Attachment A

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 SBC COMMUNICATIONS INC.

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TABLE OF CONTENTS

		Page
	Summary	i
I.	Introduction	1
II.	Federal Accounting and Reporting Rules Must Be Necessary For A Federal Regulatory Purpose	2
	A. All Federal Regulatory Accounting Rules That Have No Regulatory Necessity Should Be Eliminated	3
	1. The Existing Regulations Are Left-Overs From Rate of Return Regulation and Should Be Eliminated	4
	2. Effective Competition Eliminates The Need For Accounting Regulation	5
III.	The Joint Conference Should Not Propose Adding Or Reinstating Regulatory Accounting and Reporting Rules Solely for the States	6
IV.	The Joint Conference Should Recommend That The Commission Should Not Increase Accounting Requirements or Reinstate Regulations Recently Repealed	11
V.	The Joint Conference Should Recommend That The Commission Reconsider The Wholesale and Retail Sub-Accounts Established By The *Phase 2 Order*	15
VI.	The Joint Conference Should Recommend That The Commission Reconsider Changing The Reporting Requirement To "Loop Sheath Kilometers"	17
VII.	The Joint Conference Should Recommend That The Commission Clarify That Rule 32.11 Applies To ILECS That Are Dominant In Their Markets	18
VIII.	Conclusion	20

SUMMARY

The Joint Conference should find that there is no need for additional regulation in the telecommunications regulatory accounting arena and recommend that the Commission continue streamlining many of the outdated accounting and reporting regulations and allow carriers more flexibility to transition to generally accepted accounting principles (GAAP) for regulatory reporting.

To be consistent with the obligations of Section 11, the Joint Conference must make a determination of "regulatory necessity" as it examines the existing regulatory accounting rules and considers additional accounting regulations in this docket. The determination of necessity cannot be based on regulatory convenience; it must be grounded in a specific need to achieve a desired regulatory goal. Consequently, the Joint Conference should find that price cap carriers are entitled to relief from the Commission's Part 32 accounting rules since the Commission can achieve its regulatory goals with GAAP accounting.

Similarly, the Joint Conference should determine that there is no need for additional accounting or reporting requirements considering the current competitive telecommunications marketplace that exists today. The ILECs are subject to a competitive disadvantage since they are the only class of carriers still required to expend significant financial and administrative resources to comply with the ARMIS and Part 32 accounting rules. The Joint Conference should encourage the Commission to level the playing field.

In addition, the Joint Conference should concur with the Commission's previous finding that the following accounts are not necessary in the public interest: Interconnection Revenue and Expense, Universal Service Support Revenue and Expense, Optical Switching, Switching Software, Loop and Interoffice Transport, Directory Revenues, and Depreciation and Amortization expense.

Conversely, the Joint Conference should recommend that the Commission reconsider establishing wholesale and retail subaccounts for account 6620 and changing the reporting requirement on the ARMIS 43-07 Infrastructure Report from "Sheath Kilometers" to "Loop Sheath Kilometers" because the Commission did not illustrate the regulatory necessity for these rule changes.

Finally, the Joint Conference should recommend that the Commission clarify that rule 32.11 applies only to incumbent LECs that are dominant in their markets.

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SBC Communications, Inc., for itself and its wholly owned affiliates[1] ("SBC"), submits the following comments in response to the Public Notice released in the above-captioned proceeding.[2]

I. INTRODUCTION

The Commission established the Federal-State Joint Conference on Accounting Issues ("Joint Conference") to ensure that regulatory accounting and reporting requirements are adequate and effective in the current market to protect consumers and carry out federal and state regulatory responsibilities."[3] The Joint Conference's review should focus on achieving Congress's goal of creating a "pro-competitive, deregulatory national policy framework"[4] and ensure that regulatory accounting and reporting rules are necessary for a valid regulatory interest.[5] Since the Commission's primary use of regulatory accounting and reporting focuses on

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

[2] *Federal-State Joint Conference on Accounting Issues*, Request for Comment, DA 02-3449, at 1 (rel. Dec. 12, 2002) ("*Joint Conference Request for Comment*").

[3] *Id.* at 2.

[4] Joint Explanatory Statement of the Committee of Conference, S. Conf. Rep. No. 104-230, at 113 (1996).

[5] *See 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2*, Report and Order in

establishing rates, evaluating jurisdictional separations, and calculating universal service support, the regulatory accounting rules must be <u>necessary</u> to support these functions.

The Joint Conference may be tempted to entertain suggestions for new telecommunications accounting regulations since the impetus for the Joint Conference was the "troubling disclosures by some telecommunications carriers"[6] resulting in public concern over the adequacy of financial accounting.[7] However, the Joint Conference should note that the additional rules proposed by the Public Notice do not relate to accounting fraud and consequently will not prevent corporate accounting scandals. Although, the recent financial accounting scandals are disturbing and should be dealt with in the strictest enforcement authority. These incidents in no way tie to the Commission's regulatory accounting rules. As such, the Commission should rely on the extensive investigation and resolutions being addressed by Congress, the Securities and Exchange Commission ("SEC"), the Financial and Accounting Standards Board ("FASB"), the American Institute of Certified Public Accountants ("AICPA") and other capable regulatory and legislative bodies.

There is no need for additional regulation in the telecommunications regulatory accounting arena and the Joint Conference should recommend that the Commission continue streamlining many of the outdated accounting regulations and allow carriers more flexibility to transition to generally accepted accounting principles (GAAP) for regulatory reporting.

II. FEDERAL ACCOUNTING AND REPORTING RULES MUST BE NECESSARY FOR A FEDERAL REGULATORY PURPOSE.

Section 11 of the Act requires that the Commission develop pro-competitive regulatory reforms by requiring a biennial review to eliminate all regulations "no longer necessary in the

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

[6] See Press Statement of Chairman Powell, Re. Federal-State Joint Conference on Regulatory Accounting Issues, Released September 5, 2002.

[7] *Joint Conference Request for Comment* at 2.

public interest."[8] Accordingly, the Joint Conference must make a determination of "necessity" as it examines the existing regulatory accounting rules and considers additional accounting regulations in this docket.

The D.C. Circuit held that the meaning of the word "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."[9] Therefore, the Joint Conference's determination cannot be based on mere regulatory convenience, i.e. the Commission staff or states seeking information that it may find informative.

To determine whether rules are necessary, the Joint Conference must ensure that the burden of justifying any ILEC accounting or reporting regulation is carried by the party advocating the requirement, *not* on the ILEC to show that the regulation is unnecessary. Chairman Powell voiced his agreement with this approach:

> if we don't have a clear and demonstrable justification of a rule, then the appropriate role of government is to take the rule away or not interfere in the otherwise proper functioning of a market, rather than leave a rule in for good measure. Over history a lot of rules that were left for good measure ... have secondary effects that often harm the welfare of consumers. ... I don't think you've got to prove to me that a rule is not necessary. I think I have to prove that it is necessary. And if I can't do that, I don't think that I should intervene.[10]

A. All Federal Regulatory Accounting Rules That Have No Regulatory Necessity Should Be Eliminated.

In the Public Notice, the Commission stated that regulatory accounting is necessary to fulfill our regulatory responsibilities and promote a competitive telecommunications marketplace.[11] The current regulatory accounting rules are the least efficient means of achieving

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[8] 47 U.S.C. §161(b). This section is comprised of two sections. The first requiring the Commission to review all existing regulations and "determine whether any such regulation is no longer necessary in the public interest as the result of meaningful economic competition between providers of such service." The second section requires that the "Commission shall repeal or modify any regulation it determines to be no longer in the public interest." 47 U.S.C. § 161.

[9] *GTE Service Corp. v. FCC*, 205 F.3d 416, 423 (D.C. Cir. 2000)

[10] "Powell defines stance on telecom competition," COMMUNICATIONS DAILY, May 22, 2001 at 2-3.

[11] *Joint Conference Request for Comment* at 2-3.

these goals. Many regulations still exist that are unnecessary. Many of these regulations are vestiges of the rate of return regulation paradigm and have outlived their usefulness and others are unnecessary because effective competition eliminates the need for them. In a growing competitive environment, the burdensome and costly accounting requirements imposed on incumbent LECs must be eliminated or significantly reduced. Other telecommunications providers are not subject to these requirements and can establish a single accounting system and process to meet their business and regulatory reporting needs. On the otherhand, these one-sided outdated rules required incumbent LECs to unnecessarily keep redundant sets of books. Instead, incumbent LECs should be permitted to adopt a single set of accounts and accounting procedures to satisfy <u>all</u> of their corporate reporting obligations. Then, the Commission could effectively monitor all telecommunications companies by reviewing data reported to the financial community and by comparing incumbent LEC results to those of other companies.

1. The Existing Regulations Are Left-Overs From Rate Of Return Regulation And Should Be Eliminated.

The Part 32 accounting and ARMIS reporting rules were developed as tools for rate of return regulation and other cost-plus methods of regulating rates. Most incumbent LECs, however, including SBC and other RBOCs are no longer subject to rate of return regulation. Moreover, the *Price Cap Performance Review*[12] eliminated sharing mechanisms from price cap regulation, thereby, removing all vestiges of cost-based rate regulations. The Part 32 and ARMIS rules were developed when the ILECs rates were set using a cost plus basis that has since been replaced with price cap regulation with pricing flexibility. Thus, subscriber rates are no longer based on the ILECs costs. Since pure price cap carriers may set rates based on the demands of the market, rather than costs, they should be relieved of the Part 32 accounting and ARMIS reporting rules.

[12] *See Price Cap Performance Review of Local Exchange Carriers*, CC Docket No. 94-1, FCC 97-159, ¶¶ 148-155 (1997) ("*Price Cap Performance Review*").

2. Effective Competition Eliminates The Need for Accounting Regulation.

Competition in the local exchange and exchange access markets make the existing accounting and ARMIS reporting rules no longer necessary in the public interest. When the federal accounting and reporting rules were implemented, there was little competition in the exchange access market and no competition in the local exchange market. Now, competition exists in both local exchange and exchange access and in business as well as consumer markets. For example, at the close of 2002, CLECs accounted for about 20 percent of local access lines and most of these lines, between 60-70 percent, are served by facilities based CLECs.[13] In recognition of this competition, the Commission has granted 271 approvals in 35 states – deeming those markets "irreversibly open" to competition[14] and has granted SBC either limited or full pricing flexibility relief, based on meeting the competitive triggers established by the Commission in its Pricing Flexibility proceeding,[15] in 45 markets for dedicated transport and special access services and 38 markets for end user channel termination services. The Commission should not hamper this competition with unnecessary regulation.

In this environment, asymmetric regulation distorts competition. Only one class of carriers, ILECs, is required to expend significant financial and administrative resources to comply with the ARMIS and Part 32 accounting rules, leaving the ILECs at a competitive disadvantage. There is no justification for the ILECs' additional burden since the Commission can maintain the necessary degree of oversight through GAAP. And while all public companies

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[13] See Attachment A, UNE Fact Report 2002, Summary of Competitive Entry in SBC Regions – Comments of SBC Communications Inc., CC Docket 01-338, p. 3 (April 5, 2002). ("*UNE Fact Report 2002*").

[14] To date, the Commission has granted 271 for the following markets: BellSouth: Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, and Tennessee; Qwest: Colorado, Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, Washington, and Wyoming; SBC: Arkansas, California, Kansas, Missouri, Oklahoma, and Texas; Verizon: Connecticut, Delaware, Massachusetts, Maine, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, and Virginia.

[15] *See Access Charge Reform*, CC Docket No. 96-262, *Fifth Report and Order*, 14 FCC Rcd. 14221 (1999) (*Pricing Flexibility Order*), aff'd, *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

are subject to the GAAP accounting rules, only a small number of large ILECs are also subject to the Commission's regulatory accounting rules. The application of these regulations only to a diminishing subset of market players flies in the face of the very outcome that such regulation attempts to measure – full competition in all communications markets. Regulators need not look to add one-sided regulatory burdens in an increasingly competitive marketplace, but rather should strive to achieve a level regulatory playing field that applies equally to all industry players in order for competition to be truly market-based. Therefore, the Joint Conference should recommend that the Commission free the ILECs from the burden associated with the Part 32 accounting and ARMIS reporting so that all carriers can compete on a level playing field.

III. THE JOINT CONFERENCE SHOULD NOT PROPOSE ADDING OR REINSTATING REGULATORY ACCOUNTING AND REPORTING RULES SOLELY FOR THE STATES.

The Joint Conference seeks comment on whether the "FCC has the authority to maintain accounts used solely by the states" and whether additional accounts should be added at the request of the states.[16] The answer to both questions is no. The FCC's rulemaking authority is limited to the dispatch of the FCC's responsibilities. Section 201(b) of the Act states that "the Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[17] In addition, Section 4 of the Act provides: "[t]he Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of ***its*** functions."[18] (emphasis added). Thus, the Commission may establish Part 32 accounting and ARMIS reporting rules to the extent such rules are necessary to the execution of the <u>FCC's</u> statutory responsibilities but it has no statutory authority to establish rules simply to assist states

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[16] *Joint Conference Request for Comment* at 4.

[17] 47 U.S.C. § 201(b).

[18] 47 U.S.C. § 154(i).

in applying state law. To the extent state commissions do not have sufficient information to apply state law, that is a matter for state legislation.

The Commission itself has recognized that it has no authority to establish federal rules for the purpose of implementing state law. It noted that "if we cannot identify a federal need for a regulation, we are not justified in maintaining such a requirement at the federal level"[19] and acknowledged the states have independent authority to promulgate rules to carry out state regulatory requirements.[20]

Thus far, the states have yet to articulate a specific regulatory purpose directly tied to the creation of new accounts, or subaccounts, other than the ostensible need to better track costs associated with specific UNEs, such as loops and switching, or to develop UNE (or Universal Service Fund ("USF")) cost models. But UNE rates are not set with reference to ARMIS costs; they are established pursuant to a wholly separate cost methodology – TELRIC. Moreover, in establishing rates pursuant to TELRIC, the states have had no trouble obtaining requisite cost data and developing forward looking cost models without the creation of new accounts and subaccounts. Although the current USOA chart of accounts prescribed by Part 32 of the Commission's rules is used to develop certain factors that may serve as inputs to UNE cost studies or USF cost models, no commenting party has put forth a "compelling case" as to why the existing accounts under GAAP accounting would be insufficient for this purpose.

In the Public Notice, the Joint Conference seeks comment on whether the Commission should add accounts to the USOA at the request of the states. For the foregoing reasons, the Joint Conference should recommend that the Commission adopt its previous ruling on the following accounts:

- *Interconnection Revenue/Expense Accounts*:

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[19] *Phase 2 Order* at ¶ 207.

[20] *See Phase 2 Order* at ¶ 36 (noting that the Commission's action of consolidating Directory Revenue accounts did not restrict state commissions from receiving disaggregated directory revenues from carriers if state-specific reasons required them to do so).

With the adoption of its *Phase 2 Order*, the FCC flatly declined to adopt new accounts for interconnection-related revenues and expenses (UNEs, resale, reciprocal compensation, and other interconnection arrangements).[21] The Commission reasoned that such accounts were unnecessary in light of existing requirements that perform the same or similar function.[22] In fact, the Commission first proposed adding new accounts for interconnection-related revenues and expenses in a Notice of Proposed Rulemaking released in October of 1997.[23] The lack of a final ruling for over five years and the eventual termination of this proceeding in the *Phase 2 Order* further demonstrates that the Commission was not then, and is not now, persuaded that there is a need to adopt these new accounts. If anything, the need for these accounts has waned since they were first proposed given the rapidly increasing competition in local markets and the availability of broader mechanisms for monitoring local competition that are more comprehensive in their application.

As discussed previously, the additional regulatory burdens that would result from the adoption of new accounts far outweigh any benefit to be derived and cannot be squared with the pro-competitive deregulatory goals of the Act.[24] Furthermore, the only purported objective to be accomplished by adopting these accounts - monitoring the extent of local competition – cannot, and should not, be achieved by focusing solely on one segment of the telecommunications

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[21] *See Phase 2 Order* at ¶¶ 65-73.

[22] For example, with respect to revenue accounts, the Commission found that "[t]he Form 477 already provides information on the extent of local competition." *See Phase 2 Order* at ¶ 66. The Commission concluded that "the information collected through the [Form 477] provides a way to monitor the extent of local competition, and we do not need at this time to add new USOA revenue accounts…". *Id.* With respect to interconnection-related expense accounts, the Commission found "insufficient support to justify imposing new Class A accounts to record [such expenses]." *Id.* at ¶ 69. Rather the Commission relied on the statutorily created obligations on incumbent LECs (under sections 251 and 252 of the Act) to document these costs. *See Id.*

[23] *See* Amendments to Uniform System of Accounts for Interconnection, CC Docket No. 97-212, *Notice of Proposed Rulemaking*, 12 FCC Rcd 36577 (1997).

[24] Even the Commission recognized the lack of cost-benefit justification concluding that "no compelling case has been made that the regulatory need for this new revenue account outweighs the burdens associated with its creation." *Phase 2 Order* at ¶ 68.

industry.[25] As the Commission previously recognized, when it correctly declined to adopt interconnection-related revenue and expense accounts in the *Phase 2 Order* based on the absence of any specifically identifiable regulatory purpose (federal or state) to be achieved other than a purported general interest, imposing reporting requirements on incumbent LECs alone cannot provide complete information in any event.

- <u>*Universal Service Support Revenue/Expense*</u>:

Like the proposed interconnection-related revenue and expense accounts, the Commission declined to adopt new accounts for universal service support receipts and payments in the *Phase 2 Order*.[26] Once again the Commission found that adopting new accounts was unnecessary concluding that there is "no need to separately track this information from a smaller universe of carriers through the USOA."[27] The incumbent LECs represent only a small subset of the universe of telecommunications service providers that contribute to, or receive support from, the federal universal service funds. Thus, there is no compelling regulatory purpose that justifies the imposition of unduly burdensome accounting requirements solely on incumbent ILECs when other sources of such information which cover all telecommunications service providers already exist. Most important with respect to universal service, the Commission has several on-going proceedings[28] that address all universal service matters broadly obviating the need for the

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[25] In the *Phase 2 Order*, the Commission recognized this unbalanced approach by concluding that the "[Form 477 – *Local Competition and Broadband Data Gathering Program*] covers a broader range of providers than the incumbent LECs." *See Phase 2 Order* at ¶ 66.

[26] *See Phase 2 Order* at ¶¶ 74-75.

[27] With respect to revenues, the Commission noted that "we already collect information on amounts recovered from end users for state or federal universal service contributions in FCC Form 499-A Telecommunications Reporting Worksheet." *Phase 2 Order* at ¶ 74. With respect to expenses, the Commission similarly noted that "there is no need to adopt a universal service expense account, as the amounts that carriers contribute to support universal service are readily available from the Universal Service Administrative Company (USAC)." *Phase 2 Order* at ¶ 75. *See also* Federal-State Joint Board Staff Monitoring Report at http://www.fcc.gov/wcb.iatd/monitor.html (Tables 1-1 to 1-57 show industry revenues and contributions and Tables 2-1 to 5-11 show the support that carriers received from USF).

[28] *See e.g.*, Federal-State Board on Universal Service, CC Docket No. 96-45 (With respect to this docket, the FCC must consider the recommendations of a Federal-State Joint Board on Universal Service.).

Commission to impose unnecessary and potentially duplicative accounting requirements only on incumbent ILECs.[29]

- *Optical Switching:*

The FCC concluded in the Phase 2 Order that "adding the optical switching account is premature because the technology has not yet developed to the point where widespread deployment is imminent."[30] Consistent with the FCC's ruling, optical switching has yet to be deployed in SBC's network. However, SBC reemphasizes its position that the more critical consideration is that the FCC should refrain from adopting new accounts simply to accommodate developing technologies unless a compelling federal regulatory purpose can be articulated. The request for optical switching data is clearly premature considering that (1) the technology has yet to be deployed, (2) there is a pending federal question regarding the obligation to unbundle new technologies and (3) even if ILECs are required to unbundle optical switching, the pricing methodology for UNEs is not dependent on ARMIS data.

- *Switching Software:*

In addition to the arguments against creating new accounts raised above, SBC fervently agrees with the Commission's conclusion in the *Phase 2 Order* that there is "no regulatory need at this time to separately track investment in switching software in a new subaccount."[31] The Commission correctly recognized the sufficiency of its current rules that require incumbent LECs to maintain subsidiary record categories for general purpose computer software and network software.[32]

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[29] For example, the Commission stated in the *Phase 2 Order* that "we currently have a proceeding to reform how universal service contributions are assessed and how these costs are recovered." *Phase 2 Order* at ¶ 75.

[30] *See Phase 2 Order* at ¶ 60.

[31] *Phase 2 Order* at ¶ 62.

[32] *See Id.*

• *Loop and Interoffice Transport:*

The Commission likewise declined to add new subaccounts for loop and interoffice transport. It found that "allocating these costs to separate subaccounts would be overly burdensome because, in some cases, both loop and interoffice transport would be carried on the same cable facility."[33] The Commission ruled as such even though it recognized that "it may be useful to have this disaggregated information."[34]

As discussed in the *Phase 2* proceeding, there is no need to incur the burdensome financial and administrative costs associated with massive accounting system changes to create these accounts and subaccounts since they are unnecessary, provide disaggregated information that is not required to be provided by competitors, and would not otherwise be created based on management's needs.[35]

IV. THE JOINT CONFERENCE SHOULD RECOMMEND THAT THE COMMISSION SHOULD NOT INCREASE ACCOUNTING REQUIREMENTS OR REINSTATE REGULATIONS RECENTLY REPEALED.

The Joint Conference also asked for comment on whether there are additional accounting requirements that should be adopted and whether certain accounting reforms adopted in the Commission's *Phase 2* proceeding should be reinstated.[36] As discussed above, there is no longer a need for Part 32 accounting and ARMIS reporting. Thus, far from adding to these requirements, the Commission should eliminate them.

Nothing has changed in the last year to justify adding accounts or reinstating the accounts recently eliminated or consolidated in the Phase 2 proceeding. Revelations of abuse of SEC/GAAP accounting rules are very disturbing, but they have no bearing whatsoever on the need for, or adequacy of, FCC regulatory accounting rules. Targeting the FCC's accounting

[33] *Phase 2 Order* at ¶ 63.

[34] *Id.*

[35] See *Phase 2 Comments of Verizon* at 2 – 3 (discussing burdens associated with adding accounts to ILEC systems).

[36] *Joint Conference Request for Comment* at 3.

rules will do nothing to solve the problems in the headlines or punish the companies at fault. Indeed, for the most part, these rules do not even apply to the bad actors that violated existing laws. Furthermore, it wasn't the absence of rules that lead to these scandals, but the choice to blatantly ignore the existing rules.

If the FCC wants to prevent future abuses, it can do so by utilizing its existing enforcement authority and using remedies that "have a solid, deterrent effect against illegal activities."[37] It certainly is not necessary to add accounting regulations to one segment of the market.

Moreover, other laws and regulations exist, outside of the FCC's jurisdiction, that are designed to protect the marketplace from anti-competitive and monopolistic behavior and obviate the need for additional accounting regulations. In particular, the SEC promulgates securities regulations designed to protect the public and investors while the IRS is responsible for tax rules that also influence how companies operate. These government agencies and Congress are reviewing and reinforcing the law and rules to ensure that our markets and consumers are protected from corporate fraud. For example, Congress acted quickly to pass the Sarbanes-Oxley Act of 2002 and the Corporate and Criminal Fraud Accountability Act of 2002 to improve the accuracy and reliability of corporate disclosures and enhance the available penalties for auditing and accounting improprieties at publicly traded companies. Likewise, the SEC has and continues to make changes to its rules.[38] In addition, there are industry groups like the AICPA and FASB that are charged with providing guidance on accounting and reporting procedures.

[37] FCC New Release, *FCC Chairman Michael Powell Outlines Six Critical Steps for Telecom Industry Recovery; Calls for Legislation in Three Areas* (July 30, 2002).

[38] The SEC recently implemented several rules as a result of the Sarbanes-Oxley Act, including, *Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Release Nos. 34-46421, 35-27563; IC-25720, File No. S7-31002 (Effective August 29, 2002); *Certification of Disclosure in Companies' Quarterly and Annual Reports*, Release Nos. 34-46427, IC-25722, File No. S7-21-01 (Effective August 29, 2002); *Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002*, Release No. 34-47235, File No. S7-40-02, (Effective March 3, 2003); *Retention of Records Relevant to Audits and Reviews*, Release Nos. 34-47241, IC-25911, FR-66, File No. S7-46-02 (Effective March 3, 2003).

There is no overlap between the accounting reforms granted in the *Phase 2 Order* and the improvements necessary to prevent auditing and accounting scandals.

- *Account 5230 – Directory Revenues:*

The Commission was not persuaded in the Biennial Review that Account 5230 was necessary for a federal regulatory purpose.[39] While Commission acknowledged that a few states requested this information, the Commission concluded that this consolidation did not "restrict state commissioners from receiving these data from carriers when state-specific reason require them to do so."[40] Thus, the Joint Conference should recommend that the Commission uphold its previous finding since there is no compelling federal regulatory purpose for requiring ILECs to report Directory Revenues separately.

- *Depreciation/Amortization Expense Accounts:*

The FCC should not reinstate the depreciation and amortization expense accounts (Account 6561 through Account 6565) that were consolidated into Account 6560, *Depreciation and amortization expenses* in the *Phase 2 Order*.[41] The FCC once again recognized that there is no federal regulatory purpose that justifies maintaining these accounts (or, by logical extension, reinstating these accounts in the instant proceeding). Furthermore, the Commission's expectation that "companies will provide these records to the state commissions, if needed for state rate cases" reflects the Commission's recognition of the separate authority of states with respect to ratemaking and depreciation treatment.[42] In other words, the Commission's decision to consolidate the depreciation and amortization expense accounts for federal regulatory

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[39] *Phase 2 Order*, ¶ 36.

[40] *Id.*

[41] *See Id.* at ¶ 38.

[42] *Id.* For example, in response to a concern that depreciation expense associated with property held for future use is important in state rate cases, the FCC concluded that "[d]ue to the *de minimis* nature of this account, we will adopt our proposal to consolidate these depreciation accounts." *Id.*

accounting purposes has absolutely no impact on the authority, or ability, of states to ensure that *intrastate* rates are just and reasonable.[43]

The Commission should not require incumbent LECs to maintain depreciation and amortization expense accounts, unnecessary to serve any federal regulatory purpose, to accommodate state regulation when the depreciation rates and methods of many states do not mirror that of the FCC. Consistent with the Commission's decision in the *Phase 2 Order*, no compelling argument can be made to justify maintaining burdensome federal accounting requirements when states already have separate authority over depreciation rates and methods.[44] Furthermore, simply consolidating depreciation and amortization expense accounts will have no impact on FCC or state prescribed depreciation rates and methods, and thus, no impact on rates (e.g., interstate access, local rates, UNE prices, USF costs, etc.). For example, there would be no increased risk that incumbent LECs would seek to increase rates in states that impose the same depreciation treatment as the FCC, but utilize a different overall method of rate regulation (e.g., rate of return). Rather, only the breakdown by account in which the amounts are booked would change – not the depreciation records available and the depreciation costs used in setting rates.

- *Affiliate Transactions Rules:*

The Commission should not reconsider any of the changes to the affiliate transactions rules that were adopted in the *Phase 2 Order*. To the contrary, the Commission should continue its deregulatory streamlining efforts with respect to the burdensome and largely unnecessary affiliate transactions rules. The Commission adopted the affiliate transactions rules in 1987 to protect ratepayers of regulated telecommunications services from bearing the costs and risks

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[43] In *Louisiana PSC*, the Supreme Court ruled that section 152(b)(2) of the Act reserves the authority of states to ensure that intrastate rates are just and reasonable and to prescribe rates and methods of depreciation. *Louisiana PSC*, 476 U.S. at 364, 371.

[44] *See Id.* at *f.* 63. The FCC was not persuaded by parties that argued that: the FCC should retain Account 6562, Depreciation expense for property held for future use and Account 6563, Amortization expense-intangible; the use rate-of-return regulation would benefit from separate identification of amortization of intangible expense because these costs require special scrutiny; or that it is important to retain the detail accounts as potential tools for maintaining a check on the accuracy of RBOC cost studies. *Id.*

associated with a carrier's nonregulated activities.[45] The nearly ubiquitous replacement of the old rate-of-return model of price regulation with the imposition of price caps (or other incentive based regulation), in which the relationship between costs and prices are severed, has all but obviated the need for these rules.[46] Indeed, the Commission's decision in the *Phase 2 Order* to "simplify our affiliate transactions rules so that carriers have greater flexibility in how they price transactions with affiliates"[47] endorsed this view.

While there are some carriers that are still subject to rate of return regulation or price caps with sharing mechanisms, SBC and most ILECs are not subject to either and should not be subject to these regulations unnecessarily. Since elimination of regulation for a particular class of carriers is consistent with the deregulatory goals of Section 11, the Commission should certainly continue its streamlining efforts in this area.

V. THE JOINT CONFERENCE SHOULD RECOMMEND THAT THE COMMISSION RECONSIDER THE WHOLESALE AND RETAIL SUB-ACCOUNTS ESTABLISHED BY THE *PHASE 2 ORDER*.

In the *Phase 2 Order*, the Commission did not carry its burden of proving that the creation of Account 6620 for Wholesale and Resale was necessary in the public interest nor did it identify the *federal* need for these subaccounts. The Commission justified the wholesale/retail distinction as "important" because it believed the subaccounts would "assist the states in

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[45] *See Joint Cost Order*. The affiliate transactions rules govern the manner in which incumbent LECs value and record transactions between regulated entities and nonregulated affiliates. *See* 47 C.F.R. § 32.27.

[46] The Commission notes that "[t]here are several potential ramifications of cost misallocations arising out of affiliate transactions." *Phase 2 Order* at ¶ 99. However, as these concerns continue to diminish as competition continues to increase, it becomes more difficult to meet the burden required to demonstrate the relevance and necessity of the affiliate transactions rules. Especially, when less burdensome alternatives exist to prevent cost misallocation (such as the FCC and state commission complaint processes; anti-trust laws; numerous other enforcement mechanisms) including ultimately competition and market forces.

[47] *Phase 2 Order* at ¶ 86.

developing UNE rates that properly reflect the costs of providing a wholesale service."[48] But as noted above, Section 11 requires a finding of regulatory "necessity."[49]

In addition to side-stepping the Section 11 mandates, the Commission obviously underestimated the magnitude of the burden that this change places on the ILECs. The ILECs estimated that they would incur approximately $3.5M in implementation costs and $2.5M per year in on-going costs to support this accounting requirement.[50] This level of expense is not justified absent a real demonstrable need, absent here, for separate wholesale and retail subaccounts. Furthermore, as the *Joint PFR* pointed out, not only is the wholesale and retail split completely unnecessary for UNE rates, it is not even *arguably* relevant to much of Account 6620, as two of the three services reflected in that account (6621 - Call Completion Services and 6622 - Number Services) are not even required to be offered at UNE rates.[51] Because of SBC's nondiscriminatory obligations for wholesale OA/DA under Section 251(b)(3) and 271 checklist item vii, SBC utilizes the same resources to provide retail and local wholesale operator and directory assistance services. Resources and expenses cannot be segregated between retail and local wholesale under the law and under current operational structures. Further, SBC, like other LECs, provide retail OA and DA services using the same resources as it does for a variety of wholesale entities, not just UNE-based CLECs. Resale, UNE-based and switch-based CLECs, as well as ILECs, wireless carriers and some IXCs are served using the incumbent's resources. A wholesale break-out of expenses in accounts 6621 and 6622 is not possible, and would be of no value since it would include expenses unrelated to UNE-based CLECs.

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[48] *Phase 2 Order* at ¶ 64 (emphasis added).

[49] *See infra* pp. 2-4 .

[50] *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 PFR*") at 5-6.

[51] *Joint PFR* at 3-4.

Furthermore, should the Joint Conference recommend imposing a requirement to record a wholesale/retail breakdown in Account 6623 - Customer Services, incumbent LECs would have to develop and implement studies to be performed periodically in order to allocate certain costs recorded in this account. Such a requirement is unnecessary and not justified. Undertaking studies to allocate costs is unduly burdensome and costly. Furthermore, factors developed from studies performed during a prior period would be applied to current data, and therefore, would only reflect a representation of costs associated with wholesale and retail activities related to customer services rather than the actual costs incurred for such purposes.[52]

VI. THE JOINT CONFERENCE SHOULD RECOMMEND THAT THE COMMISSION RECONSIDER CHANGING THE REPORTING REQUIREMENT TO "LOOP SHEATH KILOMETERS."

The Joint Conference should recommend that the Commission change the "loop sheath kilometer" measurement back to "sheath kilometers." The Commission implemented this rule change based on regulatory convenience, not regulatory necessity. In the *Phase 2 Order*, the Commission merely stated that this change would be "more *useful* for policymakers and interested parties,"[53] but did not articulate any reason to justify why changing "Sheath kilometers" to "Loop kilometers" is "necessary in the public interest." Consequently, the Commission failed to meet its burden of showing regulatory necessity as required by Section 11.

In addition, the Commission did not seem to consider the additional financial burden this change puts on the ILECs. As discussed in the *Joint PFR*, the additional studies that would be required to calculate loop sheath kilometers are very time consuming and expensive.[54] This burden certainly outweighs the nonexistent benefits of generating this data.

[52] This results in a violation of 47 CFR 32.2 that provides that Part 32 accounts "should not reflect an *a prior* allocation of revenues, investments or expenses to products or services."

[53] *Phase 2 Order* at ¶ 170.

[54] *See Joint PFR* at 9 (Verizon estimating that the analysis would cost $5.5 million).

VII. THE JOINT CONFERENCE SHOULD RECOMMEND THAT THE COMMISSION CLARIFY THAT RULE 32.11 APPLIES TO ILECS THAT ARE DOMINANT IN THEIR MARKETS.

In the *Phase 2 Order*, the Commission concluded that section 32.11 of its rules should be amended to specifically apply to incumbent ILECs. In reaching this conclusion, the Commission stated that its accounting rules are applied only to ILECs because these carriers are dominant in their markets.[55] However, the Commission, upon adopting the amendment, relied on the statutory definition of "incumbent local exchange carrier" in 251(h) of the Communications Act. Based on the Commission's theory that the accounting requirements should be applied only to carriers that are dominant in their markets,[56] the Commission's incorporation by reference of the section 251(h) definition of "incumbent local exchange carrier" into Rule 32.11 in an effort to clarify which entities are bound by the regulatory accounting rules is misplaced. The 251(h) definition of ILEC is not appropriate in the context of determining which entities are subject to the Commission's accounting regulation.

Section 251(h) defines the term "incumbent local exchange carrier" for purposes of section 251, and thus for purposes of identifying which carriers are subject to the market opening requirements of section 251(c). In particular, it defines the term "incumbent local exchange carrier" as, "with respect to an area, the local exchange carrier that on the date of enactment of the Telecommunications Act of 1996, provided telephone exchange service in such area; and on such date of enactment was deemed to be a member of the exchange carrier association pursuant to section 69.601(b);" or "is a person or entity that, on or after such date of enactment, became a successor or assign of a member described in [251(h)(1)(B)] clause (i) ."[57] The fact that a carrier meets the foregoing definition says nothing about whether that carrier is "dominant" in the markets in which it operates.

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[55] *Phase 2 Order* at ¶ 126.

[56] *Id.*

[57] 47 U.S.C § 251(h)(1).

Under the Commission's rules, a carrier is "dominant" if it has market power, that is, the ability to restrict output and thus raise prices in a relevant market.[58] The fact that a carrier meets the statutory definition of an incumbent local exchange carrier under section 251(h) does not mean that it is "dominant" in the markets in which it operates. For example, in the *Non-Accounting Safeguards Order*, the Commission held that a BOC could not avoid its network unbundling obligations by transferring a network element to a section 272 affiliate. Rather the section 272 affiliate would, for purposes of that element, be deemed an ILEC under section 251(h) as a successor or assign of the BOC, and thus be subject to the unbundling requirements of 251(c)(3), irrespective of whether the affiliate was dominant in the market for interexchange services.[59] Likewise, in the *Ascent* decision, the court held that SBC's advanced services affiliates are subject to the network unbundling and resale requirements of sections 251(c)(3) and (4),[60] and thus, by definition, are ILECs under section 251(h). However, as SBC has shown in its Non-Dominance Petition[61] and its comments filed in the Commission's *Incumbent LEC Broadband Notice* proceeding,[62] SBC's advanced services affiliates are nondominant in the

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[58] 47 C.F.R. § 61.3(q).

[59] *See, In the Matter of Implementation of Non-Accounting Safeguards Section of Section 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149; First Report and Order and Further Notice of Proposed Rulemaking, ¶¶158 – 170 (*Non-Accounting Safeguards Order*).

[60] *Association of Communications Enterprises v. FCC*, No. 99-1441 (D.C. Circuit, Jan. 9, 2001) (*Ascent).*

[61] See *SBC Petition for Expedited Ruling That it is Non-Dominant in its Provision of Advanced Services and for Forbearance From Dominant Carrier Regulation of These Services*, CC Docket No. 01-337, filed on October 3, 2001 (*Non-Dominance Petition)* (On December 31, 2002, the Commission granted SBC's request for forbearance from the application of dominant carrier tariff requirements to its provision of advanced services, provided that SBC must continue to offer such services through SBC-ASI, its advanced services affiliate. However, the Commission deferred its decision on whether ILECs are non-dominant in the provision of broadband services in the absence of a structurally separate affiliate to the pending *Incumbent LEC Broadband Notice* proceeding).

[62] See SBC Comments filed in *Review of Regulatory Requirements for Incumbent LEC Broadband Services: SBC Petition for Expedited Ruling That it is Non-Dominant in its provision of Advanced Services and For Forbearance From Dominant Carrier Regulation of These Services*, CC Docket No. 01-337, Notice of Proposed Rulemaking, FCC 01-360, 16 FCC Rcd 22745 (rel. Dec. 20, 2001) (*Incumbent LEC Broadband Notice*).

market for broadband services. Thus, the Commission's decision to apply its accounting rules to ILECs as defined in Section 251(h) is overly broad and disconnected from the Commission's stated goal of applying the accounting rules only to dominant carriers. The Commission should reconsider section 32.11, as amended, and further amend it to ensure that the rule does not sweep in carriers that are not dominant in the markets in which they operate. In particular, the Commission should clarify that the accounting rules apply only to ILECs as defined in sections 251(h)(1)(A) or 251(h)(1)((B)(i).

VIII. CONCLUSION.

The Joint Conference should urge the Commission to continue streamlining its accounting and ARMIS reporting requirements consistent with Section 11 and Congress' goal of creating pro-competitive deregulatory national policies.

Respectfully submitted,

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