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

In the matter of	)	
	)	
Federal-State Joint Conference	)	WC Docket No. 02-269
On Accounting Issues	)	
	)	

COMMENTS OF VERIZON TO JOINT CONFERENCE REQUEST FOR PUBLIC COMMENT

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To: The Joint Conference

I. Introduction and Summary

The Commission has given the Joint Conference a "broad mandate to evaluate accounting requirements that state and federal regulators need to carry out their responsibilities."[2] While the Commission has stated this will include examination of "any *additions to or eliminations of* accounting requirements," *id.* (emphasis added), pursuant to the deregulatory nature of the Act, and of Section 11 in particular, the Joint Conference's primary focus should be on the *elimination* of unnecessary accounting requirements. As the Joint Conference recognized, "Section 11 of the Communications Act requires that the Commission review every two years those regulations that are 'no longer necessary in the public interest as a result of meaningful economic competition between providers' of telecommunications service."[3] The Joint

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[1] The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications, Inc. listed in the Attachment.

[2] *Federal-State Joint Conference On Accounting Issues*, 17 FCC Rcd 17025, ¶ 7 (2002). ("Joint Conference Order").

[3] *Federal-State Joint Conference on Accounting Issues*, Request for Comment, WC 02-269, DA 02-3449, at 1 (rel. Dec. 12, 2002) (citing 47 U.S.C. § 161) ("Joint Conference Request for Comment").

Conference's investigation and recommendations should assist the Commission in its statutory mandate to review "*all* regulations," and "repeal or modify" any that are "no longer *necessary*." 47 U.S.C. § 161 (emphasis added).

The Commission recently stated that those who argue that parts of the accounting rules or the ARMIS reporting requirements should not sunset by a date certain, "should identify with specificity which rules should remain in place and provide a full analysis of the justification for that rule, on a rule-by-rule basis."[4] That approach is the right one. The Commission has a continuing duty to eliminate regulations that are not "necessary" in the public interest. 47 U.S.C. § 161. Moreover, as the Commission recognized in the Phase 2 Report and Order, "any unnecessary regulation places a corresponding, unnecessary burden on the carriers that are subject to it." Phase 2 Order & Phase 3 NPRM at ¶ 2. Thus, if the Joint Conference cannot articulate *specific* reasons why there is a *federal* need for any *specific* rule or regulation, it should recommend that the rule be eliminated, because the Commission simply is "not justified in maintaining such a requirement at the federal level." Phase 2 Order & Phase 3 NPRM at ¶ 207.

In particular, the Joint Conference should reject suggestions to add even more regulations contrary to clear Congressional intent, or to "reinstate" accounts and regulations that the Commission has already eliminated as unnecessary, or to use these regulatory accounts for purposes to which they are not suited. *See* Joint Conference Request for Comment, at 3-4. As the Commission has recognized, most of the regulatory accounting requirements, which are the focus of the Joint Conference investigation, are based on "original justifications" that "may no longer be valid," and impose inordinate burdens on only one class of carriers. *See* Phase 2 Order

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4 *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2*, 16 FCC Rcd 19911, ¶ 209 (2001) ("Phase 2 Order & Phase 3 NPRM").

and Phase 3 NPRM at ¶ 206. Specifically, the *regulatory* accounting and ARMIS reporting requirements under consideration by the Joint Conference were created for entirely different purposes than *financial* accounting requirements and those purposes no longer exist. Indeed, requiring additional regulatory accounting or ARMIS reporting requirements would have done nothing to prevent or mitigate the accounting irregularities presented by WorldCom, which is not subject to these requirements.[5] Retaining them certainly cannot be justified on that basis.

Instead, the focus should be on streamlining the accounting and reporting regulations so that all carriers keep similar sets of books.[6] The Joint Conference should recommend that the Commission eventually transition away from separate regulatory accounting and allow all carriers to operate pursuant to Generally Accepted Accounting Principles ("GAAP").

II. The Joint Conference Recommendation Must Comport With The Deregulatory Mandate of Section 11 and the "Necessary" Standard.

When considering the proper scope of inquiry and recommendations, the Joint Conference should keep in mind the deregulatory nature of the Act, and the mandate of Section 11 in particular. In 1996, Congress amended the Communications Act to "promote competition and *reduce* regulation," 1996 Act, Preamble (emphasis added) and to create a "pro-competitive, *de-regulatory* national policy framework."[7] One of the central pillars of this new framework was the addition of Section 11 of the Communications Act, which requires the Commission to review

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5 The same is true of Global Crossing, because only a small part of the company, Rochester Telephone, is subject to ARMIS reporting.

6 Carriers today must maintain multiple, often redundant, sets of books to comply with different requirements of the FCC, state commissions, and the Securities and Exchange Commission.

7 S. Conf. Rep. No. 104-230, 104th Cong. 2d Sess. at 1 (1996) (emphasis added).

regulations every two years, and eliminate those that are "no longer necessary in the public interest as a result of meaningful economic competition." 47 U.S.C. § 161.

Two aspects of this binding statutory standard are of particular importance to the Joint Conference's task:

a) *Only regulations that the Commission expressly finds remain "necessary" to serve the public interest may be retained.* Under the express terms of Section 11, the Commission may retain only those regulations that it determines are "*necessary* in the public interest." 47 U.S.C. § 161 (emphasis added). This statutory language, when combined with the deregulatory purposes of the Act, plainly requires that a regulation may not be retained merely because it is "useful." Rather, to justify its continuance, the Commission must find a regulation is "necessary." Both the Supreme Court and the D.C. Circuit Court have previously found that the word "necessary," when used in the other sections of the 1996 Act, must be read in accordance with its ordinary meaning. *See AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 390 (1999); *GTE Service Corp. v. FCC*, 205 F.3d 416, 422 (D.C. Cir. 2000). In *Iowa Utilities Board*, the Supreme Court examined the Commission's interpretation of Section 251 of the Act, which requires the agency to consider whether access to a proprietary network element is "necessary" before imposing unbundling requirements on that element. 47 U.S.C. § 251(d)(2)(A). The Commission had determined that an element was "necessary" to provide service if its denial would cause any increase in cost or decrease in quality. *Iowa Utils. Bd.*, 525 U.S. at 389. The Court rejected the Commission's expansive reading of the word "necessary," finding that this term requires "the FCC to apply *some* limiting standard, rationally related to the goals of the Act," and that the agency's broad interpretation was "simply not in accord with the ordinary and fair meaning of [the statute's] terms." *Id.* at 388, 390.

Likewise, when the D.C. Circuit subsequently addressed the meaning of the word "necessary" in a different section of the 1996 Act, it explained that:

> As is clear from the Court's judgment in *Iowa Utilities Board*, a statutory reference to 'necessary' must be construed in a fashion that is consistent with the ordinary and fair meaning of the word, *i.e.*, so as to limit "necessary" to that which is *required* to achieve a desired goal.

GTE v. FCC, 205 F.3d at 423 (emphasis added). The court went on to say that the Commission was "almost cavalier" in suggesting that requirements that solely provided an efficiency benefit were "necessary," and that the "FCC cannot reasonably blind itself to statutory terms in the name of efficiency" since "*Chevron* deference does not bow to such unbridled agency action." *Id.* at 423-24.

The common or ordinary definition of "necessary" is "absolutely required," "indispensable," or "essential." *Merriam Webster's Collegiate Dictionary,* 774 (10th ed. 2001). Thus, under Section 11, the Joint Conference should recommend that the Commission repeal any regulations that are not "absolutely required," "indispensable," or "essential" to meet its federal regulatory obligations.

b) *The Commission must bear the burden of basing any finding that rules remain necessary on substantial record evidence.* The Commission cannot adopt a "wait and see" attitude toward its regulations – it must bear the burden of finding clear evidence in the record to justify their retention or repeal them.[8] In other words, as the Commission has previously recognized, "if we cannot identify a federal need for a regulation, we are not justified in

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[8] *See Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1042 (D.C. Cir. 2002) ("*Fox*") ("[t]he Commission's wait-and-see approach cannot be squared with its statutory mandate"). Although a portion of this decision was modified on rehearing, the subsequent order left intact the portions of the initial decision quoted and cited here. *See Fox Television Stations, Inc. v. FCC*, 293 F.3d 537 (D.C. Cir. 2002).

maintaining such a requirement at the federal level."[9] Therefore, any recommendation of the Joint Conference to retain an accounting rule (or to adopt new requirements) should include findings as to what evidence of record justifies such action.

In addition, the Commission is not free to rest simply on its predictive judgment or speculation about the potential benefits of existing regulations as a basis for retaining them. *Fox*, 280 F.3d at 1051. In order to retain a regulation, the Commission must both provide evidentiary support for the existence of an immediate problem and make a fully supported finding that its regulation is an essential part of the solution. *See Fox*, 280 F.3d at 1051; *Sinclair Broadcast Group, Inc. v. FCC*, 284 F.3d 148, 152 (D.C. Cir. 2002). Section 11 is a mandate for deregulation, not a charter for regulatory inertia. *See Fox*, 280 F.3d at 1043; *Sinclair*, 284 F.3d at 159.

As the D.C. Circuit put it, "the statute imposed upon the Commission a duty to examine critically the [rule] and to retain it only if it continued to be necessary." *Fox*, 280 F.3d at 1043. Similarly, in *Sinclair*, the same court noted that Section 202(h), which is a part of the Section 11 review, "carries with it a presumption in favor of repealing or modifying the ownership rules." 284 F.3d at 159. Indeed, as then-Commissioner Powell put it:

> Frankly, I believe *the burden should be on us*, the FCC, to re-assess and re-validate the rule under either Section 11's biennial review or Section 10's forbearance authority. ... *We must be prepared, if this is what the record evidence shows, to make a compelling and convincing case that the rule must be kept. If we cannot, or if the evidence in support of the rule is lacking, we must modify or eliminate it* and rely on competitive market forces or other mechanisms, such as the antitrust laws.

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9 *See* Phase 2 Order & Phase 3 NPRM at ¶ 207.

1998 Biennial Regulatory Review–Spectrum Aggregation Limits for Wireless Telecommunications Carriers, 13 FCC Rcd 25132, 25177 (1998) (Separate Statement of Commissioner Michael Powell) (emphasis added).

Thus, in conducting its inquiry, the Joint Conference should undertake a presumption of deregulation. Moreover, any recommendations to retain existing regulations must be based on evidentiary support that the regulations are necessary, not just conjecture about potential benefits.

III. It Would Be Inappropriate To Recommend Federal Accounting and ARMIS Regulations Solely for State Needs, or for Goals Other than Regulatory Accounting Purposes.

The Joint Conference has asked for comment on "the purposes of regulatory accounting," including how they "compare to the purposes of other types of accounting, including, among others, taxation, public company financial disclosure, and corporate planning." Joint Conference Request for Comments, at 4. This question is central to the Joint Conference's inquiry, and highlights why certain non-regulatory goals – such as ensuring investor confidence and accurate financial accounting – are not appropriate for *regulatory* accounting and reporting.

The existing accounting requirements, including ARMIS, are relics of rate of return regulation and have very limited value for carriers that are subject to price cap regulation, because their rates are not based upon revenue requirements. With the growth of competition, this value will continue to decline, because rates should increasingly be market-based. Yet the ARMIS requirements apply only to the largest incumbent local exchange carriers, most of which are price cap regulated at the federal level and are subject to competition for all their services, and do not apply to smaller incumbent local exchange carriers, many of which continue to be rate of return regulated. Therefore, these rules have no continued value even for *regulation*.

Under Section 11, if continued application of the accounting requirements to the large price cap carriers is not *necessary* to meet federal regulatory requirements, those requirements must be eliminated.

If the accounting rules serve no *federal* regulatory purpose, they should not be retained based on arguments that they might conceivably be used for non-regulatory oversight, such as to uncover corporate accounting irregularities or for tax auditing. The simple fact is that they have *no* potential value for that purpose. First, the accounts are limited to only the regulated telecommunications operation of diversified companies and were designed to give regulators information to enable them to set rates based upon revenue requirements. As such, they would not provide the broad view of the company's books needed to monitor irregularities. There are other accounting requirements that are designed to show a company's entire financial picture, and those are the GAAP requirements that are under the SEC auspices. And the regulatory accounts would have no value whatever for taxation, which is based upon accounting requirements adopted by applicable taxing authorities. Those authorities, likewise, must look at the entire corporate enterprise, not just regulated telecommunications operations.

Moreover, the financial difficulties and accounting irregularities presented by Enron, WorldCom and Global Crossing, while they are of serious public concern, simply do not implicate the *regulatory* accounting and ARMIS reporting requirements being reviewed by the Joint Conference. The problems highlighted by these companies are not something unique to the telecommunications industry – much less, to a handful of specific Class A carriers – and cannot be used to justify retaining or adding FCC regulations. Any concerns about accounting irregularities can be (and are being) addressed by the Securities and Exchange Commission, so that they can be applied to *all* publicly reported companies, not just telecommunications carriers, and there is no reason for the Joint Conference or the Commission to duplicate those efforts. Certainly, there is no reason to believe that applying antiquated accounting requirements to only one set of carriers (and stricter Class A accounting rules to a few incumbent local exchange carriers) would prevent the next Enron or WorldCom from occurring. Instead, only the broad-based requirements of the Securities and Exchange Commission, which include non-regulated and non-telecommunications activities, could possibly provide the early warning needed to prevent future similar irregularities.

It was to address these very concerns that Congress recently enacted broad-based legislation requiring detailed corporate disclosure and giving the SEC authority to investigate possible irregularities and take action to prevent or redress problems. *See* the Sarbanes-Oxley Act, PL 107-204 (enacted July 30, 2002). Among other protections, this law establishes a series of detailed requirements for public accounting firms that prepare audit reports of publicly traded corporations, requires public companies to establish audit committees comprised of outside directors, imposes obligations on the chief executive and financial officers of public corporations to personally certify to the accuracy of financial reports, enhances corporate financial disclosure obligations, and imposes additional criminal penalties for persons who destroy financial records or commit securities fraud. There is no need for a separate set of redundant and burdensome rules (that are irrelevant to the concerns in any case) to address potential concerns in one industry, telecommunications.

By the same token, federal accounting rules should not be retained solely to meet the data needs of individual states. As pointed out above, the Commission has plainly stated that if it cannot articulate *specific* reasons why there is a "federal need" for a *specific* rule or regulation, it is "not justified in maintaining such a requirement at the federal level." Phase 2 Order & Phase 3

NPRM, ¶ 207. Pursuant to Section 11, the Commission simply cannot adopt *federal* regulations to accommodate *state* requests for data. Federal accounting rules must relate directly to the FCC's jurisdiction over the federal costs. *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986). Rules that are merely convenient for state purposes cannot be turned into a federal requirement under the Act, especially when (as here) that convenience is bought at the expense of the incumbent local exchange carriers who must comply with these burdensome accounting and reporting obligations.

Using federal requirements to satisfy all of the states' stated needs not only would violate Section 11, but would be inappropriate as a matter of policy as well. As an initial matter, the Joint Conference properly noted that "[t]he Commission and the states have different regulatory obligations, and thus may use information for varying purposes." Joint Conference Request for Comment, at 2. Thus, attempting to draft one set of national accounting and reporting rules that incorporates the diverse stated needs of all state jurisdictions would result in duplicative reporting – to federal regulators (which, in many cases, already have determined there is no federal need for the regulations) and to states, many of which already impose their own reporting requirements. *See* Joint Comments of BellSouth, SBC, Verizon, Qwest, Frontier, and CBT at Att. B (filed Apr. 8, 2002) ("Joint ILEC Phase 3 Comments"), which lists the state-specific reporting requirements.

More importantly, the goals mentioned by the Joint Conference – namely, to ensure that regulations are sufficient "to ensure that federal and state regulators have sufficient information to protect consumers, promote investment, promote competition, and monitor the marketplace" – in many cases are best met, and are already being met, through methods *other than* accounting regulations and ARMIS reporting. Joint Conference Request for Comment at 3. For example, long distance companies, wireless providers, competing local exchange carriers, and others, provide financial information for assessments for Universal Service, Local Number Portability Support, Telecommunications Relay Service, and Number Administration (Form 499A), even though they are not subject to Part 32 accounting requirements. Similarly, wireless providers, CLECs, and others – again, not subject to Part 32 accounting – provide infrastructure information on Local Competition/Broadband Report (Form 477). *See also* Phase 3 Comments of ITTA, at 3 n.10 (noting that the Commission decided to rely exclusively on data submitted to NECA to determine switch allocation for the universal service model, not ARMIS, because ARMIS was incomplete).

Much of this information is being gathered by entities other than the Commission. For example, the GAO issued a report on federal and state universal service programs and challenges to funding, which included information on state-specific rates, and which was not based on ARMIS data. *See* Telecommunications, Federal and State Universal Service Programs and Challenges to Funding, GAO-02-187 (rel. Feb. 2002), *available at* www.gao.gov/new.items/d02187.pdf. Financial information is routinely reported in SEC filings. In addition, Wisconsin states that it already collects financial data from CLECs, which do not use Part 32 or report ARMIS. *See* Wisconsin Phase 3 Comments, at 6. *See also* Joint ILEC Phase 3 Comments, Attachment B (showing that states generally collect their own financial service quality and infrastructure data).

When the Commission itself collects and reports industry data, it relies primarily on sources other than ARMIS. For example, the FCC's May 2002 Study on Telephone Trends, (*available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend502.pdf) contains some 111 tables, nearly all of which are derived from sources other than ARMIS. Even the few that use ARMIS are not financial tables but relate to industry infrastructure, and even these are limited to the former Bell operating companies, because ARMIS does not give the Commission industry-wide information. [10]

Therefore, the only proper purpose of the FCC's accounting rules is to meet specific needs in regulating the telecommunications industry. Where those needs do not exist, the rules are no longer "necessary" and must be repealed.

IV. The Joint Conference Should Recommend that the Commission Eliminate Additional Regulations that Are Not "Necessary."

The Joint Conference should identify additional accounting regulations that can be eliminated. It should recommend that the Commission begin the effort to phase out the accounting and ARMIS regulations in favor of GAAP. In the meantime, the Commission should be asked to eliminate the detailed continuing property record rules, improve the forecasting requirements for nonregulated usage of central office and outside plant, and reconsider the portions of the Phase 2 order that created wholesale and retail subaccounts to Services Account 6620 and that changed total Sheath Kilometers to Loop Sheath Kilometers in ARMIS report 43-07.

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10 Table T8.1 attempts to extrapolate the total of U.S. telephone lines by using the figures from only some carriers reported in ARMIS. The other three, T18.1 (Central Offices and Access Lines by Technology), T18.2 (Features Available in Central Offices), and T18.3 (Local Transmission Technology) are limited to data from the former Bell operating companies and make no attempt to include the rest of the industry.

A. The Joint Conference Should Recommend that the Commission Phase Out the Commission's Separate Accounting Rules in Favor of GAAP Accounting.

It is high time to begin the effort to eliminate entirely the separate federal regulatory accounting rules and rely instead on the GAAP accounting requirements that nearly all telecommunications carriers in the competitive arena already follow. Therefore, the Joint Conference should recommend that the Commission phase out all regulatory accounting and ARMIS reporting requirements, at least for price cap regulated carriers. The information that Class A carriers must report in ARMIS is far more than is needed for regulatory purposes. Indeed, much of what is still reported in ARMIS either is not required under the current regulatory regime or is available from other public sources. *See* Joint ILEC Phase 3 Comments, at 3-5, 14-18; Phase 3 Comments of ITTA, at 3-4.

The existing accounting and ARMIS reporting requirements are a relic of rate of return regulation. They were imposed on the local exchange carriers in the era prior to significant local competitive entry, before their rates were under price caps, and before the Commission provided for pricing flexibility. In recent years, elimination of the lower formula adjustment and sharing, and implementation of the CALLS plan, reduce incentives to shift cost and eliminate any tie between rate development and the Commission's accounting and reporting rules. And, as shown above, even where the Commission develops reports tracking the industry in its Study of Telephone Trends, it relies little on regulatory accounting and ARMIS reports. In short, they are not "necessary," and, under Section 11 of the Act, must be eliminated. Therefore, the Joint Conference should recommend that the FCC refrain from adopting additional regulatory accounting or ARMIS reporting requirements. Instead, the FCC should phase out existing requirements, especially for price cap regulated carriers.

Additionally, the information the Commission (and the states) receive from ARMIS covers only a segment of the industry. For example, in 2001 (the last reported year), only BellSouth, Qwest, SBC and Verizon needed to file the ARMIS 43-07 (Infrastructure) report. By contrast, well over 200 holding companies reported similar information on Broadband and Local Competition Form 477.[11] Many commenters have agreed with this assessment, and point out that reporting infrastructure information on Form 477 would provide a more inclusive representation of the national network. For example, Oregon argued that, "[m]oving the ARMIS 43-07 information collection to the Local Competition and Broadband Data Gathering Program would help provide a more adequate assessment of infrastructure status." Oregon Phase 3 Comments, at 8. Similarly, another state regulator argued that "this data should be collected on a mandatory basis from the larger universe of carriers rather than only the price-cap companies." Wisconsin Phase 3 Comments at 7.[12] Therefore, to the extent any of the information in ARMIS is found still to be "necessary," it should be reported by all carriers – not just those few that are subject to ARMIS reporting requirements – in a far less burdensome manner on Form 477. Applying the same reporting obligations on all carriers allows the Commission to draw comparisons among carriers and obtain a better picture of the industry.

Commenters who have opposed eliminating the regulatory accounting and ARMIS reporting requirements appear to mistakenly believe that if carriers are allowed to move to GAAP, they will lose information needed for the universal service program and UNE rates.

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[11] 203 holding companies reported broadband data, while 225 holding companies submitted local exchange information on Form 477. *See* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/filers1201.pdf.

[12] *See also* NARUC Comments at 19 ("More information regarding telecommunications infrastructure is needed, especially as competitive carriers own more of the infrastructure").

However, these fears are unfounded. The Commission already gathers data for universal service from carriers not subject to Part 32 accounting and ARMIS reporting. For example, carriers already report financial information for universal service outside of the ARMIS process.[13] *See* Joint ILEC Phase 3 Comments at 18-19. And, as pointed out above, specific cost factors for deriving UNE rates are not applied to the booked costs but to forward-looking costs that are developed in a model, not in the Part 32 accounting system. Those models largely ignore actual booked costs.[14] Moreover, even if the UNE requirements were modified to recognize the need for recovery of actual costs, such information is already available from GAAP accounts and there is no need for redundant regulatory accounts.

As discussed, most of the original concerns with cross-subsidization, which provided the original impetus for ARMIS and many of the other accounting requirements, have largely been eliminated by the move to price cap regulation and pricing flexibility.[15] And "predatory pricing" makes no sense for telecommunications carriers where, even when competitors exit the market, the competitive facilities remain. *See Voicestream Wireless Corp., and Powertel Application for Transfer of Control to Deutsche Telekom AG,* 16 FCC Rcd 9779 (2001). In addition, predatory pricing is essentially an antitrust concern – it is not specific to the telecommunications industry, and it does not require unique regulatory accounting rules applied to only one class of carriers.

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[13] *See, e.g.*, 47 C.F.R. § 36.611 (requiring each incumbent local exchange carrier to provide to National Exchange Carrier Association annual reports providing certain unseparated investment, depreciation, deferred tax, maintenance expense, and other information); 47 C.F.R. § 36.612 (applying similar reporting requirements to rural telephone companies).

[14] The limited use of booked accounting data is in the development of factors that create a relationship between assets and maintenance expenses or assets and overhead expense.

[15] *See* Wisconsin Phase 3 Comments at 8 ("It is true that with price-cap regulation the cost to rates relationship has been eliminated so there is limited potential for regulated services to be burdened with non-regulated expenses").

B. The Joint Conference Should Recommend the Elimination of Detailed Continuing Property Records Rules.

The Joint Conference should also recommend that the Commission go forward with its tentative conclusion to eliminate the detailed rules relating to continuing property records. *See* Phase 2 Order & Phase 3 NPRM at ¶ 212. As the Commission has recognized, the record already demonstrates that these "detailed requirements, which include rigid rules for recording property, impose substantial burdens on incumbent LECs." *Id.* (footnote omitted). In a paper already presented to the Commission, one independent accounting firm estimated that moving to GAAP in lieu of the current USOA Class A accounting and reporting requirements would result in average cost efficiencies of $20 million *per year* for *each* incumbent local exchange carrier.[16] An estimated $5 million per year of those savings could be realized just by allowing the incumbents to operate under simplified continuing property record procedures. *Id.*

As Verizon and others showed in their initial comments, price cap regulation has eliminated any need for regulators to require detailed documentation of costs that make up their plant asset base and contribute to the calculation of depreciation expenses. With rates no longer tied directly to costs, such micromanagement of carriers' plant assets serve absolutely no purpose. *See* Joint ILEC Phase 3 Comments at 11. And even for those few states that have retained rate of return regulation for large telephone companies, GAAP provides assurance that costs for physical plant are accurately stated as inputs for revenue requirements. *See id.* at 12.

Moreover, contrary to the claims of some parties, elimination of the continuing property record detailed *rules* will not result in the elimination of the continuing property records

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[16] *See* Supplement to July 15, 1998, Position Paper, "Accounting Simplification in the Telecommunications Industry," attached to letter to Magalie R. Salas, FCC, from Carl R. Geppert, CC Docket Nos. 98-81, 98-117 and 96-150 at 8 (filed Nov. 10, 1998).

themselves, as some parties allege. *See, e.g.*, NARUC Phase 3 Comments at 20-22. Instead, it will enable carriers to utilize the efficiencies of modern software-based general ledger and feeder systems such as fixed asset systems. Today those systems must be customized to comply with the continuing property record rules, and that eliminates much of their efficiency. In addition, the requirement to pre-notify the Commission and obtain approval of any changes to the record units list causes substantial delays in carriers' ability to change their property records. This benefits no one except, perhaps, their competitors.

And the burdens imposed on the incumbent local exchange carriers are completely unnecessary because, as the Commission has also noted, "[i]ncumbent LECs are subject to a number of other regulatory constraints and appear to have ample incentives to maintain a detailed inventory of their property." Phase 2 Order & Phase 3 NPRM at ¶ 212 (footnote omitted). Indeed, many commenters – including state regulators – recognized that the existing continuing property record rules are unnecessarily burdensome and have advocated that they be streamlined. *See, e.g.*, Oregon Phase 3 Comments at 8-11, Joint ILEC Phase 3 Comments at 9-13.

C. The Joint Conference Should Recommend Improvements In Forecasting Requirements for Nonregulated Usage of Central Office and Outside Plant.

When a nonregulated activity makes use of regulated outside plant or regulated central office facilities, current rules require that accounting for the nonregulated activity must use either a tariff rate or a UNE rate or be directly assigned to nonregulated. When none of these methods can be used, the investment is considered to be shared, is subject to Section 64.901(b)(4) forecasting, and is allocated using the higher of forecast or actual usage. In the Phase 2 proceeding, several carriers asked the Commission to replace the forecasting with actual usage.[17] In rejecting this approach, the Commission noted that state regulators that opposed relying only on actual usage expressed concern that the actual usage would be low at the beginning of the product life cycle. *See* Phase 2 Order & Phase 3 NPRM at ¶ 124. However, a one-time 3-year forecast should address this concern by taking into account both initial and anticipated usage and eliminate the need for on-going three-year forecasts.

D. The Joint Conference Should Recommend That the Commission Reconsider Two Parts of its Initial Decision.

1. The Requirement to Create Wholesale and Retail Subaccounts for Services Accounts Should Be Eliminated.

The Commission correctly recognized that there is an "important" distinction between wholesale and retail dial tone services. Phase 2 Order & Phase 3 NPRM at ¶ 64. However, while the distinction between wholesale and retail services is important in the marketplace, it is unnecessary and burdensome to carry that wholesale/retail separation into *regulatory expense accounting* for Class A Account 6620 (Services).[18]

The only regulatory function the Commission articulated as being served by wholesale and retail subaccounts was that they "will assist the states in developing UNE rates that properly

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[17] *See* Phase 2 Comments of Verizon at 10 and Qwest at 11, showing that at least 95%-97% of nonregulated central office and outside plant accounts resulted from direct assignment and not from the forecasting process.

[18] Account 6620 (Services) combines the former 6620 Services account with the three former subaccounts that comprised 6620: 6621 (Call Completion Services), 6622 (Number Services), and 6623 (Customer Services). *See* Phase 2 Order & Phase 3 NPRM at ¶ 41; *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and 3*, App. 1, 15 FCC Rcd 20568 (2000) ("Phase 2 NPRM").

reflect the costs of providing a wholesale service." Phase 2 Order & Phase 3 NPRM at ¶ 64. However, the Commission's regulations regarding the pricing of unbundled network elements require that rates for each element shall be established "pursuant to the forward-looking economic cost-based pricing methodology" adopted by the Commission in its *Local Competition Order* – a costing methodology that is divorced from accounting costs. *See generally* 47 C.F.R. § 51.503(b)(1). As a result, the accounting costs to be included in the wholesale and retail subaccounts as ordered by the Commission would be of no value in reviewing the forward-looking costs included in UNE cost studies.

In addition, as outlined more fully in the Joint Petition for Reconsideration, there are considerable burdens associated with creating wholesale and retail subaccounts to Account 6620.[19] Petitioners estimated that, depending on the method of compliance chosen, it could cost either close to $3.5 million in additional implementation costs and over $2.5 million per year in ongoing costs (using a special study), or as much as $12.5 million and take 18 months (if the systems were duplicated) to implement these changes. *See* Joint ILEC PFR at 5-6. These costs would be incurred by *each* Petitioner who undertook this method of accounting.

Even if the Joint Conference limited the wholesale-retail breakdown to just Account 6623 Customer Services and the study method were used to allocate costs, this would still not be a

[19] *See 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2,* Petition of BellSouth, SBC and Verizon for Reconsideration of Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286 (filed Mar. 8, 2002) ("Joint ILEC PFR").

cost-effective process.[20] Journalizing study results provides for unnecessary work and would lead to confusion because the factor from the prior year would be applied to calculate the amount to be journalized as wholesale, while UNE studies are conducted using data from the current year.[21] Given the dynamics of the industry, applying a backward-looking factor to current data would produce confusing results with little probative value.

2. "Sheath Kilometers" Should Not Be Changed to "Loop Sheath Kilometers" In ARMIS 43-07.

The Joint Conference also should recommend that the Commission reconsider the new requirement that changes the first section in Table II of the ARMIS 43-07 Infrastructure Report from total "Sheath Kilometers" to "Loop Sheath Kilometers." Phase 2 Order & Phase 3 NPRM at ¶ 170. The only justification the Commission gave for this change was a statement, without elaboration, "that this information would be more useful for policymakers and interested parties if it were narrowed to local loop facilities connecting customers to their service office." *Id.* It did not attempt to articulate what the information would be used for, or why "loop" measurement would be more useful than total sheath kilometers. *See* Phase 2 NPRM at ¶ 71.

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[20] Many of the costs reflected in Account 6620 are completely unrelated to UNE pricing because the services reflected in two of the three accounts that are part of Account 6620 (Call Completion Services and Number Services), are not required to be offered at UNE rates. *See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, ¶ 442 (1999) ("incumbent LECs need not provide access to [operator services and directory assistance] as an unbundled network element").

[21] Even if the information to trend wholesale Customer Services expense (Account 6623), were necessary, which it is not, the rules provide that Part 32 accounting is not a cost allocation process. *See* 47 C.F.R. § 32.2(c), which specifies that the Part 32 accounts "should not reflect an *a priori* allocation of revenue, investments or expenses to products or services, jurisdictions or organizational structures."

The fact is that there is no public interest justification whatever for the new requirement. Loop sheath kilometers are not "useful" as a measure of competition, in large part because only certain Class A incumbent local exchange carriers – and not their competitors – are required to report these data. And other data that are already being reported – such as number of loop lines – suffice to satisfy any regulatory need for loop information.[22] Moreover, the additional studies that would be required in order to separately calculate loop sheath kilometers are incredibly time consuming and expensive. *See* Joint ILEC PFR at 9 (Verizon estimates that the analysis would cost some $5.5 million). Moreover, no party appears to find a need for these data, because that portion of the reconsideration petition was unopposed.

V. The Joint Conference Should Not Recommend That the Commission Adopt Additional Accounting Rules Or Reinstate Those It Eliminated.

For the reasons stated above, the Joint Conference's focus should be on assisting the Commission to identify regulations that are no longer necessary and must be repealed, pursuant to Section 11. Given the deregulatory mandate of the Act, and of Section 11 in particular, it would be particularly inappropriate to recommend the addition of new regulations, especially those the Commission has already eliminated as unnecessary. It should not revisit the prior changes to the affiliate transaction rules, restore the directory revenue accounts, break down depreciation expenses into subcategories, add separate optical switching or switching software accounts, break down the loop and interoffice transport or interconnection accounts, or adopt new universal service accounts. Each of these is discussed in the Appendix to these Comments.

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[22] *See, e.g.,* ARMIS 43-01, Table II (requiring reporting of access lines); *Local Telephone Competition: Status as of June 30, 2001*, Industry Analysis Division, Common Carrier Bureau (February 2002) (according to data collected on Form 477, CLECs "reported providing about one-third of switched access lines over their own local loop facilities").

VI. Conclusion

The Joint Conference should focus on the deregulatory purposes of the Act, and of Section 11 in particular, and assist the Commission in identifying accounting and ARMIS reporting regulations that are no longer "necessary" and should be repealed.

Respectfully submitted,

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January 31, 2003

Attachment

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.

APPENDIX

As discussed in the text, the goal of this proceeding is to eliminate rules that are no longer "necessary," not to add new regulations. To that end, the Joint Conference should not recommend that the Commission revisit decisions that it has already taken to eliminate accounting rules and should not adopt additional rules. In the sections below, Verizon shows why proposed additional requirements are not necessary and should not be adopted.

1. Affiliate Transaction Rules. The Joint Conference should not recommend that the Commission revisit the changes to the affiliate transaction rules that were adopted in the Phase 2 Order. First, the ceiling/floor modification adopted by the Commission, Phase 2 Order & Phase 3 NPRM at ¶¶ 91-92, allows nonregulated affiliates to bill the local exchange carrier at less than fully distributed cost. This is proper because not all nonregulated affiliate accounting systems can easily calculate all the components of fully distributed cost ("FDC") charge. Providing for a ceiling allows the nonregulated affiliate the flexibility to charge the local exchange carrier less than FDC and avoid the cost of having to calculate all the components. Second, the $500,000 asset transfer threshold, under which an estimated fair market value ("EFMV") comparison to Net Book Value will no longer be required, conforms the affiliate rule for assets to the affiliate rule for services. *Id.* at ¶ 98. Finally, as the Commission properly found, the 25% benchmark for prevailing price is sufficient to establish that an outside market for the service exists and is consistent with a competitive environment. *See* Phase 2 Order & Phase 3 NPRM at ¶ 94.

Indeed, if the affiliate transaction rules are reconsidered at all, it should be to *eliminate* the requirement to perform EFMV calculations and FDC comparisons when no public rates are available, in favor of the more streamlined test proposed by Verizon and other carriers. *See* Joint

ILEC Phase 3 Comments at 28-30.[1] The current affiliate transaction rules, and the EFMV/FDC comparison in particular, have turned out to be far more burdensome than anticipated. They are not "necessary," and should be repealed.

2. Account 5230 (directory revenues). As one Commissioner has noted, only a small number of states have articulated a need for the information contained in this account.[2] And even these states already receive this information directly from the carrier, so that a federal account is unnecessary. The Joint Conference should not recommend that the Commission reinstate this account.

3. Accounts 6561, 6562, 6563.1, 6563.2, 6564, 6565 (depreciation and amortization expense accounts). The Commission has already determined that it is not necessary to break down depreciation expenses into six subcategories. Phase 2 Order & Phase 3 NPRM at ¶ 38. This is undoubtedly correct, and the Joint Conference should not recommend such a breakdown. States that need depreciation information at that level can and already do ask for the information in their various rate case proceedings. For example, New York, Virginia, and Pennsylvania have mandatory annual depreciation reporting in significant detail. Moreover, depreciation expenses are not treated consistently in state and federal accounts, so adopting federal depreciation requirements would not assist in state accounting. In fact, only one of the 35 states in which Verizon has incumbent local exchange operations (New Hampshire) follows the FCC's

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1 Under that plan, a carrier need not recover more than the actual cost of providing assets or services to a nonregulated affiliate. When the carrier acquires assets or services from the affiliate, the full cost of the asset or service would be the ceiling, allowing the transfer to be at or less than the full cost.

2 *See* Separate Statement of Commissioner Copps, Phase 2 Order & Phase 3 NPRM at 19993 ("In other instances, as with directory assistance revenue, the information was directly sought by only a few states").

depreciation assumptions and has the same depreciation expense. As a result, current FCC depreciation rules and practices are simply not needed by the states.

4. Optical Switching Accounts. Effective January 1, 2003, large Class A carriers implemented a breakdown of Digital Electronic Switching equipment into circuit and packet. *See* 47 C.F.R. § 32.2212(a)-(c). A separate account for optical switching should not be required at this time, because the technology is not yet widespread and no large local exchange carrier currently has optical switches. Therefore, such a separate account is not "necessary", and, under Section 11, should not be adopted. Just because there is a *potential* for this new technology to proliferate some time in the future is no reason for the Joint Conference to recommend increasing the number of accounts. On the other hand, if there is investment information relative to certain technology that is critical for a regulator to have, that request should be made of all facilities-based providers on Form 477. Such a request can be made without requiring a new Optical Switching account.

5. Switching Software. A separate account for switching software is also not "necessary" under Section 11. The Commission has already ordered large Class A carriers to maintain separate subsidiary records for general purpose and network software. *See* 47 C.F.R. § 32.2690(b). There is no need or justification for replacing these existing, sufficient subsidiary records with a brand new account.

6. Loop and Interoffice Transport Accounts. This subaccount breakdown is based on a request originally made by the state of Wisconsin. *See* Wisconsin Phase 2 comments, Attachment A (Accounts 2230 through 2441) (filed July 21, 2001). However, the Wisconsin Commission has since conducted its own proceeding and has determined that the loop and

interoffice breakdown *is not necessary* to have in its Chart of Accounts.[3] Therefore, the request is moot and should not be included in the Joint Conference's recommendation.

7. Interconnection Revenue and Expense Accounts. If the Joint Conference envisions that the interconnection expense account would include a breakdown of expenses that large carriers incur in providing interconnection services, the record already shows why such a breakdown is not feasible. As USTA explained, an entirely new study-driven allocation process would have to be built to divide all of the existing functional expense accounts between end-user and UNE/interconnection. Once separated, the dollars would need to be rebooked from their original accounts into a single new account. This would eliminate the existing functional classification of the expense. *See* USTA Phase 2 Comments at 6-9 (filed July 13, 2001).

If, on the other hand, this account is intended to show how much a large incumbent local exchange carrier spends purchasing interconnection, it is unclear what the value of such information would be, because the incumbents are usually the sellers, not the purchasers, of UNEs and resold services. Likewise, the revenue for resold services is journalized to various revenue accounts, just as are revenues from the existing services. The proposed new account would eliminate the existing classification of the revenue by class of service. In addition, any new revenue or expense account that causes movement from one major accounting classification to another would impact the jurisdictional separations process, which is currently frozen. It

[3] *See* Biennial Review of Depreciation Rates and Ranges for Classes of Capital of Telecommunications Utilities, Case No. 05-OT-105, Final Decision (WI PSC Dec. 20, 2002), *available at* psc.wi.gov/pdffiles/ord_notc/S555.PDF. In that proceeding, Verizon explained that the same equipment can be used for both loop and interoffice facilities. However, a discrete item of equipment can be booked into only one account. The only breakdown of this equipment occurred in the jurisdictional separations process, where the breakdown was based on special studies, not in any accounting proceeding, and is now frozen. If a state needs to find the jurisdictional breakdown of this equipment, it need only refer to the separations process. Therefore, no accounting change is necessary.

would not be appropriate to make major changes to the jurisdictional separations process at this time. For these reasons, no additional interconnection accounts should be recommended.

8. Universal Service Revenue and Expense Accounts. Finally, there is no need to prescribe new revenue and expense accounts for universal service. Information related to these revenues and expenses is readily available from USAC, and is monitored and reported by the Federal-State Joint Board Staff. *See* 2002 Monitoring Report, *available at* http://www.fcc.gov/wcb/iatd/monitor.html (Tables 1-1 to 1-57 show industry revenues and contributions; tables 2-1 through 5-11 show the support that carriers received from the universal service fund). Therefore, the information is readily available, and setting up formal accounts for this purpose is not "necessary" under Section 11 of the Act.

CERTIFICATE OF SERVICE

I hereby certify that, on this 31st day of January, 2003, copies of the foregoing "Comments of Verizon to Joint Conference Request for Public Comment" were sent by first class mail, postage prepaid, to the parties listed on the attached.

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