Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Conference On Accounting Issues	)	WC Docket No. 02-269
	)	
2000 Biennial Regulatory Review - Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II	)	CC Docket No. 00-199
	)	
Jurisdictional Separations Reform and Referral to the Federal-State Joint Board	)	CC Docket No. 80-286
	)	
Local Competition and Broadband Reporting	)	CC Docket No. 99-301

COMMENTS OF SBC COMMUNICATIONS INC.

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COMMENTS OF SBC COMMUNICATIONS INC.

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

I. INTRODUCTION AND SUMMARY

In November 2001, in the 2000 Biennial Review, the Commission undertook a comprehensive review of its accounting rules and ARMIS reporting requirements to determine whether those regulations remained necessary in the public interest in light of growing

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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 Telephone Company, Nevada Bell Telephone Company, Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, Wisconsin Bell, Inc. and The Southern New England Telephone Company.

[2] *Federal-State Joint Conference on Accounting Issues*, WC Docket No. 02-269, et al, Notice of Proposed Rulemaking, FCC 03-326 (rel. Dec. 23, 2003) ("NPRM").

competition between providers of telecommunications services,[3] as required by Section 11 of the 1996 Act.[4] The Commission observed that the existing accounting and reporting requirements had been established when there was a government-sanctioned monopoly provider of telecommunications services and its main function was rate regulation, which required extensive accounting and reporting information. Noting that it could not "retain a particular regulation unless it advances a valid regulatory interest," the Commission concluded that it should streamline its accounting rules and reporting requirements to reflect current regulatory needs in an increasingly competitive environment.[5] It therefore substantially consolidated and streamlined its Part 32 accounting requirements and relaxed its affiliate transactions rules, among other things, eliminating many requirements that the Commission found no longer were in the public interest or served a legitimate federal regulatory purpose.[6]

Less than a year later, in response to the fraudulent accounting schemes of WorldCom, Enron and others, which were then rocking financial markets, the Commission convened the Joint Conference on Accounting Issues ("Joint Conference") to establish an open dialog to determine whether accounting reforms were necessary to ensure that accounting data collected for regulatory purposes is adequate, truthful and thorough.[7]

The Joint Conference, however, has completely disregarded the Commission's charge. Rather than focusing on whether the existing rules are sufficient to ensure that accounting data filed with the Commission is adequate, truthful and thorough to meet the Commission's current regulatory needs, the Joint Conference has sought to turn back the clock on the accounting and

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[3] *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2*, CC Docket No. 00-199, Report and Order, 16 FCC Rcd 19911 (2001) ("*Phase 2 Order*").

[4] 47 U.S.C. § 161.

[5] *Phase 2 Order* at para. 3-4.

[6] *Id.*

[7] *Federal-State Joint Conference on Accounting Issues*, Order, WC Docket No. 02-269, 17 FCC Rcd 17025, ¶ 4 (2002).

reporting reforms adopted little more than two years ago. In so doing, the Joint Conference offers no explanation why the existing rules are insufficient to achieve legitimate federal regulatory objectives. Nor does it explain how the public interest would be furthered by re-imposing burdensome and market-distorting accounting and regulatory reporting requirements on companies that have in no way been implicated in the fraudulent accounting schemes of WorldCom and others that led to the establishment of the Joint Conference in the first place. Indeed, the only justifications proffered are vague references to the needs of state regulatory commissions. But as discussed below, the Commission has a statutory obligation to ensure that its regulations are *necessary* for a *federal* regulatory purpose; it may not impose expansive and burdensome regulatory requirements on carriers solely to meet the needs of state commissions, which, in any event, have authority to request any information they need from carriers in their own jurisdictions. The Commission therefore should reject the Joint Conference's recommendations.

II. THE COMMISSION MAY NOT IMPOSE FEDERAL ACCOUNTING AND REPORTING REQUIREMENTS SOLELY TO MEET THE NEEDS OF STATE REGULATORY COMMISSIONS.

The NPRM seeks comment on whether the "FCC has the authority to adopt accounting and reporting requirements to meet the needs of the state regulatory commissions."[8] It does not. 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."[9] 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"[10] (emphasis added). The statute thus authorizes the Commission to adopt Part 32 accounting and ARMIS reporting requirements only to the extent such rules are

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[8] *NPRM* at ¶ 6.

[9] 47 U.S.C. § 201(b).

[10] 47 U.S.C. § 154(i).

necessary to the execution of the FCC's statutory responsibilities; but it may not establish such rules simply to assist states in applying state law.

The Commission itself has long recognized this limit on its authority. In 1986, for example, the Commission eliminated 10 schedules associated with the annual financial reporting requirements for certain common carriers, despite claims by state regulators that they relied on the reported data in state audits, on the ground that the schedules no longer served a federal regulatory purpose. In particular, the Commission concluded that: "[t]he fact that state commissions may use data contained in Form M for rate case audits is not reason enough to retain this information in a federal report. A state commission that is in need of particular information in a rate case has the authority to request this information from exchange carriers within its jurisdiction."[11]

More recently, in the *Phase 2 Order,* the Commission concluded that it had no authority to establish federal rules for the purpose of implementing state law: "if we cannot identify a federal need for a regulation, we are not justified in maintaining such a requirement at the federal level."[12] And it again observed that the states have independent authority to promulgate rules to carry out state regulatory requirements.[13]

With few exceptions, the Joint conference recommends that the Commission reverse its Phase 2 relief and re-impose all prior accounting and reporting requirements on the large ILECs. In some cases, the Joint Conference justifies its proposals based on the potential needs of state

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[11] *Amendment of Annual Report Form M and FCC Report 901*, CC Docket No. 85-308, Report and Order, FCC 86-97, 1986 FCC LEXIS 3817, ¶¶ 43-51 (1986). See also *1998 Biennial Regulatory Review - Review of Accounting and Cost Allocation Requirements*, CC Docket No. 98-81, Report and Order, FCC 99-106, 14 FCC Rcd 11396, 11413, ¶ 34 (1999) (after finding no federal regulatory purpose, the Commission consolidated the reporting of all non-regulated revenue into one account over objections by the states).

[12] *Phase 2 Order* at ¶ 207.

[13] *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).

cost docket or rate case proceedings.[14] In other cases, the Joint Conference does not even purport to cite a current state need; instead, the Joint Conference proposes that the Commission retain accounts out of fear that the states may be unable to obtain the data themselves.[15] As discussed above, the Commission cannot implement or retain regulation solely for states regulatory needs and it certainly cannot impose regulation based on speculative fears.[16] To do so, would be regulation for regulations sake and contrary to the Commission's statutory obligations and policy. As Chairman Powell rightly observed, "if we don't have a clear and demonstrable justification [for] 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 the rule in for good measure."[17]

Even if the Commission had the authority to impose regulations for states purposes, which it cannot, the Commission still has no justification for implementing the Joint Conference recommendations because the proposals are not necessary in the public interest. For example, the Joint Conference stated that new switching accounts would be helpful for the states determination of universal service cost levels and UNE prices.[18] However, UNE cost dockets referenced in the Joint Conference Report are not based on ARMIS costs. Moreover, the states have had no trouble obtaining requisite cost data and developing forward looking cost models without the creation of new accounts and subaccounts. Furthermore, both UNE and TELRIC rules are under review and changes may occur that may eliminate the states need for additional accounts. Any changes in those requirements and rules could well obviate any purported state need for additional accounts. Additionally, even if the current USOA chart of accounts

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[14] *See* Letter from Federal-State Joint Conference on Accounting Issues to Marlene H. Dortch, Secretary, FCC (Oct. 9, 2003) ("*Joint Conference Report*") at p. 9 (discussing Directory Revenue account), p. 10 (discussing the Customer Services accounts) and p. 16 (discussing Depreciation and Amortization Expense accounts).

[15] *See Joint Conference Report* at p. 17 (discussing the addition of accounts for optical switching, switching software, loop and interoffice transport, interconnection revenue, Universal Service Support revenue and expense).

[16] *See infra* p. 4 and note 11.

[17] "Powell Defines Stance on Telecom Competition," COMMUNICATIONS DAILY, May 22, 2001 at 2-3.

[18] *Joint Conference Report* at p. 18.

prescribed by Part 32 of the Commission's rules may be used to develop certain factors that may serve as inputs to UNE cost studies or USF cost models, the Joint Conference did not explain why the existing accounts under GAAP accounting are insufficient for this purpose.

For the foregoing reasons, the Commission should not adopt the following Joint Conference recommendations: Reinstatement of Account 5230 Directory Revenue, Not Implementing the Phase 2 decision to Consolidate the Depreciation and Amortization accounts, Addition of Optical switching, Switching software, Loop and Interoffice transport, Interconnection revenue, Universal Service Support revenue and expense accounts, and Hybrid fiber/copper loop reporting in ARMIS 43-07. [19]

With regard to the Part 32 6620 series of accounts, the Joint Conference recommended that the Commission request further comment on the consolidation of these accounts. The Commission should consolidate accounts 6621-6623 into account 6620. In light of the *Separations Freeze Order*,[20] the amounts reported in Part 36 do not reflect actual account balances; the account balances reported are based on the ratio of the classifications (Operator Services, Number Services and Other Customer Services) for the period ending December 31, 2000. Therefore, since Customer Service Expense is reported by classification in Part 36 and not by account, the Commission should consolidate these accounts since these accounts no longer provide a view of the actual distribution of dollars in Part 36.

Also, as discussed in the *Joint Petition for Reconsideration*, the Commission should not adopt wholesale/retail subaccounts since they impose unnecessary and burdensome regulation and have no regulatory benefit.[21] However, if the Commission determines that wholesale/retail

[19] SBC discussed each of these issues in detail in its Comments filed January 31, 2003 in the Joint Conference Request for Comment released Dec. 12, 2002. SBC incorporates those Comments by reference and attaches them hereto for the Commission's convenience as Attachment A.

[20] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, 16 FCC Rcd 11382 (2001) ("*Separations Freeze Order*").

[21] *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 Petition for Reconsideration*") at pp. 2-6.

subaccounts are necessary for a federal purpose and it is in the public interest to provide these subaccounts, Accounts 6621, 6622 and 6623 should not be consolidated into 6620 since Accounts 6621 - Call Completion Services and 6622 - Number Services are not required to be offered as UNEs.[22] Because of SBC's nondiscriminatory obligations to offer wholesale Operator Services and Directory Assistance ("OS/DA") under Section 251(b)(3), SBC utilizes the same resources to provide retail and local wholesale operator and directory assistance services. As a consequence, SBC cannot segregate the resources and expenses used to provide these services between retail and local wholesale. As such, a wholesale sub-account for expenses in accounts 6621 and 6622 is not possible, and would be of no value.

III. THE JOINT CONFERENCE'S PROPOSED CHANGES TO THE AFFILIATE TRANSACTIONS RULES ADD ILEC COSTS WITH NO CORRESPONDING BENEFITS.

The Joint Conference also proposes to eliminate the reforms to the affiliate transactions rules that the Commission adopted in the *Accounting Safeguards Order* and the *Phase 2 Order* based on speculation that ILECs might engage in "anti-competitive behavior" or misallocate costs in transactions with their affiliates.[23] At least with respect to price cap carriers, like SBC, these speculations are baseless. As discussed below, price cap carriers have no incentive or ability to misallocate their costs in affiliate transactions. Consequently, the Commission should reject the Joint Conference's proposal to reinstate the prior affiliate transaction regime, at least insofar as it would apply to price cap carriers.

The previous affiliate transaction rules were adopted in 1987 to protect the ratepayers of regulated telecommunications services from bearing the costs and risks associated with a

[22] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advances Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, ¶ 560 (2003) ("*Triennial Review Order*"). *See also Joint Conference Report* at p. 10.

[23] *Joint Conference Report* at pp. 23, 26. The Joint Conference cannot seem to make up its mind about the purported risk of anticompetitive behavior posed by the existing rules. Indeed, they argue variously that ILECs could shift costs either to or from their non-regulated affiliates. As discussed below, price cap ILECs have neither the incentive nor the ability to engage in either behavior.

carrier's non-regulated activities under rate-of-return regulation.[24] Since that time, the Commission has replaced the old rate-of-return model for carriers serving most of the nation's lines with price cap regulation, eliminating incentives and the ability to misallocate costs. As the Commission itself has acknowledged, "[b]ecause price cap regulation severs the direct link between regulated costs and prices, a carrier is not able to recoup misallocated nonregulated costs by raising basic service rates, thus reducing the incentive for the BOCs to allocate non-regulated costs to regulated services."[25] It further has recognized that a system of pure price caps, such as that applicable to SBC and other ILECs, "effectively eliminates any incentive for cost shifting."[26]

While the Commission's price cap rules alone prevent ILECs from misallocating costs in affiliate transactions, other Commission safeguards provide additional protection. In particular, these transactions are scrutinized at a minimum, every two years, in Cost Allocation Manual audits,[27] in which the auditors review an ILEC's affiliate transactions pricing methodology, and must disclose even the appearance of impropriety.[28] Thus, there is no credible basis for concluding that price cap ILECs, like SBC, could misallocate costs or engage in other anticompetitive behavior in affiliate transactions, as the Joint Conference speculates. Therefore,

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[24] *See Separations of Costs of Regulated Telephone Service from Costs of Nonregulated Activities*, CC Docket No. 86-111, Report and Order, 2 FCC Rcd 1298 (1987) ("*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.

[25] *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, FCC 96-309 at para. 136 (1996), citing *Computer III Remand Proceedings: Bell Operating Company Safeguards*, 6 FCC Rcd 7571, 7596 (1991). *See also United States v. Western Electric Co., et al.*, 993 F.2d 1572, 1580 *cert. denied*, 114 S. Ct. 487 (1993) ("[Price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling").

[26] *Policies and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd 2873, 2924 (1989); *Price Cap Performance Review for Local Exchange Carriers*, 10 FCC Rcd 8962, para. 187 (1995).

[27] 47 CFR § 64.904.

[28] In addition, affiliate transactions between an ILEC and its Section 272 affiliates are also subject to review in the 272 Biennial audits required by Section 272(d) of the Act.

the Commission should reject the Joint Conference proposals and continue its deregulatory efforts to streamline these burdensome and unnecessary rules for price cap carriers.

IV. THE COMMISSION SHOULD NOT IMPLEMENT THE JOINT CONFERENCE RECOMMENDATION TO APPLY 47 CFR §32.11 TO ILECS AS DEFINED IN SECTION 251(H).

The Commission should reject the Joint Conference's proposal that the Commission apply its accounting and reporting requirements to all ILECs as defined in Section 251(h). The Joint Conference argues that limiting the definition of ILEC would allow ILECs to avoid their regulatory obligations by transferring discrete services to affiliates.[29] However, the Commission justified its imposition of Part 32 accounting requirements on "ILECs" on the ground that they are dominant in their markets. And, as discussed below, the fact that an ILEC affiliate might meet the definition of an "ILEC" under Section 251(h) says nothing about whether it is dominant in any relevant market. Consequently, the Commission should not extend burdensome Part 32 accounting requirements to an ILEC affiliate simply because the ILEC transferred a service or asset to that affiliate.

In the *Phase 2 Order*, the Commission concluded that Section 32.11 of its rules should be amended to specifically apply only to ILECs on the ground that *they are dominant in their markets.*[30] In amending its rule, the Commission incorporated by reference 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. Section 251(h), however, is inappropriate to determine which entities should be subject to the Commission's accounting rules because it provides no indication whether a particular entity is dominant in any market.

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

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[29] *Joint Conference Report* at p. 34.

[30] *Id.* at ¶ 126.

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)."[31] The fact that a carrier meets the foregoing definition says nothing about whether that carrier is "dominant" in the markets in which it operates.

The purpose of the Commission's accounting requirements is to protect ratepayers from "unjust and unreasonable interstate rates."[32] However, under the current version of the rule, an entity would be subjected to the Part 32 accounting requirements without regard to whether that entity has an impact on rates. This is an unreasonable application of the Commission rules and contrary to their underlying purpose. For example, if an ILEC transfers a switch to an affiliate and that switch only serves a few lines, under the amended version of the rule, the affiliate would become subject to Part 32 accounting requirements and must incur the expenses of implementing those requirements for an insignificant operation. In this context, subjecting this affiliate to what has historical been viewed as dominant carrier regulation, is unnecessary and serves no regulatory purpose since this affiliate has no market power to affect rates for that market.

The Commission's analysis in the *Phase 2 Order* agrees with this approach as it recognized that the accounting rules have historically applied to ILECs because they were dominant in their markets.[33] This approach is also consistent with the Commission's determination that a carrier is "dominant" if it has market power, that is, the ability to restrict output and thus raise prices in a relevant market.[34] Thus, the Commission should align Section

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[31] 47 U.S.C § 251(h)(1).

[32] *See Joint Cost Order* at ¶ 32.

[33] *Phase 2 Order* at ¶ 126.

[34] 47 C.F.R. § 61.3(q).

32.11, as amended, with the underlying purpose of accounting regulation and 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 adopt a structure that is similar to dominant carrier tariff filing requirements[35] and clarify that the accounting rules apply only to ILECs as who are dominant in their markets.

V. THE COMMISSION SHOULD NOT IMPLEMENT THE "LOOP SHEATH KILOMETERS" REPORTING REQUIREMENT.

While the Joint Conference took no position on this issue[36], the Commission should reconsider its ruling in the *Phase 2 Order* that changed the first section in Table II of the ARMIS 43-07 Infrastructure Report from total "Sheath Kilometers" to "Loop Sheath Kilometers." As discussed in the *Joint Petition for Reconsideration*, the Commission failed to provide any justification for imposing this new requirement on the ILECs, and ignored the significant costs ILECs would incur to implement this requirement.[37] Accordingly, and for the reasons stated in the *Joint Petition for Reconsideration*, the Commission should reconsider its decision to change the first section in Table II of the ARMIS 43-07 Infrastructure Report from total "Sheath Kilometers" to "Loop Sheath Kilometers."

VI. THE COMMISSION SHOULD DEFER IMPLEMENTATION OF THE PENDING ACCOUNTING AND REPORTING CHANGES UNTIL JANUARY 1, 2005.

Finally, the Commission should defer implementation of the pending accounting and reporting requirements until the start of the next fiscal year, *i.e.*, January 1, 2005. This suspension serves the public interest by avoiding the expenses associated with capturing and reporting data for two sets of accounting records if the ILECs were required to implement the pending requirements on July 1, 2004, as currently required.[38] Furthermore, this suspension

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[35] 47 C.F.R. § 61.31-61.59.

[36] *Joint Conference Report* at p. 31.

[37] *See Joint Petition for Reconsideration*" at pp. 7- 9 (Verizon estimating that the analysis would cost $5.5M).

[38] *Federal-State Joint Conference on Accounting Issues*, Order, WC Docket No. 02-269, et al, FCC 03-325 (rel. Dec. 23, 2003) (further suspending implementation of accounts and reporting requirements through June 30, 2004).

eases the burden on the Commission and states since it limits their evaluation to one set of books rather than two.

VII. CONCLUSION.

The Commission should reject the Joint Conference Report since it requires the Commission to step backwards and depart from the Commission's pro-competitive, deregulatory policy. Instead, the Commission should continue streamlining its accounting and ARMIS reporting requirements and reinstate Phase 3 of the Biennial Review proceeding.

Respectfully submitted,

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