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November 12, 2003

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, TW-A325
Washington, DC 20554

Re: WC Dkt. 02-112, Sunset of the BOC Separate Affiliate and Related Requirements; CC Dkt. 00-175, 2000 Biennial Regulatory Review of Separate Affiliate Requirements of Section 64.1903.

Dear Ms. Dortch,

On November 12, the undersigned and Lyn Haney of BellSouth met with Bill Devers, Brent Olson, Renee Crittendon, Bill Kehoe, Ben Childers, Michael Carowitz, and Pam Megna of the Wireline Competition Bureau. The purpose of the meeting was to discuss accounting issues raised by the above proceeding. All material used during the meeting is attached.

This notice is being filed pursuant to Sec. 1.1206(b)(2) of the Commission's rules. If you have any questions regarding this filing please do not hesitate to contact me.

Sincerely,

Mary L. Henze

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cc: B. Devers
B. Olson
R. Crittendon
B. Kehoe
B. Childers
P. Megna
M. Carowitz

Post-Sunset Long Distance Accounting Issues

Part 64 Cost Allocation - Summary

Under current FCC guidelines (96-150, Accounting Safeguards Order) BOC integrated incidental interLATA services are treated as non-regulated for accounting purposes.

- Non-regulated treatment triggers Part 64 Cost Allocation rules
- Allocation was feasible in limited context of incidental interLATA

Post-sunset, application of same non-regulated accounting treatment to integrated interLATA would be a) burdensome and b) unnecessary.

- Allocation not feasible when many facilities used for both local and long distance; no way to identify local vs. long distance traffic
- More importantly, cost allocation is not necessary in price cap environment where changes in accounting costs are not reflected in rates

In order to avoid unnecessary cost allocation, FCC must modify it's guidance and determine that all integrated interLATA services should be treated as regulated for accounting purposes

Part 64 Cost Allocation – Impact of Non-Reg Treatment

1. Incidental InterLATA – E911

- E911 is charged the mileage-based tariff for an incidental interLATA links that connect the BellSouth tandems to the client PSAP. Part 64.901(b)(1)

- Automatic Location Information (ALI) database facilities and all *dedicated* trunks related to the database are directly assigned to nonregulated. Part 64.901(b)(2) Each PSAP is connected to two different ALI database facilities; interLATA access to the database is involved with each E911 operation.

- Direct costs trigger the apportionment of related common costs. Part 64.902(b)(3)

Part 64 Cost Allocation – Impact of Non-Reg Treatment

2. Post-sunset Integrated InterLATA (if guidelines NOT changed)

- **64.901(b)(1)**. Tariffed services provided to a nonregulated activity will be charged to the nonregulated activity at the tariffed rates and credited to the regulated revenue account for that service.

  Tariff charges for use of BOC network would be imputed against the integrated LD operation just as it is charged to external IXCs.

- **64.901(b)(2).** Costs shall be directly assigned to either regulated or nonregulated activities whenever possible.

  Any costs, from employee time reporting to external expenditures, which can be identified as only serving the LD operation, would be directly assigned. Trends in network technology mean few, if any, expenditures could be identified and assigned solely to LD.

- **64.901(b)(3).** Cost which cannot be directly assigned to either regulated or nonregulated activities will be described as common costs [and].... allocated according to the following hierarchy: i. Origin of the cost; ii. Indirect cost causative linkage; or iii. General allocator

  Would apply to shared administrative services such as Human Resources or Finance which are standard operations of any corporation and are not specific to a line of business. Apportionment of these costs can be burdensome due to difficulty in finding acceptable links to designated nonregulated and regulated operations. Would likely require expensive system changes.

- **64.901(b)(4).** The allocation of central office equipment and outside plant investment costs between regulated and nonregulated activities shall be based upon the relative regulated and non regulated usage of the investment during the calendar year .....

  Most burdensome requirement because it is impossible to discern between LD and local usage of distinct network facilities. There is no mechanical or manual way to distinguish between a packet flowing over the network for an LD call versus a local call. Many costly studies and systems changes would be necessary to comply.

Part 64 Cost Allocation – Not Useful or Necessary

1. Data is Not Useful

Results of cost allocation of integrated interLATA is reflected in a number of accounts in regulated books: a) Revenue accounts – 5080 & 5280 or 5100; and, b) almost all expense accounts.

- Data in these accounts are not used in Federal or state ratemaking under price caps.
- Data are used only to populate Table 1 of ARMIS 43-03 report.

Result of cost allocation has no bearing on compliance with 272(e)(3), prevention of cross subsidies, or ratemaking.

2. Original purpose for non-regulated treatment is no longer valid.

In establishing original guideline for incidental interLATA, Commission said non-regulated treatment (and resulting Part 64 cost allocation) was necessary to "achieve greater accuracy" than Part 36 and Part 69 provided.

In same order, Commission noted "changes in the competitive condition of local telecommunications markets in the future may cause us to reexamine the continued need for our Part 64 cost allocation rules."

Since 1996, the local telecommunications market has become increasingly competitive and the FCC has responded with fundamental changes in interstate regulation and the role that costs play. These include:

- Price cap regulation combined with pricing flexibility has completely eliminated any link between ILECs' recorded costs and the prices they charge for services.
- Elimination of the sharing and lower formula adjustment mechanism which could have created potential incentives for price cap ILECs to shift costs
- Adoption of the CALLS plan under which rates are not based on the development and reporting of costs under any of the Commission's accounting and reporting rules.

Minimal role of costs in today's regulatory environment means "greater accuracy" of cost allocation is no longer necessary.

To avoid unnecessary burden, FCC must determine integrated interLATA should be treated as regulated for accounting purposes.

Sec. 272(e)(3) Requirements – Summary

- Commission has determined that statutory requirements of 272(e)(3) remain even after separate affiliate requirements sunset.
- Today, implementation of requirement is accomplished through existing FCC affiliate transaction and cost allocation rules.
- BellSouth proposes new Part 53 rule to implement 272(e)(3) requirement for integrated interLATA treated as regulated for accounting purposes.

272(e)(3) Requirements – Today's Implementation

Current FCC rules guide companies in implementation of provision:

- Part 32.27(c) Affiliate Transactions: "Services provided between a carrier and the affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariff rate."
- Part 64.901(b)(1) Allocation of [Internal] Costs: "Tariffed services provided to a nonregulated activity will be charged to the nonregulated activity at the tariffed rates and credited to the regulated revenue account for that service."

Actions companies take to comply with these rules

- 32.27(c). A bill is issued by the BOC to the 272 affiliate for all the access that the LD affiliate uses. BOC records as regulated revenue in Part 32 account 5082. The LD affiliate books an expense.

- Part 64.901(b)(1). The incidental interLATA service is charged/imputed for the tariffed service (mileage sensitive transport) for the circuits used that cross a LATA boundary. The BOC records a regulated revenue to Part 32 account 5084 and a contra-revenue to nonregulated revenue Part 32 account 5280.

Sec. 272 (e)(3) Requirements – Proposed Rule & Benefits

1. Proposed Rule

To implement 272(e)(3) for integrated interLATA telecommunications, the FCC should explicitly codify the language of 272(e)(3), as well as specific accounting guidance.

The text of the rule would read as follows.

> ***53.102 Sec. 272(e)(3) requirements for interLATA activities***
> The Bell operating company shall charge the 272 affiliate or impute to itself when providing integrated interLATA service an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service. Such charges or imputation should be credited to the regulated revenue account and debited against interLATA revenue.

The appropriate accounts for this transaction are currently within Part 32.
- Part 32.5080 Network access revenue credited
- Part 32.5100 Long distance message revenue debited

2. Benefits of New Rule

Implementation of 272(e)(3) in this manner

- Makes implementation of 272(e)(3) explicit and independent of other rules that may be modified in the future.

- Addresses any potential concerns about "price squeeze." BOCs' interLATA service would be charged the exact same rate for access as other interexchange carriers. Ensures that the BOC LD service has same direct costs as the LD services offered by competitors.

- Existence of explicit rule facilitates FCC enforcement under its current authority and complaint processes. In addition, FCC could monitor compliance with new Part 53.102 by requiring BOCs to report the amount of charges and/or imputation to interLATA services in a new schedule in ARMIS Report 43-02.