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

In the Matter of:	)	
	)	
Petition of BellSouth Telecommunications, Inc.	)	WC Docket No. 05-342
For Forbearance Under 47 U.S.C. § 160 from	)	
Enforcement of Certain of the Commission's	)	
Cost Assignment Rules	)	

Reply Comments of Verizon

Verizon's opening comments urged the Commission to extend the separations freeze on an interim basis pending fundamental separations reform, reaffirm that states cannot impose inconsistent cost allocation and separations rules on carriers, and move toward eliminating federal rules governing separations and inter-affiliate transfer pricing while concurrently preempting any inconsistent state requirements. Competition assures that all market participants – including incumbent LECs, competitive LECs, cable telephony providers, and wireless carriers – must charge reasonable rates, rendering these antiquated regulatory obligations both unnecessary and inimical to full and fair competition. The few comments suggesting perpetuation or even expansion of these requirements are meritless and must be rejected.

I. THE SEPARATIONS FREEZE MUST BE EXTENDED PENDING COMPREHENSIVE REFORM AND INCONSISTENT STATE REQUIREMENTS MUST BE PREEMPTED.

In the 2001 *Separations Freeze Order*, the Commission properly noted that the separations process imposes undue burdens on carriers in a competitive environment and is based on measurements that make little sense in an increasingly packet-switched network. *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Report and Order, 16 FCC Rcd 11382, ¶¶ 1, 12-13 (2001). BellSouth's forbearance petition establishes that those considerations weigh even more heavily in favor of a freeze today and underscores the need for the Commission both to extend the freeze and to prohibit state actions that are inconsistent with the freeze pending further reform – and eventual elimination – of the separations process. *See* Verizon Comments at 2-8.

Notwithstanding the growing irrelevance and indisputable burden of jurisdictional cost assignments, the New Jersey Division of Ratepayer Advocate asks the Commission to allocate more costs to the interstate jurisdiction, citing the Commission's decision to treat DSL as an interstate service. New Jersey Division of Ratepayer Advocate Comments, WC Docket No. 05-342, at 10-11. This suggestion is misguided. It makes no sense to expend scarce resources trying to resurrect an analysis that (1) is supposed to provide only a rough justice allocation,[1] and (2) was frozen in order to "reduce regulatory burdens on carriers during the transition from a regulated monopoly to a deregulated, competitive environment in the local telecommunications marketplace," *Separations Freeze Order*, ¶ 13, a transition which is essentially complete.

The New Jersey Division of Ratepayer Advocate's concern that the existing separations rules permit over-recovery of costs from intrastate customers is baseless, given widespread competition from cable telephony, wireless carriers, independent VoIP providers, and wireline CLECs. Moreover, the always-arbitrary nature of jurisdictional cost allocations has been exacerbated by the growing prevalence of distance- and usage-insensitive services that defy jurisdictional classification. As the Commission recently observed, "as more services are offered over a single loop, cost allocations are likely to become more arbitrary and thus less reasonable." *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report

[1] *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930) ("the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measure being essential").

and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14928 n.434 (2005).[2] Accordingly, the course of action suggested by the New Jersey Division of Ratepayer Advocate is unnecessary, impractical, and would saddle incumbent LECs with costs that they can ill-afford to bear in a competitive marketplace.

II. THE COMMISSION SHOULD ELIMINATE THE AFFILIATE TRANSACTION RULES AND PREEMPT INCONSISTENT STATE REQUIREMENTS.

Verizon's Comments (at 8-10) explained that the Commission's affiliate transaction rules are unnecessary and counter-productive in today's competitive environment.[3] In the historical rate-of-return environment, these rules were intended to assure that costs of unregulated operations were not shifted into the rate base and ultimately reflected in higher prices for consumers of regulated services. Today, however, even in those few jurisdictions that still employ rate base regulation, competition prevents incumbent local exchange carriers from raising rates above market-disciplined levels.[4] Accordingly, the affiliate transaction rules serve

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2 Similarly, the Commission noted the futility of trying to devise "cost causality and usage measures" applicable to nonregulated broadband Internet access services: "These measures … would have to reflect the evolution of the incumbent LECs' networks from traditional circuit-switched networks into IP-based networks. The proceedings to set these measures would be both resource-intensive and, given the changes in network technology from the time when the part 64 cost allocation rules were developed, likely to lead to arbitrary cost allocation results." *Wireline Broadband Order*, ¶ 134. The same holds true in the separations context.

3 In particular, Verizon urged the Commission to forbear from or otherwise eliminate the rule governing valuations of services and assets transferred between regulated and non-regulated affiliates (§ 32.27), and the Cost Allocation Manual and independent audit requirements, to the extent they relate to the affiliate transaction rule (§§ 64.903, 64.904, and 32.9000).

4 *See e.g., Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75, FCC 05-184, at ¶¶ 3, 91 (rel. Nov. 17, 2005) (noting "the rapid growth of intermodal competitors – particularly cable telephony providers (whether circuit-switched or voice over IP (VoIP) – as an increasingly significant competitive force in [the mass] market," anticipating "that such competitors likely will play an increasingly important role with respect to future mass market competition," and explaining that "the record reveals that growing numbers of subscribers in particular segments of the mass market are choosing mobile wireless service in lieu of wireline local services"); Marguerite Reardon, *Verizon Plays Hardball on Pricing*, New.com, Nov. 9, 2005, available at http://new.com.com/Verizon+plays+hardball+on+pricing/2100-1037_3-5942158.html,

no purpose. They do, however, add to the complexity of designing bundled offerings that contain inputs from multiple affiliates, by compelling resource-intensive and time-consuming cost allocation exercises. Accordingly, the Commission should forbear from these rules and simultaneously preempt states from establishing their own regulations governing affiliate transactions.

The New Jersey Division of Ratepayer Advocate (at 20) contends that, as a result of the Verizon/MCI and SBC/AT&T mergers, "the prospects for effective competition are diminishing," making it "premature to discontinue rules governing affiliate transactions." To the contrary, the Commission's order approving the Verizon/MCI merger expressly found that "significant public interest benefits are likely to result from this transaction." *Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75, FCC 05-184, at ¶ 2 (rel. Nov. 17, 2005). Moreover, the Commission expressly "reject[ed] commenters' arguments that consumers will be worse off after the merger," *id.* ¶ 105, observing that "intermodal competitors, including facilities-based VoIP and mobile wireless providers, are likely to capture an increasing share of mass market local and long distance services." *Id.*[5] Consequently, these recent mergers do not compel retention of the antiquated affiliate transaction rules.

("Verizon Communications has reduced rates on its traditional telephony service to new lows as it tries to compete with cable companies who are now offering telephony as part of their own packages."); *see also* Viktor Shvets & Andrew Kieley, Deutsche Bank, *Consumer Wireline Erosion: The Strategic Response to "Water Torture"* at 2 (May 19, 2005) ("access line losses will escalate over the next 12 months towards 6%, and possibly as high as 8% per annum, driven by wireless cannibalization, rapid take-off of cable telephony, and proliferation of non-facilities-based VoIP services.").

[5] Likewise, the Commission found that "there are numerous categories of competitors providing services to enterprise customers. These include interexchange carriers, competitive LECs, cable companies, other incumbent LECs, systems integrators, and equipment vendors." *Id.* ¶ 64.

III. <u>SPECIAL ACCESS RATES ARE JUST AND REASONABLE, AND ARMIS-REPORTED RATES OF RETURN ARE MISLEADING AND IRRELEVANT.</u>

Ad Hoc resurrects its tired claim that the special access returns reported in ARMIS are excessive and that the Commission must drastically reduce special access rates. Ad Hoc Comments, WC Docket No. 05-342, filed Jan. 23, 2006, at 4-10; *see also* Time Warner Telecom Comments, WC Docket No. 05-342, filed Jan. 23, 2006, at 9-10. Ad Hoc fails to recognize that returns on particular services are both meaningless from an economic standpoint and irrelevant to determining whether rates are just and reasonable. While ARMIS accounting reports and data serve certain oversight and regulatory purposes for the Commission, the agency well understands that evaluating the reasonableness of price cap rates is neither an intended nor a possible use of those data. *See generally, 1998 Biennial Regulatory Review*, 14 FCC Rcd 11443, 11448 (1999). As a result, accounting rates of return reported in ARMIS do "not serve a ratemaking purpose." *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 2637 ¶ 199 (1991). Moreover, special access rates are competitively disciplined, with dozens of facilities-based competitors operating wherever there is appreciable special access demand. *See* Comments of Verizon, WC Docket No. 05-25, filed, June 13, 2005, Declarations of Quintin Lew and Eric Bruno. And the Commission's price cap and pricing flexibility rules – in which rate of return no longer serves any purpose – act as a further, albeit unnecessary, backstop.

In any event, Verizon has thoroughly refuted Ad Hoc's claim that special access rates are excessive in its filings in WC Docket No. 05-25. Those filings establish that: (1) Verizon's overall special access revenues per line have dropped by 16.6 percent per year in real terms since 2001, even as special access lines grew by 15.3 percent per year over the same time period. (2) Individual special access service rates fell as well. Between 2002 and 2004, DS1 and DS3 prices paid by customers fell by 5.7 and 7.6 percent per year respectively in real terms. (3) Verizon offers special access discount plans with price breaks of 40 percent or more off month-to-month rates and individually negotiated contract tariffs with total discounts of up to 70 percent off month-to-month rates. Ad Hoc raises no new arguments here, and its claims should be rejected.

IV. CONCLUSION

For the foregoing reasons, and those contained in Verizon's Comments, the Commission should extend the separations freeze on an interim basis pending fundamental separations reform, reaffirm that states cannot impose inconsistent cost allocation rules on carriers (including but not limited to separations rules that are inconsistent with the separations freeze), and move toward eliminating federal rules governing separations and inter-affiliate transfer pricing while concurrently preempting any inconsistent state requirements.

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