Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Petition of AT&T Inc. For Forbearance	)	WC Docket No. 07-21
Under 47 U.S.C. § 160(c) From Enforcement	)	
of Certain of the Commission's Cost	)	
Assignment Rules	)	
	)	

AT&T INC. PETITION FOR FORBEARANCE

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I. INTRODUCTION AND SUMMARY

Pursuant to 47 U.S.C. § 160 and 47 C.F.R. § 1.53, AT&T Inc., on behalf of certain of its legacy SBC affiliates[1] (AT&T), respectfully requests that the Commission advance the public interest by granting forbearance from its cost assignment rules.[2] The cost assignment rules at

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[1] This Petition seeks relief for the following AT&T affiliates: Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone Company, The Ohio Bell Telephone Company, Pacific Bell Telephone Company, Nevada Bell Telephone Company, The Southern New England Telephone Company, Southwestern Bell Telephone, L.P., Wisconsin Bell, Inc., SBC Advanced Solutions, Inc., Ameritech Advanced Data Services, Inc. of Illinois, Ameritech Advanced Data Services, Inc. of Indiana, Ameritech Advanced Data Services, Inc. of Michigan, Ameritech Advanced Data Services, Inc. of Ohio, and Ameritech Advanced Data Services, Inc. of Wisconsin.

AT&T has two additional ILEC affiliates that are not seeking relief in this Petition. AT&T's ILEC affiliate, The Woodbury Telephone Co., is not seeking forbearance from the cost assignment rules discussed herein since Woodbury is an average schedule ILEC and is not subject to the Commission's cost assignment rules.

Furthermore, AT&T's ILEC affiliate BellSouth Telecommunications, Inc. ("BST"), is not seeking relief in this Petition as it has already filed a petition seeking relief from the Commission's cost assignment rules in the *Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. 160 From Enforcement of Certain of the Commission's Cost Assignment Rules,* WC Docket No. 05-342, filed December 6, 2005 (BST Petition). If granted, BST would be relieved of the cost assignment requirements in nine of AT&T's ILEC states. AT&T expects the Commission to rule on the BST Petition or before March 6, 2007 as discussed in an Order released by the Chief, Wireline Competition Bureau on November 14, 2006.

[2] The rules that are the subject of this Petition are Parts 32.23, 32.27, and 64 Subpart I (referred to as "cost allocation rules"); Part 36 (referred to as "jurisdictional separations rules"); Part 69, Subparts D and E (referred to as "cost apportionment rules"); and other related rules that are completely derivative of or dependent on the foregoing rules, including the cost allocation and rate of return reporting requirements in

issue in this Petition are vestiges from decades old rate-of-return regulation that originally applied to AT&T prior to divestiture and, post-divestiture, to the Regional Bell Operating Companies ("RBOCs") as well.[3] This rate-of-return regulatory regime premised rate-setting on carriers' costs and, thus, gave rise to the Commission's cost assignment rules.[4]

It has been more than ten years since AT&T has been subject to rate-of-return regulation at any level, federal or state. To the extent AT&T's rates remain regulated, they are now subject to pure price cap regulation, and in some cases, states have determined that even price cap regulation is no longer necessary.[5]

Under pure price cap regulation, rates are subject to price ceilings that are determined without reference to costs. Indeed, a key premise of price cap regulation is that consumers will

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Parts 43.21(d)(1), 43.21(d)(2), 43.21(f) and 65.600. Attachment 1 contains a detailed listing of each specific rule from which AT&T seeks forbearance, which are referred to collectively in this Petition as the Commission's "rate-of-return rules" or "cost assignment rules." The Petition also seeks limited forbearance from 47 U.S.C. § 220(a)(2) to the extent this provision contemplates separate accounting of non-regulated costs. However, AT&T is not seeking forbearance from the Part 32, Uniform System of Accounts ("USOA" or "Chart of Accounts").

[3] *See In re: Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, ¶ 26 (1990) ("*Second Report and Order*") ("The basic rate of return mechanisms that form the foundation of our current system of regulation were originally designed for the regulation of public utilities decades ago").

[4] *Id.,* 5 FCC Rcd at ¶ 24 ("... extensive attention is placed on carrier costs. Costs enter the accounting system pursuant to our Part 32 [USOA], and are separated into regulated and non-regulated components in processes dictated under our Part 64 Rules. Regulated costs are then separated into their interstate and intrastate components according to the Part 36 rules. For LECs, interstate regulated costs are then allocated among the access elements we have prescribed in our Part 69 rules."); *see also Wireline Broadband Order*, at ¶ 132 ("The rules ... require LECs to apportion, on an account-by-account basis, all of their costs between regulated and non-regulated activities .... Th[e] level of detail paralleled the level of detail in the cost-of-service calculations that LECs performed to develop their rates for interstate access services").

[5] *Application of Southwestern Bell Telephone, L.P., d/b/a SBC Oklahoma for the Classification of Intrastate Retail Telecommunications Services as Basket 4 Services* Pursuant to OAC 165:55-66(4), Cause No. 200500042, Order, Corporation Commission of the State of Oklahoma (rel. July 28, 2005); *Staff's Petition to Determine Whether Markets of Incumbent Local Exchange Carriers (ILECs) Should Remain Regulated*, PUC Docket No. 31831, Order, Public Utility Commission of Texas (rel. Dec. 28, 2005); In Arkansas, more than 90% of AT&T's access lines are no longer subject to price cap regulation pursuant to A.C.A. § 23-17-407 (1997).

benefit from increased efficiencies that will result from severing the relationship between rates and costs. Under these circumstances, the Commission's cost assignment rules no longer serve any useful purpose. They are in no way necessary to ensure that AT&T's charges, practices, classifications, or regulations are just and reasonable and not unjustly or unreasonably discriminatory, and they certainly have no "strong connection" to these goals.[6] To the contrary, since costs are irrelevant to rate regulation, so too are rules that micromanage cost allocations and accounting.

For the same reasons, the rules at issue are no longer necessary for the protection of consumers. Under price cap regulation, consumers are protected by price cap ceilings and rate bands that prevent carriers with market power in a particular service from raising rates to unjust and unreasonable levels. Cost allocations and assignment undertaken pursuant to the Commission's cost assignment rules are wholly irrelevant to the ratemaking process. As the Commission recently acknowledged, price cap regulation has "greatly reduced" the "incumbent LECs' incentives to overstate the costs of their tariffed telecommunications services."[7] When, as here, costs are not part of the ratemaking equation, there is no "incentive" to inflate, misallocate

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[6] *See Cellular Telecommunications & Internet Association v. FCC*, 330 F.3d 502, 512 (D.C. Cir. 2003) ("necessary," in the context of forbearance, refers to "the existence of a strong connection between what the agency has done by way of regulation and what the agency permissibly sought to achieve with the disputed regulation").

[7] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers*, CC Docket No. 02-33; *Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337; *Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements*, CC Docket Nos. 95-20, 98-10; *Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided Via Fiber to the Premises*, WC Docket No. 04-242; *Consumer Protection in the Broadband Era*, WC Docket No. 05-271, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶ 133 (2005) ("*Wireline Broadband Order*").

or manipulate costs and, thus, the cost assignment rules are not necessary to protect consumers from that behavior or similar conduct.

Nor are cost assignment rules necessary to ensure the integrity of AT&T's financial records through financial transparency or accountability.[8] These goals are the province of financial accounting rules, the Securities and Exchange Commission ("SEC"), Sarbanes-Oxley and other requirements detailed below. AT&T will continue to comply with all the financial accounting rules imposed on public companies by the SEC and will continue to be subject to the Uniform System of Accounts in Part 32 and ARMIS reporting requirements in Part 43 of the Commission's rules. Continued compliance with those rules provides ample information about AT&T's financial condition, should any regulatory agency need that information.

Granting AT&T's Petition is also consistent with the public interest. As a threshold matter, elimination of these requirements is in the public interest simply because they no longer serve a regulatory purpose. But in addition, the cost assignment rules at issue are extremely burdensome and add millions of dollars in employee and overhead costs. For every new service or modification to existing services that AT&T seeks to offer, AT&T must conduct an exhaustive analysis of every part of the network and the other resources used to provide the service to ensure compliance with the Commission's cost allocation and affiliate transaction requirements. Certainly, the public interest would be served by no longer requiring AT&T to continue to invest in outdated regulatory compliance processes so that AT&T may redirect these funds to useful purposes, like product innovation and service quality.

[8] The cost assignment rules are actually a poor substitute for GAAP accounting as a means to ensure transparency and accountability because the cost assignment rules require allocations that were designed to further different public policy goals (e.g. preventing any leveraging of market power on unregulated markets) and because the allocations required are frequently out of step with the actual usage of facilities. *See* discussion infra page 18 on the Commission's freeze of the jurisdictional separations factors.

II. THE RULES

AT&T seeks forbearance from the Commission's cost assignment rules and discrete reporting requirements, specified herein, which are contained within Parts 32, 36, 43, 64, 65, and 69. As discussed fully below, these rules are part and parcel of the legacy rate-of-return regulatory pricing regime that no longer applies to AT&T.

A. Allocation of Regulated and Non-Regulated Activities (§§ 32.23 and 64.901)

Section 32.23 establishes the basis for allocation of Part 32 investment and expense accounts into regulated and non-regulated activities and describes the accounting treatment of activities classified for accounting purposes as non-regulated. Section 32.23(c) states, in pertinent part:

> When a non-regulated activity does involve the joint or common use of assets and resources in the provision of regulated and non-regulated products and services, carriers shall account for these activities within accounts prescribed in this system for telephone company operations. Assets and expenses shall be subdivided in subsidiary records among amounts solely assignable to non-regulated activities, amounts solely assignable to regulated activities, and amounts related to assets and expenses incurred jointly or in common, which will be allocated between regulated and non-regulated activities. Carriers shall submit reports identifying regulated and non-regulated amounts in the manner and at the times prescribed by this Commission.[9]

Implementation of Section 32.23 is further codified in Part 64, subpart I. Section 64.901(a) begins the process by requiring AT&T to "separate [its] regulated costs from non-regulated costs" by using "the attributable cost method of cost allocation." The attributable cost method requires that costs be assigned or allocated on a cost causative basis through a complex hierarchy of allocation factors. This necessitates that AT&T review each and every service that it offers in order to determine whether it includes a non-regulated component.

[9] 47 C.F.R. § 32.23.

If a given service does incorporate a non-regulated component, AT&T must then follow the allocation process established by the *Joint Cost Order* and codified in Section 64.901(b)(1), which provides as follows:

> (b) In assigning or allocating costs to regulated and non-regulated activities, carriers shall follow the principles described herein.
>
> > (1) Tariffed services provided to a non-regulated activity will be charged to the non-regulated activity at the tariffed rates and credited to the regulated revenue account for that service. Nontariffed services, offered pursuant to a section 252(e) agreement, provided to a non-regulated activity will be charged to the non-regulated activity at the amount set forth in the applicable interconnection agreement approved by a state commission pursuant to section 252(e) and credited to the regulated revenue account for that service.[10]

Section 64.901(b)(1) requires AT&T to assign a cost value of a tariffed (*i.e.*, regulated) service used to provide the non-regulated service. Under this rule, when a non-regulated service uses a regulated tariffed service (or a service that is offered pursuant to an interconnection agreement filed with a state commission) the regulated side of the business must charge the non-regulated service the rate established in the tariff (or the interconnection agreement).

Most of AT&T's non-regulated services which are provisioned over network facilities are not dedicated to non-regulated services or discretely tariffed. However, the costs associated with these facilities when used by a non-regulated service must be identified and allocated. This allocation must be done to a minute level of detail to enable the Part 32 accounts containing these costs to be allocated between regulated and non-regulated. Sections 64.901 (b) (2) and (3) establish the allocation process. These rules state:

> (2) Costs shall be directly assigned to either regulated or non-regulated activities whenever possible.
>
> (3) Costs which cannot be directly assigned to either regulated or non-regulated activities will be described as common costs.

[10] 47 C.F.R. § 64.901 (b) (1).

> Common costs shall be grouped into homogeneous cost categories designed to facilitate the proper allocation of costs between a carrier's regulated and non-regulated activities. Each cost category shall be allocated between regulated and non-regulated activities in accordance with the following hierarchy:
>
>> (i) Whenever possible, common cost categories are to be allocated based upon direct analysis of the origin of the cost themselves.
>>
>> (ii) When direct analysis is not possible, common cost categories shall be allocated based upon an indirect, cost-causative linkage to another cost category (or group of cost categories) for which a direct assignment or allocation is available.
>>
>> (iii) When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities.[11]

Specifically, this section requires allocations to be based upon a cost causal relationship, which drives the division of cost between four types of cost pools: Directly Assigned, Directly Attributable, Indirectly Attributable, and Unattributable. The rules require direct assignment to the maximum possible extent. Accordingly, every effort is made to find a direct link between regulated or non-regulated operations to be able to Directly Assign costs. When that direct link is absent, AT&T must make an extensive effort to determine a direct attribution method that closely links the cost to the regulated or non-regulated operations. Special studies and statistical samples are performed in many cases in order to achieve direct attribution.

For AT&T, the allocation of these Part 32 accounts requires the use of approximately 287 cost pools (or cost groupings) following the analysis required by section 64.901 of the

[11] 47 C.F.R. §§ 64.901 (b) (2) and (3).

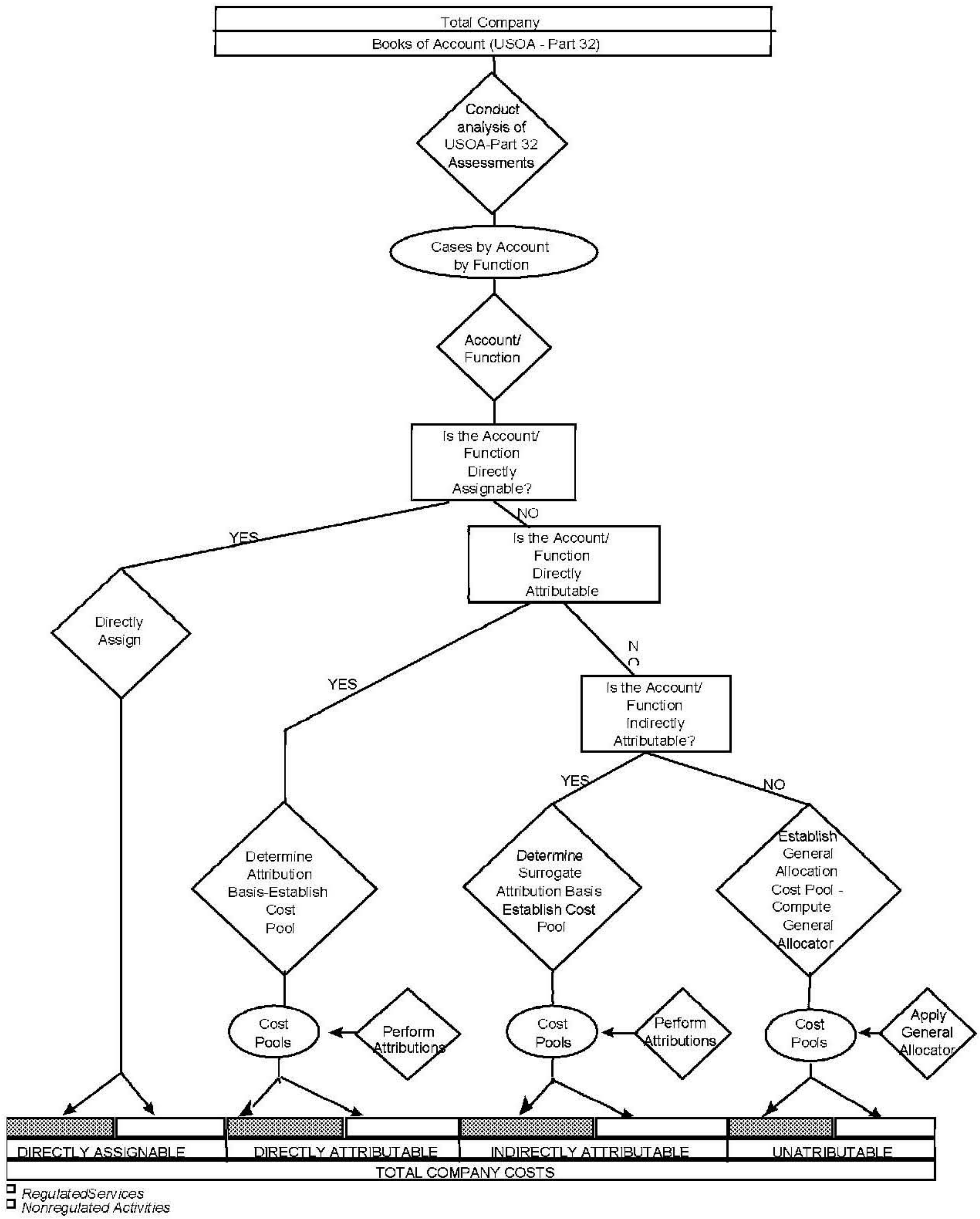
Commission's rules. If direct attribution cannot be achieved for certain costs, AT&T must research indirect attribution methods.

Although AT&T has instituted an extensive array of accounting codes and systems in order to comply with the Part 64.901 hierarchy, new products and services present a challenge to this hierarchy. Thus, each time AT&T seeks to bring new products and services to market, it must first review the existing array of codes to determine applicability. If, as is often the case, the codes do not fit, new apportionment methods and corresponding codes must be developed and implemented.

Furthermore, the cost allocation requirements are not limited to network or equipment costs. These rules apply to any and all costs that are incurred by AT&T, such as employee costs. As a result, AT&T must create processes to ensure that costs that are incurred throughout its business are appropriately allocated to regulated or non-regulated activities. For example, AT&T uses cumbersome time reporting processes to capture the amount of time that employees devote to regulated or non-regulated activities. AT&T requires that employees allocate their time spent on regulated or non-regulated activities. Finally, finance and accounting personnel review the captured employee costs and ensure that the regulated or non-regulated accounts are appropriately charged.

The following "Cost Allocation Flow Chart" depicts the processes described above. The chart illustrates how costs flow from their inception through AT&T's accounting system to allocation into regulated and non-regulated activities.

COST ALLOCATION FLOW CHART



1. Day-to-Day Operational Impact of Sections 32.23 and 64.901.

In today's world, engineers design integrated communications networks in order to take advantage of the efficiencies of new technologies. Consumers demand service packages that allow them to reap cost savings and the benefits of innovation. The artificial divisions that legacy cost assignment rules require are wholly unrelated to determining rates in a price cap environment. The following examples illustrate a few of the activities that routinely occur throughout AT&T in an effort to ensure compliance with these now unnecessary and outdated rules without any corresponding public benefit.

a. Time Reporting

The majority of AT&T employees, sales representatives, network engineers, science and technology planners, human resources and regulatory employees, work on multiple services – some services are regulated and some not. In order to comply with cost allocation requirements, AT&T must keep separate track of every employee's regulated and non-regulated activities. Cost allocation touches the vast majority of employees at AT&T, and requires a review of the allocation of employee time between regulated and non-regulated activities.

Customer service representatives ("CSRs") can and do provide consumers with information about multiple services over the telephone. Some services are regulated, some are not; some are provided by affiliates, and some not. The cost assignment rules require that CSR time be properly allocated to the appropriate service or affiliate.

In order to do this, AT&T has devised a statistically valid CSR time sampling plan. The plan involves a monthly randomly selected schedule of CSRs to monitor. AT&T's team of Service Representative ("SR") study analysts monitor individuals' CSR calls according to this plan. These observers listen to customer calls and use the SR study program to record the amount of time spent on each of the different products and activities within each telephone call. The data collected by the SR analysts is recorded in a database and the results are mapped to the appropriate regulatory buckets. Costs are then allocated to the appropriate product or activity based upon a percentage allocation. The underlying CSR studies, statistical sampling plan and results are subject to regular audit as part of the CAM audit. AT&T's time and effort serve no regulatory purpose other than generating allocations that are *only* used to populate the Joint Cost report (ARMIS 43-03), but the allocations are not used for ratemaking purposes.[12]

b. Floor Space Allocations

Another example of an unnecessary burden imposed by the Commission's cost allocation rules is the requirement to allocate floor space, which is an extraordinary process mandated by the *CAM Uniformity Order*.[13] In that order, the Common Carrier Bureau sought to establish uniform practices among CAM-filing LECs, which included ordering nine specific cost pools and associated methodologies to allocate floor space based on how such buildings are used.

As required by the *CAM Uniformity Order*, AT&T must perform an annual floor space study, at its own expense, to verify its floor space records and use the results to allocate floor space costs to specific activities or affiliates. As a result, AT&T reviews over 9,700 building structures containing over 113 million square feet of space every year. The first step of the study is the laborious task of matching up the continuing property records with the building records on

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[12] A sample of a CSR time analysis spreadsheet is contained in Attachment 2. The spreadsheet illustrates that during the period of October 2005 – September 2006, AT&T's small business CSRs in the Midwest Region spent 15.34% of their time on DSL services, 2.37% of their time on basic inside wire, and 3.47% of their time on voicemail.

[13] *Implementation of Further Cost Allocation Uniformity*, AAD 92-42, 8 FCC Rcd 4664, Memorandum Opinion and Order (1993) ("*CAM Uniformity Order*").

a building by building basis in order to assign a dollar value to each building. Then, AT&T determines the percentage of floor space used by affiliates, based on detailed affiliate billing records, and assigns the applicable affiliate use to the appropriate cost pool. After the affiliate use is removed, AT&T must analyze the remaining floor space using either building classifications or the job functions of the employees utilizing the floor space. The classification of each building is reviewed using detailed floor space records, which are updated on a monthly basis. The classification of the building is then used to directly assign the value of that particular building to a specific cost pool. For the remaining buildings that cannot be directly assigned to a cost pool based on the classification of the building, further analysis and detailed calculations are required. This analysis involves the review of the job functions of the individual employees utilizing the floor space. Consequently, detailed tracking of employee moves must also be maintained. For each of the remaining buildings,[14] a calculation is then made to determine the percentage of the building used for various job functions. These percentages are then applied to the remainder of the buildings in order to classify their value to the appropriate cost pools. Again, AT&T completes this very time consuming and expensive work effort to allocate costs, but the resulting allocations are no longer used for ratemaking purposes.

B. Transactions with Affiliates (§ 32.27)

Section 32.27 of the Commission's rules governs how AT&T must account for assets and services transferred or provided between itself and any of its non-regulated affiliates. The purpose of the rules was to ensure that ILECs did not record the purchase of assets or services from an affiliate at above-market prices and then pass that cost on to the ILECs' ratepayers.

[14] For AT&T Southwest only, the employee job function calculation is based on all buildings within a state rather than by individual building.

Similarly, the rules were intended to keep an ILEC from recording services or assets sold to an affiliate at below-cost prices and subsequently recovering the shortfall from ratepayers. Under price cap regulation in both federal and state jurisdictions, the costs AT&T records on its books as a result of these affiliate transaction rules do not "pass through" to any rates and thus no longer serve the intended ratepayer protection role. Yet, AT&T is still required to go through the labor intensive and expensive process discussed below to document, track and record these transactions.

The rules governing sales of services (32.27(c)) require that every service provided between AT&T and a non-regulated affiliate[15] must be analyzed individually according to the Commission's three-step hierarchy before the transaction can be recorded. In the first step, if a tariff or interconnection agreement exists for the service then the transaction is recorded at that rate. If no tariff, or equivalent, is available and at least 25% of AT&T's sales are to unaffiliated third parties, AT&T follows the second step and records the services at the prevailing market price.

When neither the first or second step of the hierarchy can be met, AT&T must move to the third and most complex and expensive step of the affiliate transactions hierarchy. In the third step, AT&T compares the Estimated Fair Market Value (EFMV) of the service to the Fully Distributed Cost (FDC) of these transactions. The rules require that a service transaction from

[15] AT&T's CAM includes six pages of descriptions of assets and services provided between AT&T and its non-regulated affiliates. Examples are administrative services, real estate services, power management, regulatory services and telecommunications and equipment services.

AT&T to a non-regulated affiliate be recorded at the higher of EFMV or FDC; a service transaction from an affiliate to AT&T must be recorded at the lower of EFMV or FDC.[16]

The sole purpose of calculating FDC and paying for an EFMV study is to compare the two values and record the lower or higher value on the books as the cost of the transaction. AT&T processes thousands of affiliate transactions annually. These transactions are reviewed and are subject to the annual Cost Allocation Manual audit (discussed below) for compliance with the Commission's valuation requirements. Again, despite the time and resources used to ensure compliance, the cost has no impact on the regulation of AT&T's market rates for its services.

A very similar process is required for assets transferred between AT&T and affiliates, except that the comparison is between EFMV and Net Book Costs. Ironically, if AT&T has to record an asset transfer at EFMV to comply with FCC rules, it must also maintain records for these transfers at Net Book Cost to comply with Generally Accepted Accounting Principles (GAAP). GAAP requires that all public companies transferring assets between affiliated entities record those transactions at Net Book Cost.[17]

C. The "CAM" And Independent Audit Requirements (§§ 32.9000, 64.903 and 64.904).

[16] This requirement means that, not only AT&T, but also otherwise non-regulated affiliates must maintain a costing system based upon 64.901 of the Commission's rules in order to ensure AT&T's compliance with 32.27.

[17] FAS 141, paragraph D12. "When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the equity interests shall initially recognize the assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer."

AT&T is required to file a Cost Allocation Manual ("CAM") every year in December and periodically throughout the year under specific circumstances.[18] The CAM, the preparation of which is governed by Section 64.903, must describe how AT&T separates regulated from non-regulated costs and must contain the following: (1) a description of each of the carrier's non-regulated activities; (2) a list of all incidental activities; (3) a chart showing all corporate affiliates; (4) identification of each affiliate that has transactions with AT&T and the nature of those transactions; (5) cost apportionment tables for each Part 32 account that contains costs; and (6) a description of all time reporting procedures AT&T uses. Seemingly, the creation and maintenance of the CAM was not burdensome enough because the Commission even regulates how AT&T must submit changes to its CAM.[19]

Moreover, pursuant to Section 64.904,[20] AT&T's CAM is audited for compliance with each of the Part 64, subpart I rules as well as the affiliate transactions rules. AT&T must hire an outside auditor at a cost of over $1.7 million per year to conduct this exhaustive audit.[21] The

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[18] 47 C.F.R. § 64.903 (In addition to the annual filing requirement, the Commission requires carriers to update their CAMs when implementing a change to the cost apportionment table, description of time reporting procedures and when providing new operations, installation and maintenance services to a section 272 structurally separate affiliate. *See Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates*, WC Docket No. 03-228, *Report and Order*, FCC 04-54 (2004) ("OI&M Order")).

[19] Changes to CAMs must be individually identified in a prescribed format in an attachment to the transmittal letter accompanying the filing. *See* Responsible Accounting Officer Letter 19, RE. CC Docket No. 86-111 Cost Allocation Manual – Format and Filing Procedures, Released December 23, 1991. Furthermore, AT&T must also quantify the impact the proposed CAM changes have on regulated operations in the transmittal attachment. 47 C.F.R. § 64.903(b).

[20] *See* 47 C.F.R. § 64.904.

[21] The independent audit requirement was originally designed to aid the Commission in fulfilling its responsibility to ensure that carriers complied with the Commission's rules. However, the Commission exempted mid-size carriers from performing these independent audits to "significantly lighten regulatory burdens," even though many of these carriers are ***rate-of-return regulated.*** *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform System of Accounts for Interconnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local*

auditors and AT&T employees spend the majority of every year scrutinizing the records to confirm that every cost allocation rule is followed down to its strictest detail. Given that cost allocation rules no longer serve their original purpose, and are certainly not "strongly connected" to any such purpose, it is ironic that these are the only FCC rules which are subject to such a rigorous audit requirement.

D. Jurisdictional Separations (Part 36)

Jurisdictional separations is "the third step in [the] four-step regulatory process that begins with an ILEC's accounting system and ends with the establishment of rates . . . ."[22] Under the jurisdictional separations process, AT&T must allocate regulated costs between the intrastate and interstate jurisdictions. The astonishingly detailed methodology developed to undertake this process is on display in the 86 pages of separations rules contained in Attachment 1.

In 2001, the Commission froze the Part 36 jurisdictional separations process because it recognized that its jurisdictional separations rules were outdated regulatory mechanisms that were not aligned with the rapidly-evolving telecommunications marketplace.[23] In particular, it found that the separations regime had been developed when local telephone service was provided largely through circuit-switched networks operated by companies with monopoly power in the

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Competition and Broadband Reporting, CC Docket Nos. 00-199, 97-212, 80-286 & 99-301, *Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286; Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, and 80-286*, 16 FCC Rcd 19911, 19980, ¶ 189 (2001).

[22] *Jurisdictional Separations and Referral to the Federal-State Joint Board,* CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382 ¶ 3 (2001) ("*Separations Freeze Order*").

[23] *Separations Freeze Order* at ¶13 (2001).

local market, and there was a clear delineation between interstate and intrastate services.[24] At that time, local telephone companies were subject to rate-of-return regulation, and the jurisdictional separations process was an integral component of that regulatory regime, "prevent[ing] ILECs from recovering the same costs in both interstate and intrastate jurisdictions."[25] This concern and, thus, this purpose were only valid under rate-of-return regulation where costs could have a direct impact on rates. For AT&T, the need for a separations process evaporated when both federal and state regulators moved to pure price cap regulation.

While the abandonment of cost-based rate regulation is certainly a sufficient basis, by itself, for eliminating the cumbersome archaic separations rules, it is not the only reason for doing so. When the Commission froze the separations factors in 2001, it found that, with the opening of local and long distance telecommunications markets to competition under the 1996 Act, and the rapid growth of new technologies and services (including the spectacular growth of the Internet), the telecommunications landscape had radically changed, with the lines between interstate and intrastate services increasingly blurred,[26] thereby making implementation of the separations rules inherently arbitrary. The Commission concluded that, in light of these changes and increasing competition in local markets, the time had come to reexamine its jurisdictional separations process, with a view toward reforming and ultimately eliminating that regime.[27] [28]

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[24] *Separations Freeze Order* at ¶1.

[25] *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking, 21 FCC Rcd 5516 at ¶2 (2006) ("*Separations FNPRM*").

[26] *Separations Freeze Order* at ¶1.

[27] *See id.*

The Commission's conclusions regarding the increasing unreliability and irrelevance of the jurisdictional separations process are, if anything, even more true today than they were when the freeze was adopted. As discussed more fully below, competition in local and long distance telecommunications markets has exploded, with a host of intra- and intermodal competitors (including wireless, wireline, cable, and satellite service providers) vying to attract customers with innovative and attractive service offerings that increasingly package local, long distance, and other communications services, further erasing the already tenuous distinction between inter- and intrastate services. These trends are likely to accelerate in coming years, as service providers increasingly rely on mobile and IP-based technologies that allow customers to engage in communications that transcend jurisdictional boundaries and make it even more difficult, if not impossible, to jurisdictionalize telecommunications traffic and services. These trends are clearly not contemplated by the cost assignment rules and that fact, combined with today's price cap regulation, demonstrates the appropriateness of granting AT&T forbearance from these requirements.

E. Interstate Cost Apportionment Rules (Part 69)

The final step in the interstate rate-of-return ratemaking is setting rates across the LEC's services. The purpose of the Part 69 rules was to apportion separated interstate regulated costs among interstate access service categories. The apportioned costs represented the fully distributed costs of the access categories and, prior to price caps, the cost basis upon which

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[28] The Commission found that, in the meantime, it should impose an interim separations freeze in order to simplify, and provide regulatory certainty to, the separations process until comprehensive reform was completed. *See id.* at ¶¶ 2 and 3. The Commission observed, in this regard, that a freeze would reduce regulatory burdens on ILECs during the transition from a regulated monopoly to a deregulated, competitive local telecommunications marketplace, and thus would "further the Commission's stated goal . . . of achieving greater competitive neutrality during the transition to a competitive marketplace." *Id.* at ¶ 13.

interstate access rates were set. These costs were used to calculate the interstate rate-of-return on the different interstate access categories. With the adoption of price cap regulation, these costs are no longer used for rate-setting. Thus, the cost apportionment rules, like the separations rules from which they extend, are not connected to price cap ratemaking, and, frankly, serve no other legitimate regulatory purpose for AT&T.

Nevertheless, AT&T ensures compliance with these requirements by performing monthly allocation processing and review, which includes downloading regulated/non-regulated allocations by Part 32 account from the financial systems, loading monthly affiliate transaction activity, loading the frozen separations factor data, reviewing and analyzing the results, and investigating and correcting any anomalies. In addition, AT&T must also monitor and review general accounting bulletins and changes to ensure that all data is properly captured for input and ensure that the allocation system is updated to meet any changes in accounting requirements.

AT&T undertakes this entire work effort for regulatory compliance sake. As discussed above, AT&T's rates are not based on a rate of return, so the cost apportionment to the access services categories is wholly unnecessary. Furthermore, the Commission no longer monitors rate of return at the services category level. Interestingly, the Commission hard coded with "N/A" or "0" in the access service category rate-of-return fields of the ARMIS reports, preventing any carrier from inputting these amounts. Presumably, the FCC has already decided that this data is no longer necessary, so it is only logical for AT&T to be relieved of the obligation to perform the allocations.

III. ARGUMENT

This Petition must be granted if the "three prongs" of the forbearance statute, 47 U.S.C. § 160 (a), are satisfied:

> the statutory test for forbearance under [Section 160 (a)] has three prongs that must all be satisfied before the Commission is *obligated* to forbear from enforcing a regulation or a statutory provision: (1) 'enforcement . . . is not necessary to ensure that the charges . . . are just and reasonable and are not unjustly or unreasonably discriminatory'; (2) 'enforcement . . . is not necessary for the protection of consumers'; and (3) 'forbearance . . . is consistent with the public interest.'[29]

Thus, for purposes of this Petition, if it is shown that the rules at issue are not necessary for ratemaking and are not necessary for protecting consumers, and, that granting forbearance is consistent with the public interest, the Commission *must* grant forbearance.

The D.C. Circuit, in accord with this Commission, has observed that the term "necessary" as used in the forbearance context (as opposed to its other statutory uses in the Communications Act), does not mean "absolutely required."[30] However, in the context of forbearance, regulatory requirements should not be deemed "necessary" unless there is a "*strong connection* between what the [Commission] has done by way of regulation and what the agency *permissibly sought to achieve* with the disputed regulation."[31] If the rules do not demonstrably achieve the "permissible" regulatory aims, or if the aims no longer exist, no "strong connection" exists. And, of course, when continued enforcement actually produces *negative* results, then an entirely impermissible *negative* "connection" is revealed. In either case, consistent with the public interest, forbearance must be granted.

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[29] *CTIA*, 330 F.3d at 509 (emphasis added). *See In the Matter of Petition for Forbearance from E911 Accuracy Standards Imposed on Tier III Carriers for Locating Wireless Subscribers Under Rule Section 20.18 (H), Order*, WT Docket No. 02-377, 18 F.C.C. Rcd 24648, 24653 (2003).

[30] *See CTIA,* 330 F.3d at 509-10; *Petition for Forbearance from E911 Accuracy Standards*, 18 FCC Rcd at 24644.

[31] *CTIA,* 330 F.3d at 512 (emphases added). *See also Petition for Forbearance from E911 Accuracy Standards*, 18 FCC Rcd at 24644 ("... in this context, a requirement is 'necessary' for the protection of consumers if there is a strong connection between the requirement and the goal of consumer protection").

Thus, AT&T's Petition cannot be denied based on claims that the rules are vaguely beneficial, or that the rules are helpful to some broader array of evolving goals whose connections to the rules' original purposes are weak or remote. A "strong connection" to just, reasonable and nondiscriminatory AT&T rates, to the protection of consumers and the public interest, must be shown for continued application of the rules. As demonstrated below, no such connection exists.

A. The Commission's Cost Assignment Rules Are Not Necessary To Ensure That AT&T's Rates Are Just, Reasonable, And Nondiscriminatory.

No dispute exists that AT&T's interstate and intrastate rates are regulated under price cap regulation, rather than rate-of-return regulation. It is equally beyond dispute that the complicated tracking and allocation of investments and costs between regulated and non-regulated activities and the apportionment between interstate and intrastate jurisdictions play no role under price cap regulation in determining whether AT&T's rates are just, reasonable, and nondiscriminatory at either the federal or state level. AT&T's compliance with these rules, thus, is not necessary to the Commission's rate-setting goals, and forbearance from continued enforcement must be granted.

1. The Commission Does Not Rely On Cost Assignment Data To Set AT&T's Prices.

As the Commission itself observed when it adopted price cap regulation, cost calculation is not a part of the price cap paradigm:

> . . . incentive regulation relies in the first instance on regulating *prices*. By establishing limits on prices carriers can charge for their services, and placing downward pressure on those limits or 'caps,' we create a regulatory environment that requires carriers *to become more productive*. Carriers that can substantially increase their productivity can earn and retain profits at reasonable levels above those we allow for rate of return

> carriers . . . . *If carriers fail to become more productive, they risk seeing their earnings erode*.[32]

Indeed, price caps, by design, impel carriers to police their own costs in order to achieve desirable earnings, and by adopting price cap regulation, the Commission and the states have eliminated the purpose of the cost assignment rules.[33]

At the federal level, the current price cap regime sets a ceiling on the prices AT&T may charge for its interstate services. The costs that AT&T incurs in providing these services have no bearing whatsoever on this price ceiling. It is for this reason that the continued need for the cost assignment rules under price cap regulation repeatedly has been called into question. As the Commission itself noted in *Computer III*, "because price cap regulation severs the direct link between regulated costs and prices, a carrier is not able automatically to recoup misallocated non-regulated costs by raising basic service rates, thus reducing the incentive for the BOCs to shift non-regulated costs to regulated services."[34]

To be sure, the Commission found in 1996 that price cap regulation as it then existed, did not wholly vitiate the need for the cost assignment rules[35] due to the sharing component of price

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[32] *Second Report and Order, supra*, at ¶ 22 (emphasis added).

[33] The Regulatory Background document included as Attachment 3 provides further explanation of the rate-of-return and price cap regulatory regimes and demonstrates how cost data that was once crucial to set rates under rate-of-return is no longer used in the price cap regime.

[34] *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards*, CC Docket No. 90-623, *Report and Order*, 6 FCC Rcd 7571, 7596, ¶ 55 (1991), *vacated in part and remanded, California v. FCC,* 39 F.3d 919 (9th Cir. 1994), *cert denied*, 514 U.S. 1050 (1995); *see also, California v. FCC*, 39 F.3d at 926-27; *United States v. Western Elec. Co*., 993 F.2d 1572, 1580 (D.C. Circuit), *cert denied*, 510 U.S. 984 (1993) ("[price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling").

[35] *Accounting Safeguards Order, supra*, 11 FCC Rcd 17539.

caps, the lower formula adjustment mechanism ("LFAM"), [36] and the fact that some intrastate services remained under rate-of-return regulation. However, the Commission's findings are no longer applicable to AT&T.

First, in 1997 the Commission eliminated the sharing component (*i.e*., the "sharing" of excess earnings with ratepayers) that was included in the original price cap plan. Elimination of the sharing requirement, the Commission observed, "[r]educed reliance on accounting costs," which, according to the Commission, would "facilitate[] our transition to the competitive paradigm of the 1996 Act." [37]

Second, as a result of pricing flexibility,[38] the LFAM is no longer applicable to AT&T, which further reduces any need for retaining the cost assignment rules.[39] Indeed, in eliminating the LFAM for ILECs operating under pricing flexibility, the Commission found that doing so

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[36] The original price cap plan included a mechanism that protected carriers from earning below a prescribed rate of return. If the carrier could demonstrate that its earnings were below the rate of return set in the plan, the carrier could make a below cap filing to increase rates to achieve the prescribed rate. As discussed herein, the LFAM has been eliminated for AT&T.

[37] *See Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, CC Docket Nos. 94-1 and 96-262, *Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262*, 12 FCC Rcd 16642, 16700, ¶ 152 (1997) ("*1997 Price Cap Review Order*"), *aff'd in part, rev'd in part, United States Telecom Ass'n v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

[38] In the *Pricing Flexibility Order*, the Commission granted price cap carriers greater freedom in pricing certain services subject to the carrier demonstrating a sufficient level of competition within the market for those services. *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket Nos. 96-262, 94-1 & 98-157, CCB/CPD File No. 98-63, *Fifth Report and Order and Notice of Proposed Rulemaking*, 14 FCC Rcd 14221, 14251 n.144 (1999) ("*Pricing Flexibility Order*").

[39] The LFAM was eliminated for any price cap ILEC that chose to take advantage of pricing flexibility for access services, which all of the major ILECs have done. *See Pricing Flexibility Order,* 14 FCC Rcd at 14304, ¶162, ("We eliminate the low-end adjustment mechanism for price cap LECs that qualify for and elect to exercise either the Phase I or Phase II pricing flexibility we grant in this Order.").

"might enable the Commission to relax, for that LEC, any accounting rules necessitated only by the rate-of-return-based low-end adjustment mechanism."[40]

Third, as discussed previously, AT&T operates under price regulation in all of its states. Thus, there are no longer any intrastate services offered by AT&T that remain under rate-of-return regulation, which further eviscerates the need for the Commission's cost assignment rules.

It has been argued in the past that, even with price cap carriers, the cost assignment rules continue to be important to the federal price cap process because they impact the productivity factor.[41] This argument is without merit. As an initial matter, the Commission has never been able to establish a productivity factor that could survive judicial review, and the Commission, therefore, eliminated productivity factors in its CALLS Order.[42] Thus, any claim that cost assignment rules are necessary "just in case" the Commission decides to resurrect a productivity factor would rest entirely on speculation, which as noted does not demonstrate the necessity for a rule under the forbearance test. Equally, if not more importantly, the productivity factor was established using a variety of methodologies based on economic inputs that look at the productivity of the domestic economy as a whole, as well as the telecommunications industry.

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[40] *Id.* at, 14306-07, ¶ 166.

[41] *See*, *e.g.*, Letter from Alan Buzacott, Senior Manager, Regulatory Affairs, MCI, to Michelle Carey, Chief, Competition Policy Division, Wireline Competition Bureau, FCC (Feb. 9, 2004), transmitted by letter from Gil M. Strober, Lawler, Metzger & Milkman, LLC, to Marlene Dortch, Secretary, FCC, WC Docket No. 02-112 & CC Docket No. 00-175 (Feb. 9, 2004) ("MCI Letter"); Letter from Michael J. Hunseder, Sidley Austin Brown & Wood, LLP, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 02-33 & WC Docket No. 02-112 (Feb. 13, 2004) ("AT&T Letter").

[42] *Access Charge Reform*, CC Docket 96-262, Sixth Report and Order, 15 FCC Rcd 12962 (2000) (Calls Order).

None of these methodologies relies on the cost assignment rules.[43] Thus, even if the Commission did resurrect a productivity factor, it would not need to rely on its cost assignment rules to establish that factor.

2. The FCC's Cost Assignment Requirements Are Unnecessary For State Regulatory Purposes.[44]

Shortly after the Commission's 1990 adoption of price cap regulation, all of the states included in this Petition shifted from rate-of-return regimes to incentive regulation. In Arkansas, California, Connecticut, Illinois, Indiana, Kansas, Oklahoma, Ohio, Michigan, Missouri, Nevada, Texas, and Wisconsin, AT&T's rates are regulated under incentive regulation (including price cap) plans without regard to the information generated by the Commission's cost assignment rules.[45] Indeed, if the Commission were to grant AT&T's Petition, the state commissions in

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[43] Although economic inputs may include total company costs, those costs are not derived from, or based on, the cost assignment rules. In any event, such total company cost information will remain readily available, should it be needed for valid regulatory purposes.

[44] By including an analysis of state needs and requirements in this discussion, AT&T does not intend to suggest an expanded view of the Commission's jurisdiction. Indeed, AT&T assumes that the Commission, as it stated in the *Phase 2 Order and NPRM*, continues to "*believe that, if we cannot identify a federal need for a regulation, we are not justified in maintaining such a requirement at the federal level*." *Phase 2 Order and NPRM, supra*, 16 FCC Rcd 19,911 at ¶ 207 (emphasis added).

[45] Arkansas: A.C.A. § 23-17-407 (1997); California: Rulemaking on the Commission's Own Motion to Assess and Revise the Regulation of Telecommunications Utilities, Rulemaking 05-04-005, Public Utilities Commission Of The State Of California (August 24, 2006); Connecticut: Application Of Southern New England Telephone Company For Financial Review And Proposed Framework For Alternative Regulations, DPUC, Docket No. 95-03-01 (November 25, 1998); Illinois: 220 ILCS 5 §13-506.1; Indiana: Petition Of Indiana Bell Telephone Company, Incorporated ("SBC Indiana") For The Commission To Exercise Its Statutory Authority Under I.C. 8-1-2.6 Et Seq. To Decline To Exercise Its Jurisdiction, In Whole Or In Part, And Use Alternative Regulatory Procedures And Standards And Approve SBC Indiana's Alternative Regulation Plan For The Pricing And Other Regulation Of SBC Indiana's Retail And Carrier Access Services, Cause No. 42405, IURC (June 3 0, 2004); Kansas: K.S.A. § 66-2005; Michigan: MCLS § 484.2304, Missouri: § 392.245 R.S.Mo.; Nevada: Nev. Rev. Stat. Ann. § 704. 68474 -704.68498; Ohio: Application of AT&T Ohio for Approval of an Alternative Form of Regulation of Basic Local Exchange Service and Other Tier 1 Services Pursuant to Chapter 4901:1-4, Ohio Administrative Code. Case No. 06-1013-TP-BLS (December 20, 2006). Oklahoma: Application Of Southwestern Bell Telephone, L.P., D/B/A SBC Oklahoma, For The Classification Of Intrastate Retail Telecommunications Services As Basket 4 Services Pursuant To OAC 165:55-5-66(4) Cause No. PUD

AT&T's region would continue to regulate AT&T's rates in the same way they have for the past decade.[46]

When a need exists for jurisdictional information for monitoring or other purposes, AT&T can develop such information to meet those state-specific requirements without continued compliance with the Commission's cost assignment rules. For example, in AT&T state jurisdictions, intrastate revenues must be identified for the purpose of assessing regulatory fees. However, AT&T's Petition does not affect revenue. Revenue can be identified by jurisdiction through the Part 32 accounts, and this Petition would not affect those accounts. This Petition deals only with the assignment of ***costs*** (expense and investment). Thus, the Commission's granting of this Petition would not impact AT&T's ability to provide revenue data on an interstate or intrastate basis. Although ARMIS reports would only contain total revenues, AT&T's accounting records contain sufficient detail to enable AT&T to provide intrastate revenue data to any state public service commission in its territory as needed.

Similarly, all of the states in AT&T's region require that the price for a new service equal or exceed the long run incremental cost ("LRIC") or the total service long-run incremental cost ("TSLRIC") of such service. However, this requirement has no bearing on the Commission's decision here because none of the cost assignment rules is necessary for the calculation of either LRIC or TSLRIC, both of which measure *forward-looking costs.* The *only* situation in which historical costs factor into a LRIC or TSLRIC calculation is with respect to indirect costs.

200500042, Order No. 508813, OCC (July 28, 2005); Texas: Tex. Utilities Code § 65.051; Wisconsin: Wis. Stat. § 196.196.

[46] *Id.* and Attachment 4.

However, indirect costs are generally determined based on ratios of direct costs, which can be calculated without having to apply the Commission's cost assignment rules.

Although states may create intrastate cost reporting requirements, it makes little sense to use federally mandated, region-wide cost data to satisfy state-specific reporting obligations. The Commission has recognized that the states have independent authority to promulgate rules to carry out state regulatory requirements.[47] Recently, in the *Joint Conference Order*, the Commission confirmed this opinion and declined to add new Part 32 accounts stating that "[w]hen states need this information, they can request it from carriers."[48] Consequently, if a state deems intrastate cost data necessary for an intrastate purpose, that state can order it. AT&T will provide state-specific data, if necessary, by performing state-specific studies.

In short, the Commission's cost assignment rules have outlived their usefulness. By regulating rates without regard to AT&T's costs, the current price cap regime at both the federal and state level has eliminated any incentive AT&T may have once had to misallocate or overstate its costs, which is the reason the cost assignment rules were adopted in the first place.

3. The Commission Has Recently Recognized The Disconnection Of Cost Assignment-Derived Data From Price Cap Rate-Setting.

The Commission recently reached this very conclusion in its *Wireline Broadband Order*, in which the Commission revisited the regulatory classification of broadband Internet access services offered by ILECs. Specifically, the Commission found ILEC broadband Internet access service to be an information service and concluded that ILECs:

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

[48] *Federal-State Joint Conference On Accounting Issues, Report and Order*, WC Docket 02-269, FCC 04-149, 2004 FCC LEXIS 3309 (rel. June 22, 2004), ¶ 23 (*Joint Conference Order*).

> are no longer required to separate out and offer the wireline broadband transmission component . . . of wireline broadband Internet access services as a stand-alone telecommunications service under Title II . . . . In addition, the Bell Operating Companies (BOCs) are immediately relieved of all other *Computer Inquiry* requirements with respect to wireline broadband Internet access services."[49]

In so doing the Commission additionally found that, while the wireline broadband Internet access is a non-regulated information service, *ILECs did not have to allocate any portion of the shared network costs to non-regulated activities* as would normally be required pursuant to Part 64. The Commission based this decision on the fact that *price cap ratemaking obviated the need for cost allocation* and further recognized the complexity and burden, with little corresponding benefit, that such allocation causes. As the Commission stated:

> Requiring that incumbent LECs classify the provision of broadband Internet access transmission provided on a non-common carrier basis as a non-regulated activity under part 64 would mean, among other matters, that incumbent LECs would have to develop, and we would have to review, methods for measuring the relative usage that this transmission and the incumbent LECs' traditional local services make of incumbent LECs' transmission facilities. *Incumbent LECs argue that they should not have to undertake this task because it would impose significant burdens on them with little discernible benefit. We agree*.[50]

The Commission further acknowledged that price cap regulation all but eliminated the need for cost allocation, especially in the light of the burdens it requires:

> During the period since the adoption of the part 64 cost allocation rules, our ratemaking methods and those of our state counterparts have evolved considerably. This evolution has greatly reduced incumbent LECs' incentives to overstate the costs of their tariffed telecommunications services. *Based on the current record, we find that this reduction in incentives diminishes the need for incumbent LECs to apply detailed and burdensome procedures to exclude the costs of providing broadband Internet access transmission from their regulated costs. A non-regulated classification therefore would generate at most marginal benefits*.

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[49] *Wireline Broadband Order,* ¶ 5.

[50] *Id.* at ¶ 131 (emphasis added).

Requiring that incumbent LECs classify their non-common carrier, broadband Internet access transmission activities as non-regulated activities under part 64 would impose significant burdens that outweigh these potential benefits.[51]

The salient regulatory principle that the Commission embraced in the broadband Internet access services context applies equally to all services provided by price cap regulated carriers such as AT&T. As the Commission concluded, the cost assignment rules provide no real benefit when price caps are in place, since they are not necessary to determine whether rates are just and reasonable – a conclusion that does not and should not depend on the service being provided.[52]

4. Under Price Cap Regulation, The Market Determines Whether Rates Are Just, Reasonable And Not Discriminatory.

Not only has rate regulation changed, but the regulated monopolies of the past no longer exist. Competition is fierce in all aspects of the telecommunications market. A decade after the passage of the 1996 Act, communications competition is flourishing. At the end of 2005, cable companies offered voice service to approximately 57% of homes nationwide; that number was expected to reach 85% by the end of 2006.[53] Cox offers voice service in every market within its footprint and provides voice service to more than 1.9 million residential customers and over 150,000 businesses.[54] Likewise, Cablevision offers voice services in each of its local markets, has 1.1 million subscribers, and reports a penetration rate of more than 24 percent of homes

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[51] *Id*. at ¶ 133-34 (emphasis added).

[52] Furthermore, given the operational burdens imposed by the cost assignment rules – burdens that go well beyond accounting for wireline broadband Internet access service – the Commission should forbear from requiring continued compliance with such rules.

[53] See C. Moffett, et al., Bernstein Research, Quarterly VoIP Monitor: Playing Follow the Leader (Cablevision, That Is) (Sept. 20, 2006).

[54] Cox News Release, Cox Digital Telephone Now Offered in All Cox Markets (Oct. 30, 2006) http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irolnewsArticle&t=Regular&id=923325&.

passed.[55] Time Warner Cable offers voice service in every market it served prior to its recent transactions with Adelphia and Comcast and serves at least 1.6 million voice subscribers.[56]

Furthermore, wireless carriers continue to place enormous competitive pressure on wireline carriers. According to the Commission's most recent Local Competition Report, there are more wireless subscribers in the United States than switched access lines.[57] Growing numbers of wireless subscribers are abandoning their wireline service altogether. The National Center for Health Statistics report that 9.6% of adults lived in households with only wireless phones.[58]

In addition to replacing the landline phone as the primary means of making local calls, wireless carriers are competing aggressively to displace long distance telephone calls that previously were made on wireline networks. Wireless service packages include unlimited long distance calling, which has contributed to wireline traffic substitution and increasing average minutes of use among wireless carriers. As one analyst explained, "[t]hanks to unlimited night

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[55] Cablevision News Release, Cablevision Systems Corporation Reports Third Quarter 2006 Results (Nov. 8, 2006), http://www.cablevision.com/pdf/Q306_earnings.pdf; Cablevision News Release, Cablevision Completes Network Rebuild (Dec 3, 2003), http://cablevision.com/index.jhtml?id=2003_12_10.

[56] Time Warner Inc. Press Release, Time Warner Reports Third Quarter 2006 Results (Nov. 1, 2006), http://ir.timewarner.com/downloads/Q306earnings.pdf.

[57] Ind. Anal. & Tech. Div., Wireline Competition Bureau, FCC, *Local Telephone Competition: Status as of December 31, 2005*, at Tables 1 and 14 (July 2006) ("2005 Local Competition Report") (Reporting 175 million switched access lines and 203 million wireless subscribers as of December 31, 2005).

[58] National Center For Health Statistics: Wireless Substitution – Preliminary Data from the January 2006-June 2006 national Health Interview Survey, http://www.cdc.gov/nchs/products/pubs/pubd/hestats/wireless2006/wireless2006.htmAnnual. *See also* Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, WT Docket No. 06-17, Eleventh Report (rel. September 29, 2006) at ¶ 205 (FCC Wireless Bureau reports that at the end of 2005, 7.8% of adults lived in households with only wireless phones).

and weekend minutes ... cellphone plans are the method of choice when it comes to long-distance calling from home."[59]

In addition to wireless substitution, independent VOIP providers are unquestionably making an impact on the telecommunications market. Analysts estimate that the U.S. VoIP subscriber base grew by 2.8 million subscribers in 2005, or 254%, to more than 4 million subscribers, of which 1.7 million are customers of independent VoIP providers, and they are expected to gain at least 4 million customers by 2008.[60] Vonage, the largest of the independent VoIP providers, has the most market share of in this segment reporting over 2 million customers at the end of the third quarter 2006.[61] With the explosion of broadband penetration, competition by VoIP providers can only increase.

As a result of these competitive developments, rates for telecommunications and other communications services increasingly are set by market forces rather regulation. Simply put, AT&T and other ILECs are price takers forced to set their rates to meet increasingly robust competition, rather than based on costs derived from the cost allocation requirements, and cannot increase rates without suffering severe consequences in the market. The Commission has long recognized that "competition is the most effective means of ensuring that the charges, practices, classifications, . . . are just and reasonable, and are not unjustly or unreasonably

[59] W. Mossberg, *The Mossberg Solution: Turning Your Home Phone into a Cellphone – Call-Forwarding Devices Let You Use Cellular Service on a Traditional Phone*, Wall St. J. at D6 (Dec. 3, 2003).

[60] Bernstein Research Call, *Quarterly VoIP Monitor: VoIP Gathering Momentum, Expecting 20M Cable VoIP Subs by 2010*, at 1, 3 (Jan. 17, 2006).

[61] Vonage Company Profile, 3rd Qtr 2006, http://www.vonage.com/corporate/factsheet/images/FactSheet.pdf.

discriminatory."[62] In short, under current market conditions, there simply is no basis to perpetuate the cost allocation requirements, which, in any event, no longer serve any regulatory purpose.

B. The Cost Assignment Rules Are Unnecessary To Protect Consumers.

While the Commission's cost assignment rules are not necessary to ensure that rates are just, reasonable and nondiscriminatory, neither are they necessary for protection of consumers in any other regard. AT&T, like all other public companies, is subject to the jurisdiction and regulations of the Securities and Exchange Commission ("SEC"). As such, it must maintain books and accounts and prepare financial reports that conform to Generally Accepted Accounting Principles ("GAAP"), which are the accounting standards employed by publicly traded companies to determine and report their financial condition to the public. This information must be audited by an independent public accounting firm and publicly disclosed.

AT&T understands that, in the wake of high-profile accounting scandals involving large, publicly-traded companies such as Enron and WorldCom, the Commission may be concerned about a perceived lessening of accounting obligations for a carrier under its jurisdiction. AT&T does not take those concerns lightly. However, the Commission should be assured that this Petition does not involve or even impact any accounting rule or regulation, whether established by this Commission or any other regulatory authority, that is designed to protect the public and consumers from corporate malfeasance and to ensure accurate reporting of a company's financial health.

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[62] *Petition of US West Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance*, 14 FCC Rcd 16252, ¶31, Memorandum Opinion and Order (1999).

This Petition, if granted, would not eliminate any accounting requirement or regulation established by, or within the jurisdiction of, the SEC or any other agency regarding the proper recording of revenues, expenses, investment, or debt in financial statements. Appendix 8 of the BST Petition for Forbearance from the cost assignment rules in WC Docket No. 05-342 is a detailed analysis of the financial accounting and reporting rules and disclosures applicable to all public companies.[63] This analysis applies equally to the AT&T ILECs requesting forbearance in this Petition and should give the Commission comfort that this Petition, if granted, will not diminish public protection.

As Deloitte & Touche ("D&T") discusses, public companies like AT&T are subject to many layers of financial oversight through federal and state regulations and statutes. AT&T is and will remain subject to the jurisdiction of the SEC, an agency that was created to "protect investors and maintain the integrity of the securities market."[64] The federal laws that the SEC administers "seek to ensure that the securities markets are fair and honest."[65] It ensures compliance through extensive periodic reporting requirements, which include an annual Form 10-K and three quarterly reports through Form 10-Q. These reports include financial information that is governed by Regulation S-X and non-financial information governed by Regulation S-K. The financial statements included in the reports filed with the SEC are required to have annual audits and interim reviews performed by independent auditors.[66]

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[63] *See* Appendix 8 - Donna Epps, Deloitte & Touche LLP, *Reporting after Reform: Financial Accounting Rules and Disclosures in Reporting by U.S. Public Companies* (2005) ("D&T Paper") in *Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. 160 From Enforcement of Certain of the Commission's Cost Assignment Rules,* WC Docket No. 05-342, filed December 6, 2005 (attached hereto for the Commission's convenience as Attachment 5).

[64] *Id*. at page 19, Appendix A: SEC.

[65] *Id*.

[66] *Id*. at page 15.

In addition to the reporting requirements, the SEC has oversight responsibilities through monitoring and enforcement. Monitoring includes review of the Forms 10-K and 10-Q at least once every three years.[67] The SEC's enforcement division has civil as well as criminal authority over violations of any securities laws. Such violations include, but are not limited to, misrepresentation or omissions of important information from filed documents, and the mis-use of non-public information.[68]

Recent federal law developments have enhanced the SEC's (and other agencies') pre-existing regulatory, oversight and enforcement authority. The result of these developments is even greater protection to the public and investors from accounting abuses. The most significant of these new laws is the Sarbanes-Oxley Act, a major corporate accountability reform measure that imposes significant new disclosure requirements on all public companies.[69] Specifically, Sarbanes-Oxley makes a company's officers personally responsible for the company's financial statements and strengthens the audit requirements by expanding the scope of work that an auditor must perform in order to provide a set of unqualified opinions regarding a company's financial statements and internal controls. Sarbanes-Oxley also created the Public Company Accounting Oversight Board ("PCAOB") "to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair and independent audit reports for companies the securities of which are sold to, by and for, public investors."[70]

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[67] *Id*. at page 16.

[68] *See* D&T Paper at 17.

[69] *Id*. at 5.

[70] *Id*. at page 25, Appendix C: PCAOB. (The PCAOB must "conduct regular inspections of each firm to ensure that the firm and its professional practitioners are in compliance with the Sarbanes-Oxley Act,

The PCAOB has enforcement authority over independent auditors of public companies and may impose appropriate sanctions[71] on any auditor that is found to violate "any provision of the Sarbanes-Oxley Act, any professional standards, any rules of the PCAOB or the SEC, or any provisions of the U.S. securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto."[72] Thus, Sarbanes Oxley not only places important new controls over the public companies themselves, it also created a regulatory body to oversee the auditors that audit these companies to ensure that they maintain independence from the companies and follow appropriate professional standards.

Sarbanes-Oxley also places significant new requirements for management and independent auditors to access, document and report on the effectiveness of Internal Control over Financial Reporting ("ICFR")."[73] This change includes "new reports and certifications by management on the effectiveness of the company's ICFR." [74] The auditor also must supplement its report on a company's financial statements with management's assessment on ICFR and on the effectiveness of the company's ICFR. This strengthening of internal control not only deters fraud but also prevents inaccurate financial statements.[75] AT&T estimates that it spends in excess of $3 million annually on Sarbanes-Oxley compliance.

PCAOB rules and standards, SEC rules and standards, as well as professional standards [*e.g.*, AICPA's]").

[71] Sanctions "may range from monetary penalties and remedial measures, such as training, new quality control procedures, or the appointment of an independent monitor, to barring the firm or individual from future audits of public companies." D&T Paper at 18.

[72] D&T Paper at 18.

[73] *Id*. at 5.

[74] *Id*.

[75] *Id*.

In past proceedings, some commenters have argued that the Commission's accounting rules should remain in place to protect against the kind of behavior seen in past accounting scandals. The Commission, of course, is not a financial regulator, and its cost assignment rules were not established to and do not protect against the kinds of abuses seen in the high-profile accounting scandals of the late 1990s. In any event, Sarbanes-Oxley amply meets the concerns that various commenters have expressed before the Commission, and should remove any reservations the Commission might otherwise have had on the subject as it considers the merits of this Petition.

The GAAP-based accounting and reporting requirements established by various federal agencies, as well as the accounting standards established under the authority of the SEC, will be unaffected by the granting of AT&T's Petition. The SEC relies on the FASB to establish GAAP in the United States ("U.S. GAAP") through a prescribed standard-setting process. Financial statements filed with the SEC that are not in conformity with U.S. GAAP are considered to be misleading or inaccurate, and are therefore unacceptable to the SEC.[76] GAAP establishes that a company must disclose, both in notes to its financial statements as well as in the statements themselves, exactly how it applies accounting standards.[77]

AT&T complies with GAAP for all financial accounting reporting purposes. The Commission accepts GAAP as an appropriate means of maintaining regulatory books and the

[76] *Id.* at 3. ("The SEC is legally charged with establishing accounting policies in the United States, but relies on private the standards –setting bodies such as the Financial Accounting Standards Board ("FASB"), [the PCAOB] and the American Institute of Certified Public Accountants ("AICPA").")

[77] D&T Paper at 7.

USOA currently prescribed by the Commission is primarily based on GAAP.[78] The Commission also has ordered ILECs' regulated separate affiliates to use GAAP.[79] CLECs, cable companies, wireless carriers, and others use GAAP for all accounting and financial reporting purposes.

AT&T is also subject to the Foreign Corrupt Practices Act ("FCPA").[80] The FCPA, among other things, requires every public company to make and keep "books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."[81] The FCPA substantially penalizes "issuers" (*i.e.*, public companies) for failing to devise and maintain proper internal controls, or for making false entries in its financial books and records.

The Sarbanes-Oxley-augmented accounting and reporting oversight provided by the various accounting regulatory agencies ensures that AT&T's investors and potential investors receive full and accurate information about all of AT&T's financial dealings. The rules from which AT&T seeks forbearance have no impact on the accounting and disclosure rules and reporting requirements that are in place to protect the investment community. Any concern that eliminating cost assignment rules will weaken accounting regulatory oversight and enforcement is an unwarranted distraction from the central issue here, which is whether the cost assignment remains necessary for the purposes for which they were developed (which is not the case).

Lastly, in addition to the foregoing provisions applicable to public companies, AT&T will remain subject to the Commission's Part 32 chart of accounts, which enables the

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[78] Because AT&T is required to maintain accounting records under Part 32, the ILEC's financial results are close to, but not exactly the same as, the financial results under GAAP (*e.g.,* depreciation expense is treated differently.) *See* 47 C.F.R. § 32.12(a).

[79] *Accounting Safeguards Order, supra,* 11 FCC Rcd at 17618 and 17649, ¶¶ 170, 243.

[80] 15 U.S.C. §§ 78m (b) (2), 78dd-1, 78dd-2.

[81] *Id.* at § 78m(b)(2)(A).

Commission to monitor AT&T's financial information for regulatory purposes.[82] Thus, AT&T will continue to record and report information pursuant to those rules although some of the data will no longer be available.[83] A summary of the impact of this Petition on ARMIS reporting is attached as Attachment 6.

In summary, there is ample federal regulatory governance over AT&T's financial reporting and use of accounting in those reports. The additional cost assignment requirements are certainly unnecessary in light of the variety of accounting safeguards specifically designed to protect the public.

C. Forbearance From The Commission's Cost Assignment Rules Is Consistent With The Public Interest.

1. The Cost Assignment Rules Are Not Only Unnecessary But Highly Burdensome.

That the Commission's cost assignment rules no longer serve their intended purpose is reason enough to forbear from applying them,[84] but forbearance is all the more necessary because of the substantial costs and burdens imposed by these rules. These costs have increased over time while the rules have become less and less linked to the consumer protection goals for which they were designed and increasingly disconnected from the ways services are designed and delivered to customers.

[82] There are two rules from which AT&T is seeking forbearance that are codified in Part 32. However, these rules are not part of the USOA, but relate specifically to rules that are further codified in Part 64, subpart I.

[83] The elimination of the cost assignment rules renders four of the Commission reporting requirements meaningless. Accordingly, AT&T seeks forbearance from the requirements to submit the Access Report (ARMIS 43-04), the Rate of Return Monitoring report (FCC Form 492), the Reg/Non-Reg Forecast Report (FCC Form 495A) and the Reg/Non-Reg Actual Usage Report (FCC Form 495B).

[84] *See* supra note 3.

As discussed in detail above, the Commission's cost assignment rules require AT&T to utilize a complex hierarchy to track, value and record affiliate transactions, to allocate costs of regulated and non-regulated services, to maintain, update and audit its Cost Allocation Manual, to jurisdictionalize intra and interstate costs and to apportion interstate costs to interstate service baskets, all of which are no longer used for ratemaking. AT&T spends approximately $7 million annually in employee-related, systems and audit costs associated with these activities to ensure compliance with these requirements. As demonstrated above, there is simply no justification for continuing to impose these significant expenses on AT&T. AT&T should be able to deploy its resources, to the maximum extent possible, toward positive activities that generate consumer benefit. It is certainly "consistent with the public interest," thus, for the Commission to free AT&T from the "rigid regulatory barriers" that the rules present to AT&T's ability to run its business in the most productive manner.

VI. CONCLUSION

For the foregoing reasons, the Commission should grant AT&T's Petition seeking forbearance from the Commission's cost assignment rules. AT&T's Petition satisfies the forbearance criteria because: (1) no "strong connection" exists between continued enforcement and application of the Commission's cost assignment rules and the Commission's statutory goal of ensuring that AT&T's rates are just, reasonable, and nondiscriminatory; (2) no "strong connection" exists between continued enforcement and application of the Commission's cost assignment rules and the Commission's statutory goal of protecting consumers in this context; and (3) granting AT&T forbearance from these antiquated rules is in the public interest. As such, the Commission must grant the forbearance sought. *See* 47 U.S.C. §§ 160 (a) and (c).

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