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 VERIZON TO NOTICE OF PROPOSED RULEMAKING

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COMMENTS OF VERIZON[1] TO
NOTICE OF PROPOSED RULEMAKING[2]

I. Introduction and Summary

Pursuant to the deregulatory nature of the Act, and of Section 11 in particular,[3] the Commission has a duty to *eliminate* unnecessary accounting requirements. Approximately two years ago, after issuing a notice of proposed rulemaking, developing a comprehensive record,

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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*, WC Docket No. 02-269, Notice of Proposed Rulemaking, FCC 03-326 (rel. Dec. 23, 2003) ("*Accounting NPRM*").

3 "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." *Federal-State Joint Conference on Accounting Issues*, Request for Comment, 17 FCC Rcd 24902, at 1 (2002) (*citing* 47 U.S.C. § 161).

and carefully considering comments from more than 35 different commenters, the Commission found there was no *federal* need for certain of its accounting and reporting rules, and it therefore eliminated them.[4] Many of the Joint Conference's recommendations suggest that the Commission revisit (and undo) those prior decisions.[5] It should decline to do so.

The Commission should not retreat from its prior findings to reinstate accounting regulations for which it has already found there is no *federal* need. The Commission needs to provide regulatory certainty with its accounting rules and reporting requirements. Verizon and other incumbent carriers have already devoted time and resources to modify their methods, procedures and systems to implement the changes to the Commission's accounting rules that were ordered about two years ago. If the Commission were to flip-flop now, the industry would need to devote additional time and resources to modify these processes again. The Commission has, in other contexts, recognized the benefits of maintaining regulatory certainty in accounting practices. *See, e.g., Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers,* 16 FCC Rcd 19613 ¶¶259-60 (2001) ("[t]he Commission found that freezing the jurisdictional separations factors for a period of five years (or until a comprehensive reform of separations can be completed) would promote stability and regulatory certainty for carriers").

Any commenter that seeks to reestablish accounting regulations that already have been eliminated bears the heavy burden of presenting recent and compelling evidence of a *federal* need for each such regulation. As the Commission itself recently stated, those who argue that

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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 (2001) ("*Phase 2 Order*").

5 Recommendation by Joint Conference, *Accounting NPRM*, Appendix A ("Joint Conference Recommendations").

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." *Phase 2 Order* ¶ 209. Moreover, "any unnecessary regulation places a corresponding, unnecessary burden on the carriers that are subject to it." *Id.* ¶ 2. In the absence of recent and compelling evidence, the Commission cannot reverse course just two years after finding that there was no federal need for such regulations.

Consistent with the Act's mandate to eliminate unnecessary regulations, Verizon supports the Joint Conference's recommendations that fulfill this statutory duty and seek elimination of unnecessary accounting requirements. Conversely, Verizon opposes the Joint Conference's recommendations that seek to reestablish accounting requirements that serve no *federal* regulatory purpose, particularly since the Commission has already found them to be unnecessary and has eliminated them. The major Joint Conference proposals are addressed below; Attachment B to these Comments addresses other proposed rule changes.

In addition, the Commission should reject suggestions to add even more regulations contrary to clear Congressional intent. As the Commission has recognized, most of the regulatory accounting requirements reviewed by the Joint Conference were based on "original justifications" that "may no longer be valid," and impose inordinate burdens on only one class of carriers. *See Phase 2 Order* ¶ 206. Specifically, the *regulatory* accounting and ARMIS reporting requirements were created for entirely different purposes than *financial* accounting requirements and those purposes no longer exist.

Instead, the Commission should continue to streamline the accounting and reporting regulations, so that the ARMIS and Class A accounting requirements, which apply to only a handful of larger ILECs, are more in line with reporting standards used by the rest of the industry. In particular, the Commission should adopt the less-detailed "Class B" accounts for all carriers that are still subject to the Part 32 accounting rules. Ultimately, the goal should be to explore situations where it makes sense to transition away from separate regulatory accounting and allow all carriers to operate pursuant to Generally Accepted Accounting Principles ("GAAP").

II. The Commission Should Not Maintain or Adopt Regulations Unless Commenters Present Substantial Evidence That They Are Necessary for a Federal Purpose.

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). Moreover, as the Commission has recognized, the burden is on those who wish to retain regulations to show substantial evidence – not just speculation – as to why they are necessary to achieve a *federal* purpose. In other words, as the Commission has previously recognized, "if we cannot identify a federal need for a regulation, we are not justified in maintaining such a requirement at the federal level." *See Phase 2 Order* ¶ 207. In addition, claims that a regulation is "necessary" must rest on more than just "predictive judgment" – commenters must provide evidentiary support both for the existence of the problem and for the proposition that its regulation is an essential part of the solution.

As the D.C. Circuit explained in *Sinclair*, the Section 11 review "carries with it a presumption in favor of repealing or modifying" the rules.[6] 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.

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).

Moreover, even under the lower standard articulated by the Commission in the 2002 Biennial Review (which Verizon has challenged on appeal), the Commission could not reinstate any rules that would not serve a federal purpose. As the Commission explained, the standard for whether a rule should be repealed is the same public interest standard as "that required for the Commission to adopt a rule in the first instance."[7] In the absence of any evidence that a rule serves a federal purpose, the Commission would not be able to promulgate that rule under its own Section 11 standard.

The rules that the Commission already has eliminated are not necessary to achieve a *federal* purpose. The existing accounting requirements, as well as ARMIS reporting requirements, are relics of rate of return regulation and have very limited value for carriers that

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6 *See Sinclair Broadcast Group, Inc. v. FCC*, 284 F.3d 148, 159 (D.C. Cir. 2002) Although Sinclair involved Section 202(h), which covers the FCC's broadcast ownership rules, as the text of that section makes clear, the FCC's review of the broadcast ownership rules is "part of its regulatory reform . . . under Section 11." 1996 Act, § 202(h).

7 *The 2002 Biennial Regulatory Review*, 18 FCC Rcd 4726 at ¶ 13 (2003).

are subject to federal price cap regulation, because their rates are not based upon revenue requirements. *See* Verizon Comments to Joint Conference, WC 02-269, at 7 (filed Jan. 31, 2003) and Verizon Reply Comments to Joint Conference, WC 02-269, at 3 (filed Feb. 19, 2003). With the growth of competition, this value will continue to decline, because rates increasingly should 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. Therefore, these rules have no continued value even for *regulation*. Indeed, arguments to continue (and, in fact, increase) these obligations for new intrastate purposes merely highlight the fact that these rules are no longer necessary with regard to their original purpose – to support federal rate of return 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. *See* Verizon Comments to Joint Conference at 8.

The Commission has asked for comment on the Joint Conference's "understanding that the Commission has authority to adopt accounting and reporting requirements in the absence of a federal need." *Accounting NPRM* ¶ 6. In particular, the Commission notes that "the Joint Conference asserts that the Commission has the authority to adopt accounting and reporting requirements to meet the needs of state regulatory commissions and other stakeholders." *Id.* These aspects of the Joint Conference's recommendations are at odds with the Act, and with this Commission's prior statements on the purposes of biennial review. As the Commission already has recognized, it cannot adopt the Joint Conference's recommendations that are designed to meet the needs of state regulators or other stakeholders.[8]

If the accounting rules serve no *federal* regulatory purpose, they should not be created or retained based on arguments that they might conceivably be used for non-regulatory oversight. For example, the Joint Conference points to "the financial and accounting scandals that rocked the telecommunications industry" as one bases for continued regulation. Joint Conference Recommendations at 7. But the simple fact is that the regulatory accounting rules have *no* potential value for that purpose. 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.

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* ¶ 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 Commission'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

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8 If the Commission 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* ¶ 207.

federal requirement under the Act, especially where (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. *See* Verizon Comments to Joint Conference at 10.

The Joint Conference notes that the Court in *Louisiana* recognized the realities of technology and economics make a clean parceling of responsibility between the state and federal jurisdictions difficult. Joint Conference Recommendations at 7. But this difficulty cannot convert a purely state need into a federal need. In addition, just because many states face the same situation does not make it a federal issue. For example, only the states have a duty to set rates for UNEs, so there is no need to make a "clean parceling of responsibility" between the states and the Commission.

Using federal requirements to satisfy the states' desires not only would violate Section 11, but would be inappropriate as a matter of policy as well. Attempting to draft one set of "national" accounting and reporting rules to solve 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, CC 00-199, at Att. B (filed Apr. 8, 2002) ("Joint ILEC Phase 3 Comments"), which lists the state-specific reporting requirements.

More importantly, the needs of the states and other stakeholders in many cases are best met, and are already being met, through methods *other than* accounting regulations and ARMIS reporting. 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* Verizon Reply Comments to Joint Conference, at 7. *See also* Phase 3 Comments of ITTA, CC 00-199, at 3 n.10 (filed Apr. 8, 2002) (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, CC 00-199, at 6 (filed Apr. 4, 2002). *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 Commission's August 2003 study on Trends Telephone Service (*available at* http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend803.pdf) contains over 90 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.[9]

Therefore, the only proper purpose of the FCC's accounting rules is to meet specific *federal* needs in regulating the telecommunications industry. Where those needs do not exist, the rules are no longer "necessary" and must be repealed. In considering the Joint Conference's recommendations, the Commission should undertake a presumption of deregulation. Moreover, the Commission should reject any recommendations to retain existing regulations that are not based on the clear evidence that the regulations are necessary to serve a *federal* purpose. *See* Verizon Comments to Joint Conference at 8.

III. The Commission Should Not Adopt More Stringent Standards for Affiliate Transactions.

The Commission should adopt the Joint Conference's recommendation to continue to exempt the first $500,000 of asset transfers from a comparison between net book cost and fair market value. See Section III.A. However, it should reject those Joint Conference recommendations that would eliminate much of the flexibility in certain of the affiliated transaction rules. These recommendations are based only on the Joint Conference's speculation that, absent more stringent rules, the existing rules might "open[] the door to" certain potential harmful behavior. See Joint Conference Recommendation at 23. However, there is no indication that any of these potential problems actually exists. The Commission specifically considered and rejected some of the limits on affiliate transactions that the Joint Conference

[9] Table T7.1 attempts to extrapolate the total of U.S. telephone lines by using the figures from only some carriers reported in ARMIS. The other three, T17.1 (Central Offices and Access Lines by Technology), T17.2 (Features Available in Central Offices), and T17.4 (Local Transmission Technology) are limited to data from the former Bell operating companies and make no attempt to include the rest of the industry.

recommends. See, e.g., Phase 2 Order ¶ 86 ("we take a number of steps to simplify our affiliate transactions rules so that carriers have greater flexibility in how they price transactions with affiliates"). Without evidence – as opposed to conjecture – that the potential harms raised by the Joint Conference are occurring, there is no reason for the Commission to consider imposing more stringent limits on affiliate transactions. Indeed, the Commission should grant ILECs more flexibility in dealing with affiliates, by eliminating the existing reporting requirements regarding transactions between an ILECs' nonregulated activities and its nonregulated affiliates. See Section III.E.

A. The Commission Should Adopt the Joint Conference's Suggestion To Continue to Exempt The First $500,000 Of Asset Transfers From A Comparison Between Net Book Cost and Fair Market Value.

Verizon supports the Joint Conference's recommendation "that the FCC affirm its decision as announced in the *Phase II Report and Order,*" allowing incumbent carriers to transfer up to $500,000 of assets in a single year to an affiliate without performing a comparison between net book costs and fair market value. *See* Joint Conference Recommendation at 21; *see also* Verizon Comments to Joint Conference, Appendix at 1. In its *Phase 2 Order*, the Commission found that the threshold for fair market valuations should be $500,000 for assets, and that "the administrative cost and effort of making such a determination [below the threshold] would outweigh the regulatory benefits of a good faith determination of fair market value." *Phase 2 Order* ¶ 89. There is no reason for the Commission to reexamine that finding.

B. The Commission Should Retain the Long-Standing Practice of Allowing Carriers to Price Centralized Services at Cost, Rather than Requiring the Carriers To Apply an Estimated Fair Market Value Rule.

The Commission should continue to allow incumbent carriers to provide centralized services at fully distributed costs without requiring a fair market value analysis. When the Commission first adopted the fair market value rules for affiliate transactions in 1996, it decided *not* to apply a fair market value requirement to centralized services. As was the case before the 1996 order, and indeed has been the case since the first affiliate rules were first established in 1987,[10] the Commission confirmed that incumbent carriers could continue to provide centralized services to their affiliates at cost pricing:

> We find that when an affiliate is established to provide services solely to the carrier's corporate family in an effort to take advantage of economies of scale and scope, the benefits of such economies of scale and scope are reflected in such affiliate's costs and are ultimately transferred to ratepayers through transactions with the carrier for such services valued at fully distributed costs. Requiring carriers to perform fair market valuations for such transactions would increase the cost to ratepayers while providing limited benefit.

Implementation of the Telecommunications Act of 1996: Accounting Safeguards under Telecommunications Act of 1996, 11 FCC Rcd 17539 ¶ 148 (1996) ("*Accounting Safeguards Order*").

The Joint Conference recommends that the Commission revisit the exception "in light of the concerns raised by the accounting scandals of recent years." Joint Conference Recommendations at 26. According to the Joint Conference, "[t]he exception confers on the carrier in its holding company the opportunity to have the carrier pay in excess of market prices

[10] *See Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and Their Affiliates*, Report and Order, 2 FCC Rcd 1298, ¶ 299 (1987).

for services obtained from an affiliate." *Id.* There is no reason for the Commission to revisit this issue.

First, the financial difficulties and accounting irregularities of certain telecommunications carriers involve financial accounts, and have nothing to do with the Commission's federal *regulatory* accounting and ARMIS reporting requirements. The problems highlighted by these companies are not unique to the telecommunications industry – much less, to a handful of specific Class A carriers – and cannot be used to justify retaining or adding Commission regulations. In fact, carriers have been using cost-based pricing for centralized services for decades, and the Joint Conference offers no evidence of abuses that occurred as a result of the centralized services pricing rules. Moreover, any concerns about accounting irregularities can be (and are being) addressed by Congress and the Securities and Exchange Commission, so that they can be applied to *all* publicly reported companies, not just a small subset of telecommunications carriers. There is no reason for the Commission to duplicate those efforts through the adoption of regulations that would only apply to a handful of carriers, and that would not be targeted to address the specific problems at issue in those scandals. *See* Verizon Comments to Joint Conference at 8-9.

Second, eliminating the exception would be costly for both ratepayers and carriers.

Under price cap regulation, carriers already have strong incentives to reduce their costs. This incentive drives carriers to achieve economies of scale and scope by obtaining services on a centralized basis from an affiliate. These economies are reflected in the centralized service affiliate's costs and are passed on to the affiliated carriers through cost pricing. Ratepayers, in turn, benefit from these economies. Indeed Commissioner Martin noted that "in the 1996 rulemaking, the Commission found that the central services organization exemption would benefit consumers by allowing incumbent LECs to take advantage of economies of scale and scope." Joint Conference Recommendations, Separate Statement of Commissioner Kevin J. Martin, note 3.

Requiring centralized services affiliates to perform fair market value analyses would lead to unnecessary costs and waste resources. It is also unlikely that market studies would result in identifying many services that could be provisioned at costs lower than those provided by the service company, so the rule would provide limited potential benefit.

Third, in many cases, it is simply not possible to develop a meaningful fair market value for those services provided on a centralized basis. Centralized service organizations often provide services to incumbent carriers that simply aren't available in the market. As the Commission noted, "insufficient third-party sales exist to substantiate a prevailing price for these services that are often tailored to the corporate family's unique needs." *Accounting Safeguards Order* ¶ 148. Furthermore, many of the services such as corporate governance and strategic planning are proprietary to the corporation and are tailored to service its unique needs. When a service is not available in the open market, it is difficult, and in certain cases nearly impossible to develop reliable estimates of fair market value. For example, the Joint Conference does not suggest how Verizon could put a fair market price on corporate governance services, such as the staff functions necessary to ensure that Verizon complies with its numerous regulatory requirements, or the unique engineering skills that are needed to design large ILEC networks.

Finally, the exception does not create opportunities for carriers to manipulate their financial statements. Centralized service organizations are required to set their charges to incumbent carriers at fully distributed costs ("FDC"). FDC requirements require the centralized service organization to allocate its costs to its services on a consistent basis. There is therefore no opportunity for manipulating financial statements.

C. The Commission Should Continue to Allow Carriers to Use the Higher or Lower of Costs or Market Valuation as Either a Floor or Ceiling In Affiliate Transactions.

The Commission should continue to give carriers the flexibility to use the higher or lower of cost or market valuation as either a floor or ceiling in affiliate transactions. In its *Phase 2 Order*, the Commission found that this flexibility "would not harm ratepayers because it would permit the regulated carrier to either pay less or charge more to the nonregulated affiliate for the service or asset." *Phase 2 Order* ¶ 92. Moreover, this flexibility is appropriate because not all nonregulated affiliate accounting systems can easily calculate all the components of FDC charges. *See* Verizon Comments to Joint Conference, Appendix at 1. 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. The Commission's creation of this flexibility for affiliate transactions was therefore consistent with its obligations under the Act.

The Joint Conference recommends that the Commission eliminate this flexibility. The only justification for this recommendation is the theoretical concern that the current rule "opens the door to anti-competitive behavior." Joint Conference Recommendations at 23. According to the Joint Conference, this flexibility "confers on the ILEC the discretion to choose any price that is below the ceiling, without consideration being given to the incremental cost." *Id.*

The Joint Conference, however, provided no evidence that such flexibility has resulted in any anti-competitive behavior. Moreover, the Commission already has considered and rejected the arguments offered by the Joint Conference. The Commission found that "[i]t seems unlikely, however, that a transaction would have such an [anti-competitive] effect, particularly if the transaction is *de minimis* and is not priced below incremental cost." *Phase 2 Order* ¶ 92.

D. The Commission Should Continue to Allow Carriers to Qualify for Prevailing Price Valuation of Affiliate Transactions When At Least 25 Percent of Sales of a Particular Asset or Service Are Made to Third Parties.

The Commission should continue to allow carriers to use prevailing price valuation for affiliate transactions where at least 25 percent of sales of the particular asset or service are made to third parties. In its *Phase 2 Order*, the Commission set the threshold at 25 percent because it "ensure[s] that sufficient transactions occur with unaffiliated parties to produce a reasonable surrogate of a true market price." *Phase 2 Order* ¶ 94. The Commission's reduction of this threshold (from 50 percent to 25 percent) was consistent with the Commission's obligations under the Act. *See* Verizon Comments to Joint Conference, Appendix at 1.

The Joint Conference recommends that the Commission reverse its position, and raise the threshold back to 50 percent. In support of its recommendation, the Joint Conference argues that "an ILEC *could* strategically underprice a relatively small amount of a particular service or asset to gain an offsetting concession from [a] third party, and at the same time confer on its affiliate a competitive advantage." Joint Conference Recommendations at 24 (emphasis added). The Commission, however, has already considered and rejected this argument. The Commission found that it would not be "a sustainable strategy for a firm significantly to underprice transactions with 25 percent of its customers in order to be able to record transactions at that price with an affiliate." *Phase 2 Order* ¶ 94.

The Commission's prediction has proven correct. There is no showing of abuse with the 25% threshold and the Joint Conference offers no evidence that carriers are engaging in the sort of transactions it speculates might occur under the 25 percent threshold. In the absence of any such evidence, there is no federal regulatory need to increase the threshold.

E. The Commission Should Eliminate The Existing Affiliate Transaction Requirements For Transactions Between an ILEC's Nonregulated Activities And its Nonregulated Affiliates.

The Commission should exempt from the affiliate transaction rules transactions between an ILEC's nonregulated activities and its nonregulated affiliates. Although the Commission had proposed eliminating these requirements in its *Notice*, the Commission did not adopt its proposal in its *Phase 2 Order.* Rather, the Commission "defer[red] action on this proposal, as it raises broader issues that should be considered in a more comprehensive fashion." *Phase 2 Order* ¶ 100. The Joint Conference recommends that the Commission maintain the current reporting requirements for transfers of nonregulated ILEC activities to nonregulated affiliates. However, that recommendation should be rejected.

Neither the Commission, nor the Joint Conference, identified any *federal* regulatory need for this reporting requirement. The Joint Conference simply argues that "[w]ith the increased re-integration into BOCs of affiliates that have previously been separate affiliates (*e.g.*, long-distance, advanced services), retention of this rule is necessary to prevent manipulation of costs and revenues associated with affiliate transactions." Joint Conference Recommendations at 26. However, this argument misunderstands the entire premise of the rule. Where a separate affiliate has been re-integrated into a BOC, there is no longer a separate affiliate and no transactions with that separate affiliate to report under the Commission's current rules. The rule simply does not come into play based on the concerns raised by the Joint Conference. In addition, the rule already does not apply to transactions between two nonregulated affiliates. *See* 47 C.F.R. § 32.27.

Rather, this rule change would apply only to an ILEC's nonregulated transactions with its nonregulated affiliates. It is hard to imagine how such a transaction could affect ratepayers. So long as the nonregulated activities are properly accounted on the carrier's books, the transactions between an ILEC's nonregulated activities and its nonregulated affiliates has no bearing on the rates for regulated services.

In the absence of a federal regulatory need, the Commission should not retain the current reporting requirements for transactions between an ILEC's nonregulated activities and its nonregulated affiliates. The Commission should therefore exempt these activities from the affiliate transaction requirements.

F. The Commission Should Not Apply Affiliate Transaction Rules To Transactions Between Incumbent Carriers Within The Same Holding Company.

The Commission should not expand its affiliate transaction rules to apply to transactions between incumbent carriers within the same holding company. In these transactions, neither carrier has an incentive to distort the value of the services or assets. Under federal price cap regulation, neither carrier can affect the prices charged ratepayers by mis-valuing these transactions. As Commissioner Martin explained, "[t]he Commission has never applied the affiliate transactions rules to these types of transactions" and "it is not clear to me that the benefits of extending the affiliate transactions rules into this area outweigh the costs." Joint Conference Recommendations, Separate Statement of Commissioner Kevin J. Martin at 1-2.

The only rationale offered by the Joint Conference to support its recommendation is that "[t]he opportunity for cost manipulation *could* permit a holding company to artificially manipulate earnings among its ILECs as a means of gaming different regulatory issues in different states." Joint Conference Recommendations at 27 (emphasis added). Again, this rationale is based entirely on speculation. *See* Verizon Reply Comments to Joint Conference at 9. The Joint Conference provides no evidence that any incumbent carriers *are* engaging in such cost manipulation or (if any were) that the only way to solve such a problem would be to saddle all incumbent carriers with burdensome new regulations.

Moreover, this rationale does not establish a *federal* need for a new regulation. To the extent the Joint Conference raises concerns about the potential for gaming "regulatory issues in different *states*," those issues are best addressed at the state level.

IV. The Commission Should Not Reinstate Part 32 Accounts That Have Already Been Eliminated, or Impose Additional Reporting Requirements.

The Commission has already identified Part 32 accounts that are no longer necessary and repealed them pursuant to Section 11. The Joint Conference recommends that the Commission reinstate certain of these Part 32 accounts. For the reasons explained in the Appendix to these Comments, the Commission should not 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.

In its *Phase 2 Order*, the Commission eliminated or consolidated several Part 32 accounts because there was no regulatory benefit from a federal perspective associated with maintaining these accounts. In the approximately two years since the Commission made those determinations, there have been no allegations of abuse that would warrant recreating those accounts. To the extent any states desire the information reported in those accounts, they can obtain that information directly from the incumbent carriers.

In addition, the Commission should not impose additional reporting requirements for which there is no *federal* regulatory need. Given the deregulatory mandate of the Act, and of

Section 11 in particular, it would be inappropriate to impose new reporting requirements, especially those the Commission has already eliminated as unnecessary.

As explained more fully in the Appendix, there is no reason for the Commission to impose dominant carrier regulations on incumbent carriers when they are operating markets that are competitive or to impose broadband reporting requirements on incumbent carriers that are more onerous than the reporting requirements of their competitors.

V. The Commission Should Eliminate Additional Regulations that Are Not "Necessary."

The Commission should eliminate the detailed continuing property record rules and improve the forecasting requirements for nonregulated usage of central office and outside plant. In addition, the Commission should begin the effort to phase out the Class A accounting and ARMIS regulations in favor of accounting and reporting regulations similar to those used by other industry players.

A. The Commission Should Eliminate Detailed Continuing Property Records Rules.

The Commission should go forward with its tentative conclusion to eliminate the detailed rules relating to continuing property records (47 C.F.R. § 32.2000(f)). *See Phase 2 Order* ¶ 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).

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. *See* Verizon Comments to Joint Conference at 16. With rates no longer tied directly to costs, such micromanagement of carriers' plant assets serves absolutely no *federal* 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, carriers' obligations to maintain standard records for financial reporting pursuant to GAAP provides assurance that costs for physical plant are accurately stated as inputs for revenue requirements. *See id.* at 12.

Moreover, elimination of the continuing property record detailed *rules* will not result in the elimination of the continuing property records themselves, as some parties have alleged. *See, e.g.*, NARUC Phase 3 Comments, CC 00-199, at 20-22 (filed Apr. 8, 2002). 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, ILECs' competitors, who continue to insist that ILECs be saddled with burdens they themselves do not face.

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* ¶ 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, CC 99-301, at 8-11 (filed Mar. 1, 2002), Joint ILEC Phase 3 Comments at 9-13.

B. The Commission Should Modify 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 and is subject to Section 64.901(b)(4) forecasting, and is allocated using the higher of forecast or actual usage. In the *Phase II* proceeding, several carriers asked the Commission to replace the forecasting with actual usage.[11] 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* ¶ 124. However, a one-time three-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.

C. The Commission Should Streamline Its Part 32 Accounting Rules with a Goal of Eventually Transitioning to More Standard Industry Accounting.

The Commission should begin streamlining its Part 32 accounting rules, with the goal of eventually allowing all carriers to operate pursuant to standard industry accounting requirements that nearly all telecommunications carriers in the competitive arena already follow. In particular, the Commission should go beyond its elimination of certain Class A accounts and allow all carriers, including the large local exchange carriers, to keep their accounts at the Class B level of detail. Ultimately, many regulatory needs can be met through GAAP accounting.

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[11] *See* Phase 2 Comments of Verizon at 10 and Qwest at 11 (CC 00-199, filed Dec. 21, 2000), showing that at least 95%-97% of nonregulated central office and outside plant accounts resulted from direct assignment and not from the forecasting process.

The Class A accounts serve no regulatory purpose, and should be eliminated in favor of Class B accounting. There is no schedule for updating the universal service proxy model's cost inputs, and doing so does not require reliance on the local exchange carriers' actual costs. To the extent that the Commission uses the carriers' costs for inputs such as overhead loading factors and expense ratios, these can be developed from Class B accounts and special studies. For example, the overhead factors used as inputs to the model today are taken from "subject to separations" data, which are derived from Class B accounts. *See Federal-State Joint Board on Universal Service*, Tenth Report and Order, 14 FCC Rcd 20156, n.838 (1999).

Although the state commissions have in the past argued that they need Class A data for ratemaking and universal service proceedings, they concede that the carriers maintain underlying data more detailed than the Class A accounts. *See* Florida Phase 2 Comments, CC 00-199, at 6 (filed Dec. 18, 2000); Idaho PUC Phase 2 Comments, CC 00-199, at 4-5 (filed Dec. 21, 2000); Maryland PSC Phase 2 Comments, CC 00-199, at 4 (filed Dec. 21, 2000).

Specific cost factors for deriving UNE rates are not applied to 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.[12] And 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. *See* Verizon Comments to Joint Conference at 15. Moreover, without Class A accounts, carriers will continue to maintain the underlying detail required for business purposes.

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[12] 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.

More to the point, the existing accounting rules 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. Incumbent carriers now face significant competition not only from each other and competing carriers, but also from cable television companies and wireless carriers.[13] Such competition makes "cost shifting" – the original rationale for imposing Part 32 accounting and ARMIS reporting requirements – improbable. In addition, elimination of the lower formula adjustment and sharing, and implementation of the CALLS plan, reduced incentives to shift cost and eliminate any tie between rate development and the Commission's accounting and reporting rules. Therefore, the Commission should begin to phase out existing Class A requirements, especially for price cap regulated carriers. *See* Verizon Comments to Joint Conference, at 13.

D. The Commission Should Eliminate Unnecessary ARMIS Reporting Requirements

The Commission also should eliminate unnecessary ARMIS reporting requirements. The information that Class A carriers must report in ARMIS is far more than is needed for *federal* 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. Even where the

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[13] One industry analyst just stated that cable-based IP telephony would be available to 82% of U.S. households by the end of 2005 and that, as a result of the MSOs' IP deployment plans, "the cable telephony threat to the RBOCs is nearly 70% greater than we had previously expected." Bernstein Research Call, *U.S. Telecom and Cable: Faster Roll-out of Cable Telephony Means More Risk to RBOCs; Faster Growth for Cable*, at 1 (Dec. 17, 2003). In addition, one recent study concludes that average long distance minutes of use per subscriber have declined from 180 to 100 (44%) because of substitution by wireless and e-mail. CIBC World Markets Industry Update, *Opportunities for Flat Rate Pricing and Bundling*, at 20 (June 26, 2003).

Commission develops reports tracking the industry in its study of Trends in Telephone Service, it relies little on regulatory accounting and ARMIS reports.

Additionally, the information the Commission and the states receive from ARMIS covers only a segment of the industry. For example, in 2002 (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.[14] 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.[15] 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.

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[14] 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.

[15] *See also* NARUC Phase 3 Comments, CC 00-199, at 19 (filed Apr. 8, 2002) ("More information regarding telecommunications infrastructure is needed, especially as competitive carriers own more of the infrastructure").

Commenters who have opposed eliminating the regulatory accounting and ARMIS reporting requirements appear to mistakenly believe that without them, they will lose information needed for the universal service program and UNE rates. However, these fears are unfounded. The Commission already gathers data for universal service from carriers not subject to ARMIS reporting. For example, carriers already report financial information for universal service outside of the ARMIS process.[16] *See* Joint ILEC Phase 3 Comments at 18-19.

Moreover, as discussed above, 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.[17] The competition that incumbent carriers now face from each other, from competing carriers, from cable-television companies, and from wireless carriers, effectively precludes cost shifting. The Commission has long recognized that predatory pricing and price squeezes are not serious threats. *See, e.g., Regulatory Treatment of LEC Provision of Services Originating in the LEC's Local Exchange Area,* 12 FCC Rcd 15756, ¶ 107 (1997) ("even if it BOC were able to allocate improperly the costs of its affiliate's interLATA services, we conclude that it is unlikely that a BOC interLATA affiliate could engage successfully in predation"); ¶ 129 ("a price squeeze strategy would give a BOC interLATA affiliate the ability to raise price by restricting its own output only if it is able to drive competitors from the market," which is "unlikely").

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[16] *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).

[17] *See* Wisconsin Phase 3 Comments at 8 ("[i]t 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").

VI. The Commission Should Further Suspend Implementation of Certain Phase 2 Accounting and Reporting Requirement Rule Changes until January 1, 2005

The Commission extended on an interim basis until June 30, 2004, the current suspension of the implementation of four accounting and reporting requirement rule modifications previously adapted by the Commission in its *Phase 2 Order. See Federal-State Joint Conference on Accounting Issues,* Order, WC 02-269, FCC 03-325 (rel. Dec. 23, 2003). The Commission seeks comments on whether the suspension should be extended until January 1, 2005. The Commission should suspend implementation of the four accounting and reporting requirement rule modifications until January 1, 2005, for two reasons.

First, the Commission has not yet resolved the petitions for reconsideration pending against certain of those rule modifications. It would be inefficient for carriers to proceed with implementation of those rule modifications if the Commission eliminates those modifications on reconsideration. Suspending implementation of the rules will give the Commission sufficient time to resolve those reconsideration petitions and give carriers sufficient time to implement those modifications the commission upholds on reconsideration.

Second, it is problematic to implement these sorts of rule modifications in the middle of a calendar year. By changing an accounting or reporting requirement in midstream, part of the data is reported under the old rule while part of the data is reported under the new rule. A split year does not allow for period-to-period comparability between management, regulatory and external reports. As such, the reported results for the entire calendar year are not particularly useful since they reflect two different sets of reporting requirements. The Commission should therefore set accounting and reporting rule modifications to coincide with the beginning of the calendar year.

VII. Conclusion

The Commission should focus on the deregulatory purposes of the Act, and of Section 11 in particular, and eliminate accounting and ARMIS reporting regulations that are no longer "necessary" and serve no federal regulatory purpose.

Respectfully submitted,

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January 30, 2004

Counsel for Verizon

Attachment A

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 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

Verizon Response to Additional Joint Conference Recommendations

1) The Commission Should Not Modify Part 32 Accounts

The Commission has already identified Part 32 accounts that are no longer necessary and repealed them pursuant to Section 11. The Joint Conference recommends that the Commission reinstate certain of these Part 32 accounts. For the reasons explained below, the Commission should not 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.

a) The Commission Should Not Reinstate Account 5230, Directory Revenues.

There is no reason for the Commission to monitor separately revenues from incumbent carriers' white and yellow page directories. In its *Phase 2 Order*, the Commission consolidated Account 5230, Directory Revenues, into Account 5200, Miscellaneous Revenue. The Commission did so because it "was not persuaded that there continues to be regulatory benefit from a federal perspective associated with maintaining directory revenue separately from miscellaneous revenue." *Phase 2 Order* ¶ 36. The Commission's consolidation of these accounts was fully consistent with its obligations under the Act.

The Joint Conference recommends that the Commission reinstate Account 5230, Directory Revenue. The only rationale offered by the Joint Conference to justify separate accounting of directory revenues is that the information "is necessary to the state regulators as they carry out the responsibility under the 1996 Act to protect consumers and competition against the incumbents' use of its local monopolies to gain a competitive advantage in the market for directory listings." Joint Conference Recommendations at 9. The Commission, however, already considered and rejected this very same argument in its *Phase 2 Order*, recognizing that states can obtain the same data directly "when state-specific reasons require them to do so." *Phase 2 Order* ¶ 36. Nothing has changed since the *Phase 2 Order* to establish a *federal* need for separate accounting of directory revenues. Any state need for such information can continue to be met through individual state requirements. *See* Verizon Comments to Joint Conference, Appendix at 2.

b) The Commission Should Continue to Consolidate Accounts 6621-6623 Into Account 6620 Without Creating Any Wholesale And Retail Subaccounts.

There is no reason for the Commission to disaggregate Account 6620 (Services). In its *Phase 2 Order*, the Commission consolidated Account 6621 (Call Completion Services), Account 6622 (Number Services), and Account 6623 (Customer Services) into Account 6620 (Services). *Phase 2 Order* ¶ 39. The Commission's consolidation of these accounts was fully consistent with its obligations under the Act.

In its *Phase 2 Order*, the Commission created wholesale and retail subaccounts for consolidated Account 6620. The Commission should eliminate this requirement for wholesale and retail subaccounts.

First, there is no *federal* need for separate wholesale and retail subaccounts. The only regulatory function that the Commission articulated as being served by the wholesale and retail subaccounts was that they reportedly "will assist the states in developing UNE rates that properly reflect the costs of providing a wholesale service." *Phase 2 Order* ¶ 64. However, the Commission's regulations regarding the pricing of UNEs state that rates for each element shall be established "pursuant to be forward-looking economic cost-based pricing methodology" adopted by the Commission in its *Local Competition Order*[1] – a cost 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 not be comparable to the forward-looking costs included in UNE cost studies. *See* Verizon Comments to Joint Conference, at 19.

Moreover, the costs reflected in Account 6620 are especially 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 any rates. Even the Joint Conference acknowledges that "[t]he wholesale/retail break down for Account 6621, Call Completion Services (operator services) and 6622, Number Services (directory assistance) are not necessary because these services are not required to be offered at UNE rates." Joint Conference Recommendations at 14.

When incumbent carriers provide services on a wholesale basis, there is no link between the price for these wholesale services and pricing for unbundled loops or unbundled local switching. Indeed, under the Commission's current pricing rules, states set rates based on the costs of a hypothetical carrier using a newly rebuilt network. *Local Competition Order*. Thus, even if wholesale and retail subaccounts would be helpful for UNE prices in general – which they would not – there is no reason to create wholesale and retail subaccounts for Call Completion Services and Number Services, which are not part of UNE loops and switch ports and are provided and priced independently from UNEs.

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[1] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*") (subsequent history omitted).

Because the services associated with Account 6620 are not already segregated into wholesale and retail subaccounts in Verizon's systems, Verizon has estimated that it would take at least four to six months to structure and conduct the studies necessary to allocate Account 6620 expenses between wholesale and retail subaccounts, costing close to $3.5 million in additional implementation costs, and $2.5 million per year in ongoing costs. *See* Joint ILEC Phase 2 Petition for Reconsideration, CC 00-199, at 5-6 (filed Mar. 8, 2002). *See also* Verizon Comments to Joint Conference, at 19.

The Joint Conference suggests that the Commission consider consolidating Accounts 6621 and 6622 into Account 6620 and retaining Account 6623 as a separate account. The Joint Conference also suggests that the Commission consider modifying ARMIS Report 43-02 to require the reporting of the wholesale/retail percent of customer service expense on an individual state basis. According to the Joint Conference, "[t]his will provide information used in determining UNE rates, developing the discount for reseller rates, as well as information regarding competition without the burdensome requirement of maintaining separate subaccounts and the need to separately journalize retail and wholesale components." Joint Conference Recommendations at 15. None of these suggestions should be adopted by the Commission.

First, the Joint Conference is turning the process on its head when it says that incumbent carriers "should be requested to quantify the burdens associated with each alternative." Joint Conference Recommendations at 15. The Commission is statutorily required to "repeal or modify any regulation it determines to be no longer necessary in the public interest." 47 U.S.C. § 161. It is the proponent of a *federal* regulatory requirement that bears the burden of justifying that requirement. *See Phase 2 Order* ¶ 209. It is not the duty of those that would be subject to the proposed regulatory requirement to show how burdensome it would be.

Regardless, there is a significant burden to implement a process to create wholesale/retail percentages for even the one account recommended by the Joint Conference. Verizon has estimated that it would take at least three months to develop and implement a process to create wholesale/retail percentages for Account 6623 expenses, costing close to $1 million per year in ongoing costs.

c) The Commission Should Continue To Consolidate Accounts 6561-6565 Into One Depreciation And Amortization Expense Account (6562).

In its *Phase 2 Order*, the Commission consolidated account 6561-6565 into one depreciation and amortization expense account (6562). The Commission found there was no *federal* need for these separate accounts and noted that "the amount in [account 6562] for year 2000, for all Bell Operating Companies (BOCs) combined, was $168,000, which is less than .001 percent of the depreciation expense." *Phase 2 Order* ¶ 38. The Commission's consolidation of these accounts was fully consistent with its obligations under the Act.

The Joint Conference recommends that the Commission "seek further comment related to the consolidation of these accounts and any possible adverse effects on potential rate proceedings at the state commissions." Joint Conference Recommendations at 15. However, there is no reason for the Commission to disaggregate Account 6562. The only rationale offered by the Joint Conference for its recommendations is that "segregation of the depreciation and amortization accounts continues to be needed by the states." Joint Conference Recommendations at 16. The Commission, however, already considered and rejected this argument in its *Phase 2 Order*, finding that states can obtain the information they need an individual basis.

> We recognize that this account may be important to state regulators in cases where property held for future telecommunications use is excluded from the rate base. . . . We

expect, however, that companies will provide these records to the state commissions, if needed for state rate cases.

Phase 2 Order ¶ 38.

Nothing has changed since the Commission issued its decision in the *Phase 2 Order*. There is still no *federal* need for the information in the consolidated accounts. And the states still have the ability to obtain the information they need on an individual basis. For example, New York, Virginia, and Pennsylvania have mandatory annual depreciation reporting in significant detail. *See* Verizon Comments to Joint Conference, Appendix at 2.

Moreover, depreciation expenses are not treated consistently in state and federal accounts, so adopting federal depreciation accounting requirements would not assist in state depreciation accounting. In fact, only one of the 35 states in which Verizon has incumbent local exchange operations (New Hampshire) follows the Commission's depreciation assumptions and has the same depreciation expense. As a result, current Commission depreciation rules and practices are simply not needed by the states.

d) The Commission Should Not Establish Separate Accounts For Optical Switching, Switching Software, Loop And Interoffice Transport, Interconnection Revenue, Universal Service Support Revenue, Or Universal Service Support Expense.

The Commission should not create the new Part 32 accounts recommended by the Joint Conference. As explained below, the Commission has already rejected these same proposals and the Joint Conference identifies no *federal* need for these new Part 32 accounts.

1. Optical Switching Account. The Commission should not establish a new Optical Switching account. In its *Phase 2 Order*, the Commission found that "adding the optical switching account is premature because the technology has not yet developed to the point where widespread deployment is imminent." *Phase 2 Order* ¶ 60. In the absence of a *federal* need for

such an account, the Commission's decision was fully consistent with its obligations under the Act.

The Joint Conference recommends that the Commission create an account for optical switching, but identifies no *federal* regulatory need for this account. For example, the Joint Conference argues that "the current level of deployment of optical switches is only one relevant factor when assessing whether to require the reporting of such information." Joint Conference Recommendations at 18. The fact of the matter is that optical switching technology is not yet widespread and no large local exchange carrier currently has optical switches. S*ee* Verizon Comments to Joint Conference, Appendix at 3. Therefore, such a separate account is not "necessary", and, under Section 11, cannot be adopted. Just because there is a *potential* for this new technology to proliferate some time in the future is no reason for the Commission to increase the number of federal regulatory accounts.

The Joint Conference also argues that "states often look to historical switched costs in estimating forward-looking costs for UNEs." Joint Conference Recommendations at 18. The determination of costs and rates for UNEs is a state function, not a federal function. If states need investment information on optical switches, they can obtain that information directly from the incumbent carriers.

Finally, the Joint Conference argues that this information "is essential so states can assess the extent to which the carriers are modernizing their networks in individual states." Joint Conference Recommendations at 18. Again, the Joint Conference identifies a state need, not a *federal* need. Moreover, establishing an Optical Switching account under Part 32 would not identify which carriers are modernizing their networks in individual states because only the four largest incumbent carriers would be required to report their investments under that new Part 32 account. 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.

2. Switching Software. The Commission should not establish a new Switching Software subaccount. In its *Phase 2 Order*, the Commission saw "no regulatory need at this time to separately track investment in switching software in a new subaccount." *Phase 2 Order* ¶ 62. In the absence of a *federal* need for such an account, the Commission's decision was fully consistent with its obligations under the Act.

The Joint Conference recommends that the Commission create a new Switching Software subaccount. The Joint Conference, however, argues only that the subaccount is needed by the *states* "to assess the impact of [switching software] costs on UNE rates and the universal service mechanism." Joint Conference Recommendations at 19. These individual state needs do not establish a *federal* basis for creating a new Switching Software subaccount.

Moreover, the Commission has already ordered large Class A carriers to maintain separate subsidiary records for general purpose and network software.[2] There is no need or justification for replacing these existing, sufficient subsidiary records with a brand new account. *See* Verizon Comments to Joint Conference, Appendix at 3.

3. Loop and Interoffice Transport. The Commission should not establish new Loop and Interoffice Transport subaccounts. In its *Phase 2 Order*, the Commission found "that allocating these costs to separate subaccounts would be overly burdensome because, in some

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[2] In the *1998 Biennial Regulatory Review - Review of Accounting and Cost Allocation Requirements*, Report and Order, 14 FCC Rcd 11396 ¶ 49 (1999), the Commission required carriers to establish and maintain subsidiary record categories for general purpose computer software and network software within the intangible asset account. *See* 47 C.F.R. § 32.2690(b).

cases, both loop and interoffice transport would be carried on the same cable facility." *Phase 2 Order* ¶ 63. In the absence of a *federal* need for such subaccounts, the Commission's decision was fully consistent with its obligations under the Act.

The Joint Conference recommends that the Commission establish new Loop and Interoffice Transport subaccounts. Joint Conference Recommendation at 19. Again, the Joint Conference identifies no *federal* need for such subaccounts. Rather, the Joint Conference argues that "to the extent ILECs claim that UNE rates do not cover accounting costs, data separating loop costs from transport costs is needed to make comparisons to accounting costs." *Id.* The determination of costs and rates for UNEs is a state function, not a federal function. If states need investment information on loops and interoffice transport, they can obtain that information directly from the incumbent carriers. In fact, this recommendation by the Joint Conference is based on a request originally made by the state of Wisconsin. *See* Wisconsin Phase 2 Comments, CC 00-199, Attachment A (Accounts 2230 through 2441) (filed July 12, 2001). 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] *See* Verizon Comments to Joint Conference, Appendix, at 3-4.

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[3] *See Biennial Review of Depreciation Rates and Ranges for Classes of Capital of Telecommunications Utilities*, Case No. 05-DT-105, Final Decision (WI PSC Dec. 20, 2002), *available at* psc.wi.gov/a_erf_share_view_viewdoc.aspx?docid=5230. 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.

Moreover, allocating costs between loops and transport would arguably not be consistent with Part 32 accounting rules, which are based on direct assignment of costs.[4] The Commission should therefore not establish separate loop and interoffice transport subaccounts.

4. Interconnection Revenue and Expense Accounts. The Commission should not establish new interconnection revenue and expense accounts. In its *Phase 2 Order*, the Commission considered and rejected such proposals. The Commission concluded that "the information collected through the *Local Competition and Broadband Data Gathering Program* provides a way to monitor the extent of local competition, and we do not need at this time to add new USOA revenue accounts for UNE revenue, resale revenue, and reciprocal compensation in order to assess the status of local competition." *Phase 2 Order* ¶ 66. In the absence of a *federal* need for such accounts, the Commission's decision was consistent with its obligations under the Act.

The Joint Conference recommends that the Commission establish new interconnection revenue and expense accounts (with subaccounts for UNEs, resale, reciprocal compensation, and other interconnection arrangements). Joint Conference Recommendations at 19-21. The Joint Conference, however, identifies no *federal* regulatory need for this information. Rather, the Joint Conference argues that "this data could prove useful to states in formulating policy." Joint Conference Recommendations at 20. These individual state needs do not provide a valid basis for establishing federal accounting requirements. Individual states can obtain the information they need directly from incumbent carriers.

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4 *See* 47 CFR § 32.2(c) ("because of the variety and continual changing of various cost allocation mechanisms, the financial accounts of the company should not reflect an a priori allocation of revenues, investments or expenses to products or services, jurisdictions or organizational structures").

Although the Joint Conference notes that the Commission's Form 477 provides some data that relates to local competition, the Joint Conference argues that "none of the data is audited, calling the reliability of the data into question." Joint Conference Recommendations at 20. The Joint Conference offers no evidence to support its claim that Form 477 is unreliable. The Commission routinely relies on Form 477 data and has not questioned its reliability.

Moreover, even if the Commission were to establish interconnection revenue and expense accounts, which it should not, such accounts would provide little information on the level of local competition. Only the four largest incumbent carriers would be required to report data in those new accounts; the rest of the industry would be exempt from those requirements. By contrast, the Form 477 data that the Commission relies on "covers a broader range of providers than the incumbent LECs." *Phase 2 Order* ¶ 66. *See* Verizon Reply Comments to Joint Conference, at 7.

In addition, implementing the Joint Conference recommendation would be very burdensome. 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, CC 00-199, at 6-9 (filed July 16, 2001). For these reasons, the Commission should not establish additional interconnection revenue and expense accounts. *See* Verizon Comments to Joint Conference, Appendix at 4.

5. <u>Universal Service Revenue and Expense Accounts.</u> The Commission should not establish new universal service revenue and expense accounts. In its *Phase 2 Order*, the Commission already found that there was no *federal* need for this information because it

"already collect[s] from all carriers 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* ¶ 74. In the absence of a *federal* need for such accounts, the Commission's decision was fully consistent with its obligations under the Act.

Moreover, 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* 2003 Monitoring Report, *available at* http://www.fcc.gov/wcb/iatd/monitor.html (Tables 1-1 to 1-53 show industry revenues and contributions; tables 2-1 through 5-12 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. *See* Verizon Comments to Joint Conference at 5.

In any event, identification of revenues received from the universal service fund in a separate revenue account would be problematic. Such identification would cause the portion of the revenue coming from the fund to lose its jurisdictional identity. Currently, carriers follow Responsible Accounting Officer ("RAO") Letter No. 27, which directs them to "record universal service support receipts in the revenue account appropriate for the service supported." For example, when a carrier provides a discount on service to a school or library, the carrier records the undiscounted rates into the state, interstate or nonregulated revenue account appropriate for the service, while it splits the receivables into two parts – the discounted payment to be received from the school or library, and the remainder to be received from the Universal Service Administrative Company ("USAC"). The total undiscounted revenue is subject to an intrastate/interstate separation. If the funding from USAC were assigned to a separate revenue account, it would lose its jurisdictional identity. The portion paid by the school or library for the service would be assigned to the appropriate jurisdiction, but the portion reimbursed by USAC would go into a universal service revenue account that would need a new and yet to be determined separations treatment. New accounts with new separations treatment are contrary to the ultimate goal of the interim separations freeze.

2) The Commission Should Not Impose Additional Reporting Requirements.

For the reasons stated above, the Commission should not impose additional reporting requirements for which there is no federal regulatory need. Given the deregulatory mandate of the Act, and of Section 11 in particular, it would be inappropriate to impose new reporting requirements, especially those the Commission has already eliminated as unnecessary.

a) The Commission Should Not Apply Dominant Carrier Accounting Requirements to Nondominant Incumbent Carriers.

The Commission recently modified Section 32.11 of its rules to apply dominant carrier accounting rules to "incumbent local exchange carriers," rather than "companies." The Commission's rationale for doing so was that the Commission "appl[ies] these requirements to incumbent LECs only, because they are the dominant carriers in their markets." *Phase 2 Order* ¶ 126. To be consistent with the Commission's rationale, the Commission should further modify its rule to apply only to "services where the incumbent local exchange carrier is dominant."

There may be instances where an "incumbent local exchange carrier" is not dominant in the relevant market. For example, a carrier might be deemed in "incumbent local exchange carrier" simply because it acquired an asset from an incumbent local exchange carrier. The acquisition of that asset, however, would not necessarily make the carrier "dominant" in the relevant market. Accordingly, that carrier should not be required to comply with dominant carrier accounting regulations where it is not a dominant carrier in the relevant market, such as broadband or long distance.

b) The Commission Should Reconsider Its Phase 2 Decision Regarding Broadband Infrastructure Reporting Requirements.

In its *Phase 2 Order*, the Commission ordered that four new areas of information related to broadband infrastructure be added to ARMIS 43-07 report: "Hybrid Fiber/Metallic Loop Interface Locations," "Switched Access Lines Served from Interface Locations," "Total xDSL Terminated at Customer Premises," and "xDSL Terminated at Customer Premises via Hybrid Fiber/Metallic Interface Locations." *See Phase 2 Order* ¶ 175 nn. 332-335. The Joint Conference supports the Commission's determination. While Verizon supports the Commission's gathering of information regarding broadband infrastructure, Verizon requests that the Commission order that such information be reported on Form 477, rather than through ARMIS.

By ordering that data regarding broadband infrastructure be reported through ARMIS, the Commission has effectively ordered certain Class A carriers to be the sole public reporters of broadband information. This unequal regulatory treatment is particularly inappropriate for broadband which, as the Commission has recognized, is an intensely competitive field. The leading technology for broadband services is not xDSL, but cable modem, and regulators and legislators are considering whether to deregulate broadband entirely, so that telecommunications carriers can compete with cable on an equal playing field. In fact, the Commission recently reported that as of the middle of last year, only about 31 percent of high-speed lines are provided by Class A carriers.[5] The Commission should not require Class A carriers to report publicly data regarding broadband infrastructure that would give cable broadband providers (and other competitors) another regulatory advantage.

Using Form 477 instead of ARMIS has the advantage of allowing the Commission to consider all broadband issues together, so that its decision regarding broadband can be made consistently and globally in one set of proceedings. Using Form 477 instead of ARMIS also avoids subjecting Class A carriers to potential duplicative and conflicting requirements. For example, carriers already report related broadband infrastructure data (*e.g.*, data regarding Asymmetric xDSL and other traditional wireline, including symmetric xDSL) on Form 477, and claim confidential treatment for such data. There is no reason to require Class A carriers to report the data in another form, especially one that does not protect proprietary information as confidential.

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

The Joint Conference takes no position on the addition of loop sheath kilometers to ARMIS Report 43-07. The Commission should, however, 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* ¶ 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.* The Commission did not attempt to

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[5] Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2003*, Table 5 (Dec. 2003) *available at* www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/hspd1203.pdf.

articulate what the information would be used for, or why "loop" measurement would be more useful than total sheath kilometers.

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 *federal* regulatory need for loop information.[6] Moreover, the additional studies that would be required in order to separately calculate loop sheath kilometers are incredibly time consuming and expensive. Verizon estimates that the analysis alone would cost some $5.5 million. *See* Verizon Comments to Joint Conference, at 21.

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[6] *See, e.g.,* ARMIS 43-01, Table II (requiring reporting of access lines); Industry Analysis Division, Common Carrier Bureau, *Local Telephone Competition: Status as of June 30, 2003* (Dec. 2003) (according to data collected on Form 477, CLECs "reported providing about 23% of switched access lines over their own local loop facilities").