subsidization risk.

b. The Simplified Affiliate Transactions Plan Is Preferable to a De Minimus Standard

The Commission proposes alternatives to the original USTA/BellSouth service exemption proposal. Setting a de minimis standard for the affiliate's external sales would address the Coalition's concern that a single, one dollar sale to an external third party would cause that service company to lose it's exemption from the service-by-service, product-by-product external EFMV documentation requirement. As previously explained, however, if FDC cost causation principles are used, there is no need for a de minimis threshold to trigger the elimination of the comparison for internal services.

In addition, should the threshold be exceeded, the non-regulated affiliates would be required to expend resources to obtain the EFMV for the transactions that continue to be provided solely to the members of the corporate family. Expending these resources on EFMV for services that continue to be provided solely within the corporate family is not necessary as the FDC cost causative principle continue to prevent cross subsidization among these services.

The Commission also proposed to base the threshold on a percentage of the volume. Tracking volume is more costly than implementing a threshold based upon readily available financial data. Should the Commission insist on establishing a standard, which it should not, a pre-subscribed dollar threshold would be possible to implement. This threshold, such as $500,000 as suggested by the Commission, would apply to the external sales. Such a threshold would automatically disqualify any operating telephone company-provided service sold 100% within the corporate family.

CONCLUSION

The Part 32 Accounting Rules and ARMIS reporting requirements should be eliminated by a date certain, not to exceed three years, with the notification, approval, and CPR rules eliminated immediately. During the transition period, carriers would continue to maintain a Chart of Accounts, simplified affiliate transaction rules, and the ARMIS financial reports (43-01, 43-02, 43-03, 43-04).

Respectfully submitted,

BELLSOUTH CORPORATION
By its Attorneys

/s/ Stephen L. Earnest
Stephen L. Earnest
Richard M. Sbaratta

Suite 4300
675 West Peachtree Street, N. E.
Atlanta, Georgia 30375
(404) 335-0711

CINCINNATI BELL TELEPHONE COMPANY
By its Attorneys

/s/ Christopher J. Wilson
Christopher J. Wilson
Associate General Counsel

201 East Fourth Street
Room 120-620
Cincinnati, Ohio 45202
(513) 397-6351

THE FRONTIER AND CITIZENS INCUMBENT LOCAL EXCHANGE CARRIERS
By its Attorneys

/s/ Gregg C. Sayre
Gregg C. Sayre
Associate General Counsel – Eastern Region
180 South Clinton Avenue
Rochester, New York 14646-0700
(585) 777-7270

QWEST CORPORATION
By its Attorneys

/s/ James T. Hannon
James T. Hannon

Sharon J. Devine
James T. Hannon
Suite 700
1020 19th Street, N.W.
Washington, DC 20036
(303) 672-2860

SBC COMMUNICATIONS INC.
By its Attorneys

/s/ Juanita Harris
Juanita Harris
Gary L. Phillips
Paul K. Mancini

1401 I Street, N.W.
Suite 400
Washington, D.C. 20005
(202) 326-8910

-and-

VERIZON
By its attorneys

/s/ Ann H. Rakestraw
Ann H. Rakestraw

1515 North Courthouse Road
Suite 500
Arlington, VA 22201
(703) 351-3174

Michael E. Glover
Edward Shakin
Of Counsel

Date: April 8, 2002