BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
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	)	
Petition of Qwest Corporation For Forbearance	)	
From Enforcement of the Commission's ARMIS	)	WC Dkt. No. 07-204
and 492A Reporting Requirements Pursuant to 47	)	
U.S.C. § 160(c)	)	
	)	
	)	

REPLY COMMENTS OF TIME WARNER TELECOM

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ATTORNEYS FOR TIME WARNER
TELECOM INC.

December 21, 2007

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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From Enforcement of the Commission's	)	WC Dkt. No. 07-204
ARMIS and 492A Reporting Requirements	)	
Pursuant to 47 U.S.C. § 160	)	
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REPLY COMMENTS OF TIME WARNER TELECOM

Time Warner Telecom Inc. ("TWTC"), by its attorneys, hereby files reply comments in response to Qwest's *Petition*.[1]

I. INTRODUCTION AND SUMMARY

Qwest is the latest RBOC to seek relief from crucial data and reporting requirements. Like the petitions filed by AT&T and BellSouth[2], Qwest's petition

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[1] *See Petition of Qwest Corporation For Forbearance from Enforcement of the Commission's ARMIS and 492A Reporting Requirements Pursuant to 47 U.S.C. § 160(c),* WC Dkt. No. 07-204 (filed Sept. 13, 2007) ("*Petition*").

[2] *See* Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Cost Assignment Rules, WC Docket No. 07-21 (filed Jan. 25, 2007). On Feb. 9, 2007, AT&T, on behalf of BellSouth, withdrew the Petition of BellSouth Telecommunications For Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Cost Assignment Rules, WC Dkt. No. 05-342 (filed Dec. 6, 2005), which sought similar relief, and then refiled that BellSouth Petition in WC Dkt. No. 07-21.

provides no justification for relief from the ARMIS reporting requirements, and it must be denied.

As a preliminary matter, the conditions established in the *Qwest Non-Dominance Order*[3] bar Qwest from obtaining the relief it requests here if it wishes to continue to be treated as a non-dominant provider of integrated, in-region interLATA services. The FCC made crystal clear in that order that Qwest could only reintegrate its in-region interexchange operations on a non-dominant basis if it complied with four conditions, one of which was the obligation to file modified ARMIS reports. Qwest could have requested forbearance from that condition in the petition at issue here, but it has chosen not to do so. Therefore, even if there were a basis for granting the instant petition (and there is not), Qwest could not give effect to such forbearance if it wishes to continue to take advantage of the relief granted in the *Qwest Non-Dominance Order*.

In any case, Qwest's petition must be denied because Qwest has not met its burden under Section 10. Section 10 requires that a petitioner demonstrate that (1) the provision for which it seeks forbearance is not necessary to ensure that the charges, practices, classifications, or regulations by or in connection with telecommunications services are just and reasonable and not unjustly or unreasonably discriminatory; (2) enforcement of the provision is not necessary for the protection of consumers; and (3) forbearance is in the public interest. Qwest premises its requested relief on its assertion that ARMIS reporting requirements are no longer necessary for (1) carriers such as Qwest that allegedly no longer possess market power in the local exchange market; and

[3] *See Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules as They Apply After Section 272 Sunsets*, Memorandum Opinion and Order, 22 FCC Rcd 5207 (2007) ("*Qwest Non-Dominance Order*").

(2) price-cap carriers whose rates are allegedly no longer set by reference to their costs. Qwest also implies that price cap regulation is only appropriate for carriers that no longer possess market power.

All of these assertions are incorrect. Less than a year ago, in the *Qwest Non-Dominance Order*, the FCC determined that Qwest must file ARMIS reports *because* it continued to possess local exchange market power. Nor is the imposition of price cap regulation a sign that a carrier no longer possesses market power. To the contrary, the FCC has long held that the *entire purpose* of price cap regulation is to ensure that price cap carriers' rates approximate what price cap carriers' rates *would be* in a competitive marketplace. Moreover, as TWTC and others have explained in detail in prior forbearance proceedings, price cap carriers' price cap regulation has not severed the relationship between their regulated prices and their costs.

Because price cap carriers like Qwest retain market power, ARMIS reports remain necessary to monitor and measure Qwest's behavior to ensure that it does not engage in price and non-price discrimination, to protect consumers, and to provide data for other important regulatory functions that are consistent with the public interest. Indeed, as TWTC and other commenters have shown in this and past proceedings, the FCC continues to use ARMIS reports to regulate price cap carriers in myriad ways. For example, ARMIS reports are used to (1) monitor and adjust price cap plans (including special and switched access rates) to ensure that price cap carriers are not over-earning; (2) monitor ILEC service quality to help detect service degradation and discrimination; (3) set prices for UNEs; (4) set USF levels for non-rural carriers; (5) set pole attachment rates; (6) set resale discount levels; and (7) make price cap level adjustments for access charges. Moreover, the importance of ARMIS reports to states has only increased as states have progressively eliminated their own reporting requirements in favor of ARMIS reports.

Nor has Qwest made any effort to calculate the "burden" associated with compliance with its ARMIS reporting obligations. This is understandable, because that burden is likely to be minimal post-forbearance, since Qwest has not requested forbearance from any accounting rules. Thus, grant of the instant petition would merely obviate the need for Qwest to populate the ARMIS reports with the data that it is required to generate by the accounting rules. Moreover, if states are forced to reestablish their own reporting requirements when ARMIS reports are eliminated, such new rules would impose new and, in the aggregate, possibly more costly obligations on Qwest.

For all of these reasons, Qwest's petition, like the similar petitions of AT&T and BellSouth, should be denied. Furthermore, any changes to the ARMIS reporting rules would more appropriately be made in a proceeding of general applicability in consultation with a Federal-State joint board.

II. QWEST CANNOT OBTAIN THE RELIEF REQUESTED IF IT WISHES TO BE CLASSIFIED AS NON-DOMINANT IN THE PROVISION OF INTEGRATED, IN-REGION, INTERLATA SERVICES

Before reaching the merits (such as they are) of the instant petition, it is important to emphasize that the petition is essentially meaningless if Qwest wishes to take advantage of the relief it received in the *Qwest Non-Dominance Order*. In the *Qwest Non-Dominance Order*, the FCC held that Qwest may provide in-region long distance service on an integrated basis subject to non-dominant regulations as long as it complies with four conditions. The FCC made clear that, if Qwest did not comply with these conditions, it would not be permitted to reintegrate its in-region long distance operations on a non-dominant basis: "The relief we grant in this order is conditioned on Qwest's compliance with the following safeguards, which will apply to the extent Qwest chooses to provide in-region, interstate, interLATA telecommunications services on an integrated basis through the BOC or through another affiliate that is not a section 272 separate affiliate." *Qwest Non-Dominance Order* ¶ 63.

The second of these conditions requires Qwest to make changes to several ARMIS reports and continue to file these reports with the FCC. If Qwest does not file those reports, it is ineligible to receive the relief granted. This makes sense because the ARMIS reporting requirements are essential to enforcing the substantive conditions that Qwest must meet in order to offer integrated, in-region, interLATA services on a non-dominant basis. For example, the FCC required that Qwest continue to comply with the requirement that it impute to itself charges for access services used to provide interLATA services. Section 32.5280 of the Commission's rules states that "amounts imputed to Qwest's in-region, interLATA services pursuant to section 272(e)(3) must be debited to account 32.5280, which includes nonregulated operating revenue." *Id.* ¶ 69. Accordingly, the FCC *required* Qwest "as a *condition* of th[e] Order, to include the imputation charges it debits to account 32.5280 in its ARMIS filings, accompanied by an explanatory footnote for each line item identifying the amount imputed." *Id.* (emphasis added). The FCC explained that Qwest would have to make changes to ARMIS Reports 43-01, 43-02 and 43-03 to ensure compliance with the imputation condition. *See id.* n.200. If Qwest is relieved of the requirement to file ARMIS reports, and does not file those reports as modified by the *Qwest Non-Dominance Order*, it cannot comply with the imputation condition. Therefore, if it does not file its ARMIS reports, it cannot take advantage of the relief provided in that Order if it chooses to reintegrate its in-region interstate, interLATA operations.

It is also worth pointing out that Qwest seems to be playing a similar shell game with state regulators. It has requested and obtained relief from state reporting requirements on the basis of its continued commitment to file ARMIS reports. For example, in August, 2006, Qwest requested a waiver from the Nebraska PSC from certain state accounting requirements. The Nebraska PSC granted the request, because

> Qwest committed to continue to maintain accounting records in accordance with FCC requirements and will continue to calculate results of operations separated between interstate and intrastate jurisdiction in Nebraska as required by the FCC. In addition, Qwest will continue to prepare and file Automated Reporting Management Information System (ARMIS) reports as required by the FCC.[4]

Less than one year after the Nebraska PSC order, Qwest filed its present petition. If the FCC grants Qwest's request in this proceeding and Qwest fails to file its ARMIS reports with the Nebraska PSC, Qwest will violate the PSC's order. This is likely only one of many circumstances in which states have granted regulatory relief to Qwest on the basis of its continued commitment to comply with ARMIS reporting requirements. Indeed, as described below, there are many other instances in which state regulators have abandoned state specific reporting requirements because they believed ARMIS reports would remain available.

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[4] *Petition for Declaratory Order Regarding Applicability of Certain Accounting Requirements or, in the Alternative, Application for Waiver of Certain Accounting Requirements*, 2006 Neb. PUC LEXIS 400, at *4.

III. QWEST'S PETITION SHOULD BE REJECTED ON THE MERITS BECAUSE QWEST HAS NOT MET ITS BURDEN UNDER SECTION 10 OF THE ACT

Regardless of whether Qwest may lawfully obtain the relief requested in light of the conditions in the *Qwest Non-Dominance Order*, Qwest simply has failed to demonstrate that forbearance from ARMIS requirements is consistent with Section 10 of the Act. Section 10 requires that a petitioner demonstrate that (1) the provision for which it seeks forbearance is not necessary to ensure that the charges, practices, classifications, or regulations by or in connection with telecommunications services are just and reasonable and not unjustly or unreasonably discriminatory; (2) enforcement of the provision is not necessary for the protection of consumers; and (3) forbearance is in the public interest. Contrary to Qwest's assertions, ARMIS reports are not a relic of a bygone rate-of-return era but remain a critical source of information for regulators to ensure that rates are just and reasonable, to prevent unjust discrimination and to protect consumers generally.

This is true even under a price-cap regime, because, in markets that are not fully competitive, regulators must monitor and periodically recalibrate (1) price cap plans to ensure that price cap carriers are not over-earning and (2) price cap carriers' service quality standards to ensure that price cap carriers are not discriminating against other carriers or end-users. State and Federal regulators also use ARMIS data to set prices for UNEs and USF levels for non-rural carriers. Moreover, ARMIS data is crucial in those contexts, such as establishing pole attachment and resale rates, and certain rules related to access charges, where price cap carriers' rates continue to be set *directly* in accordance with their costs.

Qwest predicates its petition on its conclusory assertion that local exchange markets are competitive and therefore the FCC and the states do not need ARMIS data to monitor discriminatory behavior. *See Petition* at 2. Qwest offers no evidence regarding its market power and indeed the FCC just last year determined that Qwest continues to possess market power in the local exchange market. In the *Qwest Non-Dominance Order*, the FCC concluded that, despite substantial information placed in the record regarding competition, Qwest failed "to present persuasive evidence that it no longer possesses exclusionary market power within its region as a result of its control over a ubiquitous telephone exchange service and exchange access network." *Qwest Non-Dominance Order* ¶ 47. In the absence of "persuasive evidence," indeed *any evidence* offered by Qwest to the contrary in this proceeding, the FCC must conclude that, less than a year after the *Qwest Non-Dominance Order*, Qwest continues to retain "exclusionary market power" in the local exchange market. Because ARMIS reports are necessary to monitor and protect against discriminatory behavior by carriers with market power, Qwest must continue to file such reports.

Qwest argues that certain ARMIS reports are no longer needed, because, although they were originally created to detect deterioration of ILEC service quality after the adoption of price cap regulation, "[h]istory has shown that this concern was unfounded and ILEC service quality did not decline with the introduction of price cap regulation." *Petition* at 4. Again, Qwest provides no evidence to support its assertion. In fact, the very existence of the reporting obligation diminishes Qwest's opportunity to act on its incentive to allow service quality to degrade under price caps. Moreover, Qwest's unspoken and incorrect premise is that price cap regulation is instituted only when a carrier no longer possesses market power. In fact, Qwest's analysis is *exactly backwards*. The entire purpose of price cap regulation is to *simulate* the incentives that ILECs would have in competitive markets.[5] If the local exchange market were competitive, price cap regulation would not be necessary.

Indeed, as noted above, the FCC explicitly conditioned Qwest's relief in the *Qwest Non-Dominance Order* on Qwest's continuing to file ARMIS service quality reports. Moreover, the FCC mandated that Qwest establish performance metrics for special access services to address "concerns about Qwest's incentive and ability to discriminate in its provisioning of special access services in order to impede competition in the market for interstate, interLATA telecommunications services." *Qwest Non-Dominance Order* ¶ 66. This condition was expressly patterned after conditions placed on price cap carriers Verizon, SBC, and AT&T following their recent mergers. *See id.* ¶ 64. Qwest provides no evidence why, less than a year later, such metrics are no longer necessary.

State regulators agree that the move to price cap regulation has had little or no effect on ILECs' incentive and ability to degrade performance even when faced with substantial penalties.[6] For this reason, numerous states continue to use ARMIS reports to

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[5] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 33 (1990) ("The companies we seek to regulate under an incentive-based system are large, publicly-traded firms, that compete daily for sales of nonregulated products and services, in the financial markets, and in the labor markets. If we can design a regulatory system for these carriers' access business that mirrors the efficiency incentives found in competitive markets, we will have put in place a system that will go a long way toward making the LECs stronger, more productive competitors for all of the markets in which they must operate.").

[6] *See* Joint Comments and Opposition of the New Jersey Division of Rate Counsel, Public Counsel Section of the Washington State Attorney General's Office and the National Association of State Utility Consumer Advocates, WC Dkt. No. 07-204, at 28-

measure price cap ILECs' service quality, including Qwest's. For example, as NASUCA explains, the Washington Utilities and Transportation Commission ("WUTC") uses ARMIS data to monitor whether Qwest is meeting the performance benchmarks of its latest price-cap plan. *See* NASUCA Comments at 18-19. Similarly, because California's service quality system does not cover outage times for residential customers, the California PUC relies on "data based on the FCC's ARMIS system, since our own data collection system does not cover that particular element of service quality."[7] The Colorado PUC also uses ARMIS data to measure Qwest's performance. *See NASUCA Comments* at 20-21. Numerous states also use ARMIS revenue data to calculate the amount owed if performance benchmarks are not met.[8]

Qwest next argues that, because price cap regulation has severed the link between regulation and the ILECs' costs, there is no need for ARMIS cost reports. *See Petition* at 5. Again, Qwest's premise is simply wrong. As TWTC and others have shown, price-

30 (filed Dec. 6, 2007) ("*NASUCA Comments*"). NASUCA notes that at least three states in Qwest's region "continue to have service quality plans in place with metrics and penalties for non-performance as part of the alternative regulatory framework: Arizona, Colorado, and New Mexico." *NASUCA Comment*s at 27; *see also Investigation into a Successor Incentive Regulation Plan for Verizon New England, Inc*., 2005 Vt. PUC LEXIS 152, at *173 ("Experience has shown that, even when penalties exist, Verizon failed to comply with a service quality plan that it recommended after negotiating the plan with the Department; it is hard to envision that Verizon would have maintained service quality [ ] at pre-existing levels in the absence of such penalties.").

[7] *The Office of Rate Taxpayer Advocates v. Pacific Bell Tel. Co.*, 2001 Cal. PUC LEXIS 1075, at *19.

[8] *See, e.g., Commission's Consideration of the Maryland Carrier-to-Carrier Guidelines at al.*, 2002 Md. PSC LEXIS 19.

cap ILECs' rates for special and switched access services[9] have been and will continue to be set by reference to cost and ARMIS reports remain an important, if not the exclusive way, to measure those costs. Such measurements are only becoming more important as the FCC prepares to reevaluate intercarrier compensation and RBOC special access rates.[10]

The FCC has long understood that states rely heavily on ARMIS cost data to monitor price-cap carriers' costs so that states can evaluate and recalibrate price-cap plans. In fact, in 2001, well after most RBOCs came under price-cap regulation at the state level, the FCC rejected a USTA petition to eliminate most ARMIS reporting requirements in part because such relief would prevent states from analyzing carriers' costs.[11]

The passage of six years has offered no basis for changing this conclusion. The record shows that states continue to use ARMIS reports to evaluate ILECs' price cap plans. *See TWTC AT&T Opposition* at 11-12. For example, the WUTC continues to use

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[9] Regardless of how competitive the local exchange is now or may become in the future, ILECs' costs will remain crucial to setting access rates because all carriers, including CLECs, retain a terminating access monopoly.

[10] *See, e.g.*, Comments of the AdHoc Telecommunications Users Committee, WC Dkt. No. 07-204, at 7-8 (filed Dec. 6, 2007) ("*AdHoc Comments*"); TWTC Opposition, WC Dkt. No. 07-21, at 5-8 (filed Mar. 19, 2007) ("*TWTC AT&T Opposition*"); TWTC Opposition, WC Dkt. No. 05-342, at 8-9 (filed Jan. 23, 2006) ("*TWTC BellSouth Opposition*"). TWTC's opposition in WC Dkt. No. 07-21 is attached hereto as Appendix A and its opposition in WC Dkt. No. 05-342 is attached hereto as Appendix B.

[11] *See 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II et al.*, Report and Order *et al.*, 16 FCC Rcd 19911, ¶ 134 (2001) ("*Phase II Order*") ("In the absence of alternative Federal or State mechanism(s), USTA's proposal to eliminate state-by-state ARMIS information would destroy the utility of ARMIS to states that wish to compare cost information of the incumbent LEC in their states to that incumbent LEC's costs in other states.") (internal citations omitted).

ARMIS reports to "monitor and measure" ILECs' progress under price cap plans.[12] In 2002, the Maryland PUC examined data from Verizon's ARMIS Report 43-01 and found that, "What is clear from the chart is that Verizon-MD's rate of return has steadily and significantly increased since the inception of the *Price Cap plan* in 1996." (emphasis added). Based on that finding and the MD PUC's belief "that access charges should be moved closer to cost," the PUC decided that "it is now appropriate to implement a second reduction in Verizon MD's switched access charges," since Verizon was already recovering its costs through its retail rates.[13] Similarly, as part of its reevaluation of Verizon's price cap plan, the Vermont PUC performed a cost-of-service study in which it relied in part on ARMIS data to calculate Verizon's rate base.[14] The D.C. PUC also found that ARMIS data remains critically important in monitoring, and, at the end of a price cap plan, reevaluating whether the price cap plan continues to be reasonable. As a condition of its latest price cap plan, Verizon was required to file the ARMIS USOA report. The D.C. PUC concluded that such data will be "useful as financial questions

[12] WUTC Comments, WC Dkt. No. 07-204, at 3 (filed Dec. 6, 2007) ("*WUTC Comments*"); *see also* NASUCA Comments at 18 ("An expert witness for Public Counsel, Peter Loube, also relied on ARMIS reports in his pre-filed testimony on whether Qwest's proposal met the AFOR public policy goals, whether the proposal was anti-competitive, and whether the proposed rates were reasonable. Specifically, Dr. Loube used ARMIS reports to calculate the size of Qwest's Washington state market share, and its test-year reported return on capital from interstate special access services.").

[13] *Provision of Universal Service to Telecommunications Users*, 2002 Md. PSC LEXIS 15, at *95-96.

[14] *See Investigation*, *supra* note 6, 2005 Vt. PUC LEXIS at *137-38 ("ARMIS related adjustments consist of four parts. It removes from the cost of service: (1) ARMIS non-regulated expenses of $ 8,875,000; (2) ARMIS non-regulated revenues of $ 7,282,000; (3) ARMIS non-regulated Total Plant in Service and amortizable assets of $ 7,160,000; and (4) ARMIS non-regulated accumulated depreciation reserve of $ 3,734,000.").

arise or in considering our approach to regulation of Verizon following the end of the current price cap plan."[15] There can therefore be no doubt that ARMIS data provides a crucial and unique window into price cap ILEC's costs.

In certain areas, such as the regulation of pole attachment rates, resale discounts, and certain access charge adjustments, the relationship between the price cap ILEC's costs and its rates is even clearer. As Qwest admits, ARMIS data remains absolutely necessary for calculating the appropriate rate for pole attachments and exogenous cost adjustments to price caps.[16] For this reason, the FCC has refused to eliminate ARMIS reports in the past. For example, in its *Phase II Order*, the FCC rejected the USTA petition to eliminate the obligation to report USOA ARMIS data in part because it assists parties to pole attachment disputes in calculating the appropriate attachment rate.[17] This

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[15] *Verizon Washington, D.C. Inc.'s Price Cap Plan 2004 for the Provision of Local Telecommunications Services in the District of Columbia*, 2006 D.C. PUC LEXIS 179, at *3.

[16] *See Petition* at 10 & n.25 and 14. As AdHoc notes, the data reported as part of ARMIS 43-03 is "a key element of the formulation of exogenous cost changes under the existing price caps plan and is an element that comes into play each year during the annual access tariff filing process and at subsequent points during the year as exogenous cost changes are made." *AdHoc Comments* at 4. *See also TWTC AT&T Opposition* at 12.

[17] *See Phase II Order* ¶ 48 ("Fourth, federal and state regulators currently use the information maintained in Class A Account 2411, Poles, to resolve disputes over maximum permitted rates for access to poles, ducts, conduits, and rights-of-way. As the National Cable Television Association (NCTA) observes, the current pole attachment formulae rely on Class A accounting data. Pole rents are determined by the Class A Account 2411; under USTA's proposal to eliminate all Class A accounts, a discrete account for pole investment would no longer be publicly available. Reliance on publicly available information has allowed pole owners and attaching parties to resolve rate issues without Commission involvement, which is a cost-savings benefit to utilities, cable operators, other attaching parties, and the Commission.") (internal citations omitted). Some states that have asserted the reverse preemption right under Section 224(c) also rely on ARMIS data to establish pole attachment rates. *See, e.g., Public Utilities Commission Instituting a Proceeding on Communications, Including an Investigation of the Communications Infrastructure of the State of Hawaii*, 2002 Haw. PUC LEXIS 328, at *1

is not a trivial or minor use of ARMIS data. Millions of dollars are often at stake when rates are calculated in a pole attachment adjudication. The manner in which the FCC regulates pole attachment rates has not changed since it rejected USTA's petition in 2001. In fact, the FCC's recent NPRM regarding pole attachment rates will only heighten the importance of accurately measuring the ILECs' pole costs.[18] ARMIS data is also used to calculate Qwest's avoided costs to establish resale rates.[19]

As TWTC and other commenters have argued, ARMIS data remains crucial for many other regulatory functions governing price cap carriers. These include state implementation of the TELRIC pricing model and the federal USF forward-looking cost model for non-rural carriers.[20] Without access to ARMIS data, it will be difficult if not impossible for regulators to perform these crucial functions. There is also no other

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("Pursuant to our decision and order, on January 18, 2001, Verizon Hawaii filed: (1) 1997, 1998, and 1999 maximum pole and duct rates based on Verizon Hawaii's automated reporting management information system (ARMIS) data for the previous year utilizing the Federal Communications Commission's (FCC's) cable television pole and duct rate formula (cable formula) (Compliance Item No. 1).").

[18] *See, e.g., Implementation of Section 224 of the Act; Amendment of the Commission's Rules and Policies Governing Pole Attachments,* Notice of Proposed Rulemaking, 22 FCC Rcd 20195, ¶ 15 (2007) ("We seek comment on developments related to rates, costs, and bargaining power between electric utilities and incumbent LECs.").

[19] *See, e.g., Sprint Communications Company L.P.'s Petition for Arbitration of Interconnection Rates, Terms, Conditions and related Arrangements with Midwest GTE Inc.*, 1997 Mo. PSC LEXIS 38, at *15 ("The second study, GTE's modified avoided cost study, also calculated costs for each service on a national basis, using FCC ARMIS data"); Integra Comments at 10.

[20] *See, e.g., TWTC Bellsouth Opposition* at 11 (*citing Phase II Report and Order* ¶¶ 11, 40, 45, 49-50) (noting that "states unquestionably rely on Class A accounting data and ARMIS reporting for setting TELRIC rates."); *See* Opposition of Integra Telecommunications, Inc., WC Dkt. No. 07-204, at 8-9 (filed Dec. 5, 2007) ("*Integra Opposition*").

equivalent readily available or objective data source that can assist carriers in settling interconnection disputes. *See Integra Opposition* at 9.

Qwest's *Petition* also must be rejected, because Qwest has not even attempted to identify the costs of compliance with ARMIS requirements. It is therefore impossible to know whether the burdens placed on Qwest outweigh the substantial benefits received by Qwest's continuing obligations. Every regulation has a cost. Simply stating that a requirement is "burdensome," without offering any means of measuring how burdensome, does not meet the requirements of Section 10.

In any event, it is likely that the "burden" associated with the rules for which Qwest seeks forbearance is minimal, because, as several commenters note, Qwest has not even asked for forbearance from the ARMIS accounting rules post forbearance. *See, e.g., AdHoc Comments* at 2. Qwest seeks only to be relieved of the "burden" of the additional step of populating the ARMIS reports generated by compliance with the accounting rules.

Furthermore, retention of ARMIS reporting obligations could actually save Qwest resources going forward as states eliminate their own performance reporting and increasingly rely on ARMIS reports. As the WUTC argues, ARMIS reports in many cases are preferable to state-specific reports because the uniform metrics permit benchmarking across multiple states. *See WUTC Comments* at 6.[21] As the California

[21] *See also* Comments of the Colorado Public Utilities Commission, WC Dkt. No. 07-204, at 5 (filed Dec. 6, 2007) ("Consider the Data Retrieval Module, which allows the use to compare and contrast various financial, operational, and other statistics (including demand data for Qwest's fourteen states) across Regional Bell Operating Companies (RBOCs), and rural ILECs (RLECs). The COPUC has performed many such analyses using this module."); *NASUCA Comments* at 8-9. Because all price cap carriers must file ARMIS data, the CPUC was able to benchmark Verizon's behavior against other similarly situated carriers. *See Commission's Own Motion to Assess and Revise the New*

Public Utilities Commission ("CPUC") noted, "just a year ago, the CPUC curtailed regulation of the retail telecommunications service offerings of the four major California ILECs. The CPUC expressed its intent to rely on the ARMIS reports as part of its monitoring program to ensure that the competitive market is functioning well…Additionally, the CPUC eliminated certain state specific monitoring reports which were required under the California's New Regulatory Framework" because it could rely on ARMIS.[22] Similarly, the WUTC did not "design[] state specific replacements for FCC reporting [for Qwest] because it contemplated that FCC reporting requirements would remain in place during the AFOR term." *WUTC Comments* at 4. Colorado is making a similar move away from state specific reports and towards reliance on ARMIS. *See NASUCA Comments* at 22. Without Qwest's ARMIS reports, therefore, state commissions would likely reinstitute state specific reporting requirements, thereby *increasing* Qwest's regulatory compliance burden. *See WUTC Comments* at 4-5.

There are no doubt adjustments that can and should be made to ARMIS reports. But the way to address these problems is not through *eliminating* the reporting requirements for a single price cap ILEC. As many commenters argue, the appropriate way to address any changes to the ARMIS regime is through a rulemaking of general applicability. Indeed, as TWTC has shown, the FCC has continued to modify and streamline its ARMIS rules over the years. *See TWTC BellSouth Opposition* at 4-7. The FCC can modify or eliminate outdated ARMIS requirements through a similar procedural vehicle. Given state commissions' continuing reliance on ARMIS data, the FCC should,

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Regulatory Framework for Pacific Bell and Verizon California Inc., Order Instituting Investigation et al., 2003 Cal. PUC LEXIS 657.

[22] CPUC Comments, WC Dkt. No. 07-204 at 3 (filed Dec. 6, 2007).

as Sprint/Nextel suggests, establish a Federal State Joint Board to evaluate any necessary changes.[23] Qwest provides no justification for the piecemeal approach embodied by its petition.

IV. CONCLUSION

For the forgoing reasons, the FCC should deny Qwest's petition for forbearance.

Respectfully submitted,

_____/s/___________________

Thomas Jones
Jonathan Lechter

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December 21, 2007

[23] *See, e.g.,* Sprint/Nextel Corporation Comments, WC Dkt. No. 07-204, at 6 (filed Dec. 6, 2007).

APPENDIX A

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OPPOSITION OF TIME WARNER TELECOM INC.

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OPPOSITION OF TIME WARNER TELECOM INC.

Time Warner Telecom Inc., by its attorneys, hereby submits this opposition to the petitions for forbearance filed by AT&T in the above referenced docket.[1]

I. INTRODUCTION AND SUMMARY.

AT&T has asked the Commission to forbear from enforcing virtually every cost accounting requirement to which AT&T is subject[2] and from the ARMIS reporting requirements.

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[1] *See Pleading Cycle Established for AT&T Inc. Petition for Forbearance from the Commission's Cost Assignment Rules, WC Dkt. No. 07-21*, Public Notice, DA 07-731 (rel. Feb. 16, 2007); Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules, WC Dkt. No. 07-21 (filed Jan. 25, 2007) ("*AT&T Petition*"); Petition of BellSouth Telecommunications For Forbearance Under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules, WC Dkt. No. 05-342 (originally filed Dec. 6, 2005) ("*BellSouth Petition*").

[2] *See AT&T Petition* at n.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

These regulations are necessary to measure, among other things, the costs AT&T incurs (and the profits it earns) in providing switched and special access services.[3] Under Section 10, the Commission may only forbear from enforcing these accounting rules if AT&T demonstrates that (1) the accounting rules are no longer necessary to ensure just, reasonable and not unjustly or unreasonably discriminatory rates; (2) the accounting rules are no longer necessary to protect consumers; and (3) forbearance is in the public interest. AT&T has failed to meet this standard.

AT&T's primary argument in support of its petitions is that cost accounting information is unnecessary since the Commission's existing price cap rules, that no longer include profit sharing or lower cost adjustment components, completely sever the connection between ILEC's prices and ILECs' costs. But this is simply incorrect. As long as the ILECs including AT&T retain market power and the Commission is statutorily bound to ensure that ILECs charge just, reasonable and not unjustly or unreasonably discriminatory rates, ILEC rates must be based to some extent on cost. This is not a theoretical proposition. The Commission has relied, most recently in the *CALLS* proceeding, on measures of costs yielded by the accounting regulations at issue here to set AT&T's and other price cap ILECs' prices. The Commission is also currently

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other related rules that are completely derivative of or dependant on the forgoing rules, including the cost allocation and rate of return reporting requirements in Parts 43.21(d)(1), 43.21(d)(2), 43.21(f), and 65.600)."). The rules from which AT&T seeks forbearance are collectively referred to herein as "accounting rules," unless otherwise specified.

[3] *See id.* n.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 495(A) and the Reg/Non-Reg Actual Usage Report (FCC Form 495B).") AT&T also indicates that data currently available under ARMIS reports 43-01 (cost and revenue), 43-02 (Analysis of assets sold to and purchased from Affiliates) and 43-03 (regulated/non-regulated data) will no longer be reported if its requested relief is granted. *See id.* Attach. 6.

reviewing ILEC cost accounting data to determine whether and how to re-impose price caps on special access services. Rates set under price caps are therefore very much tied to regulatory accounting costs. In addition, states rely on costs yielded by FCC cost accounting regulations to set price cap rates and for other regulatory purposes.

Moreover, the continued connection between accounting costs and price cap rates gives AT&T the incentive to misallocate the costs of unregulated and competitive regulated services to cost categories associated with regulated services such as special access and terminating switched access over which AT&T retains market power. The Commission adopted the Part 64 and Part 32 affiliate transaction rules from which AT&T now seeks forbearance to prevent exactly this type of cost misallocation. There is simply no basis for eliminating these regulations, especially since the Commission reiterated their continued importance just 10 days ago in its conditional grant of Qwest's petition for forbearance from dominant carrier regulation of integrated, in-region long distance services.

This is not to say that the current accounting rules applicable to ILECs are ideal. For example, many states have recently indicated that, because of various FCC decisions (*e.g.*, retention of the Part 36 freeze; deregulation of DSL while continuing to treat DSL costs as regulated under Part 64). the data produced by the existing cost accounting rules may no longer reflect ILECs' costs as accurately as possible. But these issues are most appropriately addressed by updating the rules to reflect changed circumstances after consultation with state regulators. There is simply no basis for eliminating the rules.

II. THE COST ACCOUNTING AND ARMIS REGULATIONS FOR WHICH AT&T SEEKS FORBEARANCE ARE NECESSARY FOR EFFECTIVE RATE REGULATION AND FOR OTHER CRITICAL REGULATORY FUNCTIONS

Section 10 of the Communications Act requires that the Commission forbear from applying a statutory provision or regulation if it determines that (1) the requirement is not "necessary" to ensure just, reasonable and not unjustly or unreasonably discriminatory charges and practices; (2) the requirement is "not necessary for the protection of consumers;" and (3) forbearance is in the public interest. *See* 47 U.S.C. § 160(a). As AT&T correctly states, the term "necessary" in this standard does not mean "absolutely required,"[4] but rather that there is a "strong connection between what the [FCC] has done by way of regulation and what the agency permissibly sought to achieve with the disputed regulation." *See CTIA v. FCC* at 512. Crucially, in determining whether a regulation still serves its intended purpose, the Commission must follow the analytical framework it has used in the past or provide an explanation as to why it has departed from that framework.[5] When applied to the petitions at issue here, it is clear that AT&T has failed to meet the Section 10 standard for forbearance.

A. Both The FCC And State Commissions Continue To Rely On Cost Accounting And ARMIS Data To Set Rates Under Price Caps And To Achieve Other Critical Regulatory Goals

Notwithstanding AT&T's claims to the contrary, federal and state ILEC price cap regulation remains critically tied to AT&T's costs as measured by regulatory cost accounting conventions. As the Supreme Court has recognized, price cap plans enacted by the states and the FCC all use a cost of service formula as a starting point for determining rates and then apply inflation and productivity adjustments to determine the cap.[6] In addition, both federal and state

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[4] *See Cellular Telecomms. & Internet Ass'n v. FCC*, 330 F.3d 502, 509-10 (D.C. Cir. 2003) (*CTIA v. FCC*).

[5] *See AT&T Corp. v. FCC*, 236 F.3d 729, 736-737 (D.C. Cir. 2001) (overturning FCC denial of petition for forbearance from dominant carrier regulation where the FCC did not apply its traditional non-dominance analysis and failed to explain why such a departure was reasonable).

[6] *See Verizon v. FCC*, 535 U.S. 467, 487 (2002) ("The price-cap scheme starts with a rate generated by the conventional cost-of-service formula, which it takes as a benchmark to be decreased at an average of some 2-3 percent a year to reflect productivity growth…subject to an upward adjustment if necessary to reflect inflation or certain unavoidable 'exogenous costs.'").

price cap plans generally expire within a certain set amount of time.[7] Upon expiration, the regulators investigate whether the ILEC's rates continue to be reasonable in light of its costs and overall productivity. ILECs are often required to submit cost data to ensure that their prices are at least reasonably related to their costs.[8] Thus, far from severing the connection between costs and prices, price cap regulation applicable to AT&T and other ILECs at the federal and state levels remains fundamentally reliant on regulatory measures of costs.

1. The FCC Has Relied On Cost Accounting And ARMIS Data In The Recent Past, And Must Continue To Do So In The Future To Set AT&T's And Other ILECs' Prices Under Price Caps.

AT&T argues that its prices are no longer subject to regulation that relies on regulatory measures of cost and that, even if the Commission were to establish a new x-factor in the future for price caps, it would rely on total company costs, thus obviating the need for FCC cost accounting requirements. *See AT&T Petition* at 24-25. But AT&T is wrong on both counts. The Commission continues to rely on its review of the costs AT&T incurs to provide specific services subject to price caps to ensure that rates for such services set under price caps continue to comply with the Section 201 and Section 202 requirements for just, reasonable and not unjustly or unreasonably discriminatory rates.

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[7] *See, e.g., Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, Fourth Report and Order and Second Report and Order, 12 FCC Rcd 16642, ¶ 166 (1997) ("*Price Cap Performance Review*") (holding that the Commission will review its price cap rules within 3 years).

[8] *See, e.g., Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service,* Sixth Report and Order in CC Dkt. Nos. 96-262 *et al.*, 15 FCC Rcd 12962, ¶ 57 (2000), *subsequent history omitted* (stating that price cap LECs have the option of submitting "a cost study based on forward looking economic cost that will be the basis for reinitializing rates to the appropriate level.") ("*CALLS Order*").

For example, in the *CALLS Order*, the last time the FCC modified ILEC price cap levels, the Commission conducted an explicit review of carrier costs to determine the appropriate rate for various ILEC access services. ILECs electing[9] *CALLS* were given no pricing discretion on a number of services; such ILECs were required to meet target rates, which were in turn tied to the ILECs' costs. The x-factor (which was not a productivity factor *per se*) was set so as to move switched access charges closer to the costs associated with specific service categories, in particular switching and transport.[10] Importantly, price reductions were targeted only at those baskets with excessive rates-of-return.[11] The 15 percent rate-of-return earned by the ILECs on the common-line basket was not targeted for reduction since the Commission believed, based on ARMIS data (likely ARMIS report 43-04), that this was a reasonable rate-of-return.[12] Without the accounting rules from which AT&T seeks forbearance, there would have been no way for the Commission to determine the costs for particular services (*e.g.*, interstate special access) and therefore no way to set the cap to ensure that the ILECs' prices remained within a zone of

[9] Those ILECs that did not elect CALLS were to be subject to a cost-study proceeding to accomplish of the longstanding Commission goal that "interstate access charges [would] reflect the forward looking economic costs of providing interstate access services." *See CALLS Order* ¶ 60. The price cap index of LECs opting out of *CALLS* would be "set at forward looking economic costs." *Id.* ¶ 150.

[10] *See id.* ¶ 158 (noting that the *CALLS* plan will drive "switched access usage charges closer to their *actual costs*…"); *id*. ¶ 167 ("Targeting the x-factor reductions to switching and switched transport charges will more quickly reduce charges for these services *towards cost-based levels* than would be possible under the existing price cap methodology.") (emphasis added).

[11] *See id.* ¶ 171 ("…price cap LECs' basket earnings are significantly higher for traffic-sensitive services than for common line services…Therefore we find it reasonable to target reductions to traffic-sensitive services rather than to common line services.").

[12] *See id.* n.376 ("Based on 1999 ARMIS data, Commission staff calculated approximate rates of return of 85 percent for the traffic-sensitive basket, 20 percent for the trunking basket, and 15 percent for the common line basket."). A fifteen percent rate of return is within the range held to be reasonable in the first price caps order. *See Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶¶ 164- 165 (1990).

reasonableness.[13] For this reason, the Commission made clear that ARMIS data in report 04-03 should continue to be provided until the CALLS regime is replaced.[14]

In addition, the Commission is currently relying on cost data reported by AT&T and other incumbents to determine whether the FCC should re-impose price cap regulation on ILEC special access services subject to *Phase II* pricing flexibility. In the NPRM in WC Docket No. 05-25, the Commission used ARMIS data to examine "the relationship between demand growth and growth in expenses and investment" to determine if incumbent LECs had achieved economies of scale and scope that warrant a reexamination of special access rates.[15] The Commission also examined ARMIS data in connection with whether it should adopt a "g" factor in the special access price cap index formula. *See Special Access NPRM* ¶ 40.

There are other contexts in which the Commission will need to rely on accounting data in the future to ensure that ILEC rates remain just, reasonable and not unjustly or unreasonably discriminatory. In particular, the proponents of the Missoula plan relied heavily on separations data and ARMIS reports in determining the impact of its proposed reforms.[16] Without such data,

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[13] As the National Association of State Utility Consumer Advocates ("NASUCA") argued in its comments in opposition of the BellSouth Petition, "The existence of market dominance is reason to guard against anticompetitive behavior. One way to detect such behavior is to analyze costs to determine whether predatory pricing is being practiced. Without following cost assignment rules, predatory pricing could not be detected." Reply Comments of NASUCA, WC Dkt. No. 05-342, at 6 (filed Feb. 13, 2006) ("*NASUCA Reply Comments in Dkt. No. 05-342*").

[14] *See 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II et al.*, Report and Order, 16 FCC Rcd 19911, ¶ 149 (2001) ("*Phase II Report and Order*").

[15] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services,* 20 FCC Rcd 1994, ¶ 29 (2005) ("*Special Access NPRM*").

[16] *See* Missoula Intercarrier Compensation Plan at 107, attached to Letter from Tony Clark, North Dakota PSC Commissioner and Chair, NARUC Committee on Telecommunications; Ray

it would be nearly impossible to measure the effect (and wisdom) of any proposed changes to switched access prices. Indeed, the Commission stated that further changes in intercarrier compensation, including access charge reform post-CALLS, require continued availability of the information reported in ARMIS Report 43-04.[17] For example, the manner in which costs are allocated has an effect on the proper price cap carrier subscriber line charge ("SLC") level in any new intercarrier compensation reform scheme.[18] As long as incumbent LECs retain market power in the provision of terminating switched access services (to say nothing of special access), the Commission is statutorily bound to keep track of incumbent LEC costs to ensure that switched access charges remain just, reasonable and not unjustly discriminatory as required by Sections 201(b) and 202(a).[19]

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Baum, Oregon PUC Commissioner and Chair, NARUC Task Force on Intercarrier Compensation; and Larry Landis, Indiana URC Commissioner and Vice-Chair, NARUC Task Force on Intercarrier Compensation, to Hon. Kevin J. Martin, Chairman, FCC, CC Dkt. No. 01-92 (filed July 24, 2006).

[17] *See Phase II Report and Order* ¶ 148 ("but not for local switching. The Commission's ability to monitor and evaluate local transport access rates would be greatly hindered if it could not identify and track local transport costs separately from local switching costs.").

[18] *See Comments of NASUCA et al.*, CC Dkt. No. 80-286, at 9 (Aug. 22, 2006) ("…if carriers properly allocated and assigned costs to unregulated services, the SLC -- which for the BOCs and other price cap carriers, is currently based on their [part 69] CMT revenue requirement -- would likely decline, as the cost of regulated services would decline.") (citation omitted) ("*NASUCA Comments in Dkt. No. 80-286*").

[19] AT&T provides an extensive discussion of its financial accounting practices and obligations in support of its point that Commission cost accounting regulations are unnecessary for ensuring financial transparency. *See, e.g., AT&T Petition* at 32-28. But this is a red herring. Unless sound policy dictates otherwise, the Commission has eliminated or refused to adopt cost accounting requirements where the information at issue would be included in reports filed with the SEC. *See Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I*, Report and Order, 15 FCC Rcd 8690, ¶ 40 (2000) ("*Phase I Report and Order*"). In any event, the Commission has never placed

2. The States Also Remain Critically Dependent On Cost Accounting And ARMIS Data To Set AT&T's And Other ILECs' Prices And For Other Regulatory Purposes.

States continue to rely on FCC accounting rules, especially Part 36, to regulate AT&T's and other ILECs' rates, including rates for UNEs and rates for intrastate services subject to price caps. They do so because they are legally bound to rely on some form of jurisdictional cost allocation and because it is sound policy for them to do so.

In *Smith v. Illinois Bell Tel. Co.*, the Supreme Court held that some form of jurisdictional separations system, such as Part 36 (in combination with Parts 32 and 64), is *required* to enable the jurisdictions to carry out their respective ratemaking tasks to the extent those are performed in reliance upon the regulated company's costs.[20] States continue to believe that *Smith v. Illinois Bell* mandates that some form of separations continue in effect even under a price cap environment.[21] States believe that while separations rules could be simplified, "So long as there remain two jurisdictions, cost assignment should at least roughly follow jurisdictional authority and revenue assignment." *Glide Path II Paper* at 9. The FCC's Wireline Competition Bureau seems to agree, holding in its Biennial Regulatory Review released just last month that the "WCB staff concludes that Part 36 remains necessary in the public interest, in some form."[22]

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primary reliance on the need to ensure financial transparency as a basis for retaining its cost accounting rules.

[20] *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148-51 (1930).

[21] *See Jurisdictional Separations and Referral to the Federal-State Joint* Board, Order and Further Notice of Proposed Rulemaking, 21 FCC Rcd 5516, Appendix B - *Post Freeze Options for Separations*, at 14 ("*Glide Path II Paper*") (2006) ("*Jurisdictional Separations FNPRM*").

[22] *See FCC 2006 Biennial Regulatory Review*, WC Dkt. No. 06-157, Wireline Competition Bureau Staff Report, DA 07-656, at 18 (rel. Feb. 14, 2007) ("*WCB Staff Report*").

Furthermore, states have specifically rejected AT&T's assertion that the adoption of price cap regulation obviates the need for the accounting rules for which AT&T seeks forbearance. States assert that they need Part 36 separations data "to operate universal service plans or for rate design purposes." *Glide Path Paper at 14.*[23] The Texas commission asserted that affiliate transaction rules in Part 36 are necessary in setting UNE rates and state USF requirements.[24] Part 64 rules are also used by states to calculate UNE rates.[25] The FCC has also used data in ARMIS Report 43-04 and separations data when setting UNE rates on behalf of states.[26] States

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[23] *See* Comments of State Members of Separations Joint Board, WC Dkt. No. 04-36, at 5 (filed Oct. 24, 2004) ("…states use intrastate-separated costs as an element in their state universal service fund calculations.")

[24] *See* Phase 3 Reply Comments of the Texas Office of Public Utility Counsel, CC Dkt. Nos. 00-199 *et al.*, at 3 (filed May 7, 2002) (stating that "affiliate transaction rules are still very relevant to the determination of UNE rates and the Universal Service Fund requirements. Texas, for instance, requires the utilization of forward looking long run incremental cost studies for the setting of UNE rates and USF fees. Forward looking LRICS in these cases are highly dependant on historical loop costs, which often include costs incurred through transactions with other affiliates.").

[25]*See* Reply Comments of the Public Utilities Commission of Ohio, CC Dkt. Nos. 00-199 *et al.*, at 7 (filed May 9, 2002) ("Generally, ILECs consider all regulated expense from their corporate books 'Part 64 regulated expenses.' Analysis is performed to such expenses at an accounting code level...The remaining expenses are TELRIC expenses. If the FCC were to subject its reporting requirements to a three-year sunset, it would be impossible to calculate accurate the ILECs' TELRICs.").

[26] *Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration in the Matter of Petition of AT&T Communications of Virginia Inc., Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia Corporation Commission Regarding Interconnection Disputes With Verizon Virginia Inc.*, Memorandum Opinion and Order, 18 FCC Rcd 17722, ¶ 456, n.1162 (2003).

also rely on accounting data to "effectively conduct imputation tests for competitive services" to prevent cost misallocations.[27]

Most crucially, despite AT&T's protestations to the contrary, states, like the FCC, continue to need separated cost information to ensure that rates subject to price caps remain just and reasonable. As NASUCA asserts, "Contrary to the views espoused by various incumbent local exchange carriers…the presence of incentive regulation does not make the separations process irrelevant. Among other reasons…interstate and intrastate rates -- including those that prevail under alternative regulation -- require re-initialization to incorporate correct separations accounting." [28] This is so even if "a company's intrastate rates have been totally de-coupled from costs." *California Comments in Dkt. No. 80-286* at 8. As the Wisconsin commission indicated, "[r]ates are not completely divorced from costs until the potential for adjustments based on earnings levels [is] also eliminated."[29]

States have put this theory into action by regulating price cap carriers, including AT&T, with reference to their costs. For example, in reviewing its three year price cap plan in 2004, Indiana required SBC (now AT&T) to "submit cost studies to support price decreases for existing services and introductory prices for new services."[30] Cost studies were also necessary

[27] *See* Comments of the People of the State of California and the California Public Utilities Commission ("California"), CC Dkt. No. 80-286, at 10 (Sept. 26, 2000) ("*California Comments in Dkt. No. 80-286*").

[28] Reply Comments of NASUCA *et al*., CC Dkt. No. 80-286, at 2 (Nov. 20, 2006); *see also California Comments in Dkt. No. 80-286* at 7 ("For companies with intrastate price cap mechanisms, such increases [from a jurisdictional freeze] could arise either by direct recognition of the separations changes through exogenous factor adjustments or more directly through earnings-related components of the regulatory mechanisms.").

[29] Comments of the Wisconsin PSC, CC Dkt. No. 80-286, at 5 (Aug. 17, 2006).

[30] *Petition of Indiana Bell Telephone Company, Incorporated ("SBC Indiana") For the Commission to Exercise its Statutory Authority Under IC. 8-1-2.6 Et. Seq. to Decline to Exercise*

for bundled pricing plans. *See SBC Indiana Order* *68. As a part of its three-year long price cap review, an audit by the California PUC determined that SBC had "significantly overstated the expenses it had reported" during the late 1990s.[31] The commission planned to take that finding into account in determining how to revise its price-cap plan. *See SBC California Opinion* at *257-8.

Finally, jurisdictionally separated accounting data is also necessary for states to properly calculate exogenous cost increases for price cap carriers. As NASUCA demonstrated in its initial comments on the *BellSouth Petition*, resetting of price cap rates and the calculation of exogenous costs "can only be reflected by using costs recorded pursuant to the Commissions' accounting rules." *NASUCA Reply Comments in Dkt. No. 05-342* at 6. Similarly, Vermont and Nebraska have indicated that even under price caps, "separations rules can still affect [switched access rates]" through the calculation of exogenous adjustments.[32] Accounting data is necessary so that exogenous adjustments at the state and Federal level do not result in ILEC over-earnings.[33]

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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, et al., Cause No. 42405, 2004 Ind. PUC LEXIS 253, *18 (2004) ("*SBC Indiana Order*").

[31] *Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the New Regulatory Framework for Pacific Bell and Verizon California Incorporated*, Interim Opinion Regarding Selected Issues Related to the Audi of SBC Pacific Bell Telephone Company, 2004 Cal. PUC LEXIS 55, *1 (2004) ("*SBC California Opinion*").

[32] Comments of Vermont Public Service Board, Vermont Department of Public Utilities, and Nebraska Public Services Commission, CC Dkt. No. 80-286, at 7 (Aug. 22, 2006).

[33] *See* California Reply Comments, CC Dkt. No. 80-286, at 9 (Oct. 10, 2000).

B. In Light Of The Strong Connection Between AT&T's Regulated Prices And AT&T's Costs, Part 64 And Part 32 Affiliate Transaction Rules Remain Necessary To Prevent AT&T From Engaging In Anticompetitive And Inefficient Cost Misallocation

It is bedrock FCC policy that ILECs subject to some form of cost-based regulation have strong incentives to misallocate the costs of unregulated and even regulated services subject to competition to cost accounting categories associated with regulated services over which ILECs have market power. In light of the strong connection between AT&T's federal and state regulated rates and the regulatory cost accounting categories maintained by the FCC, it is clear that the Part 64 and Part 32 affiliate transaction rules that are designed to prevent cost misallocation remain necessary to ensure just, reasonable and nondiscriminatory rates and to protect consumers against the distortions and inequities of cross-subsidy.

There should be no dispute that the Commission's established policy is to apply appropriate cost accounting rules to ILECs as long as ILEC prices are based to some degree on regulatory accounting costs. Even when most BOCs offered unregulated services *via* separate corporate affiliates, the Commission imposed accounting requirements, most importantly the affiliate transaction rules, to ensure that BOCs would not subsidize unregulated service offerings by inappropriately shifting costs from the affiliate to the regulated rate base. But proper cost allocation rules became especially critical when, in the *Computer III* proceeding, the Commission eliminated the requirement that BOCs provide enhanced services through a separate affiliate (which had obviated much of the need for comprehensive accounting safeguards) and instead permitted them to offer those services on an integrated basis. As the Commission explained in its initial *Computer III* order, the elimination of structural separation requirements created the risk that, "unless checked in some fashion, [the BOCs] would be able to shift costs properly attributable to their enhanced services offerings to those regulated services for which they still have market power."[34] The Commission correctly observed that "[s]uch cost-shifting can have adverse impacts on ratepayers, by improperly increasing the prices they pay for their use of regulated services, and on competition in unregulated markets, by providing an opportunity for carriers to charge artificially low prices for their unregulated goods and services." *See Computer III Report and Order* ¶ 234.

To limit the ILECs' opportunities to misallocate the costs of unregulated service offerings, the Commission adopted its Part 64 cost allocation rules. Those rules utilize a fully distributed cost methodology and a hierarchy of cost apportionment rules to separate the costs of regulated and unregulated services. In establishing these rules, the Commission's express intention was to (1) "keep regulated common carriers from using the revenues from their regulated services to subsidize nonregulated enterprises," and (2) "ensure that ratepayers receive their appropriate share of the benefits [in the form of economies of scope] arising from the offering of regulated and nonregulated services on a structurally unseparated basis."[35] The Commission adopted these requirements as the most appropriate means of preventing BOCs from charging unjust and unreasonable rates in violation of Section 201(b) for their *regulated* service offerings.[36] It is important to note in this regard that the Commission adopted the Part 64 rules notwithstanding the fact that the market for unregulated enhanced services was

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[34] *See Third Computer Inquiry*, Report and Order, 104 FCC 2d 958, ¶ 234 (1986), *subsequent history omitted* ("*Computer III Report and Order*").

[35] *See Separation of Costs of Regulated Telephone Service from Costs of Non Regulated Activities et al.;* Report and Order, 2 FCC Rcd 1298, ¶ 69 ("*Joint Cost Order*") (1987).

[36] *See id.* ¶ 37 ("protecting ratepayers from unjust and unreasonable interstate rates is the primary purpose behind the accounting separation of regulated from nonregulated activities"); ¶ 39 ("assurance of just and reasonable rates does not stop with assuring that regulated operations do no cross-subsidize nonregulated activities. Rather, if there are savings to be gained from the integration of regulated and nonregulated ventures, those savings must be shared equitably with ratepayers in order to achieve regulated service rates that are just and reasonable.").

competitive. The focus of the Commission's concern was the consequences for regulated rates of the BOCs' entry into unregulated, competitive markets.

The Commission has also adopted accounting requirements designed to limit ILECs' ability to act on their incentives to misallocate the costs of competitive, regulated services to cost categories associated with regulated services over which ILECs have market power. In every case, the Commission adopted these requirements notwithstanding the fact that the ILECs lacked market power or any significant market share in the would-be subsidized service. For example, the Commission established special accounting requirements to prevent ILECs from misallocating the costs of facilities deployed for the purpose of providing video dialtone. Video dialtone was a common carrier video transmission service to be provided *via* facilities that shared substantial joint and common costs with the facilities used to provide local exchange and exchange access services. Then, as now, the ILECs argued that there was no need for detailed accounting regulations because the ILECs had no market power in the provision of video services, a market dominated by the incumbent cable companies that were (and are) not subject to cost allocation regulations.[37] The Commission rejected these arguments, and found that accounting requirements were necessary to "ensure that telephone ratepayers do not have to bear the costs of video dialtone" and also to "protect cable operators from potential anticompetitive actions by LECs, stemming from LEC incentives and opportunities to price video dialtone

[37] *See Telephone Company - Cable Television Cross Ownership Rules Sections 63.54 - 63.58 and Amendments of Parts 32, 36, 61, 64, and 69 of the Commission Rules to Establish and Implement Regulatory Procedures for Video Dialtone Services,* Memorandum Opinion and Order on Reconsideration, 10 FCC Rcd 244, ¶ 159 (1994) ("*VDT Recon Order*") (describing ILEC arguments that accounting regulation "is unnecessary because LECs offering video dialtone have no market power as new entrants competing against established video monopolies"). *See also id.* ¶ 203 (same).

service unreasonably low relative to the costs of providing such service." *See VDT Recon Order* ¶ 2.[38]

Accordingly, the Commission required that ILECs establish separate accounting categories to capture "the revenues, investments, and expenses wholly dedicated to video dialtone" and to capture the "revenues, investments and expenses that are shared between video dialtone and the provision of other services." *Id.* ¶ 173. *See also id.* ¶¶ 215-220 (explaining the need for these requirements to avoid cross-subsidy). The Commission also required ILECs to seek waivers to establish new Part 69 rate elements for video dialtone ("to help ensure that interstate video dialtone costs are not recovered through charges for access services provided to interexchange carriers" *id*. ¶ 195) and established a separate price cap basket for video dialtone service charges to "prevent potential cross-subsidization"[39] These same concerns have added relevance now that AT&T, among other ILECs, is entering the video market in earnest and providing (thus far) unregulated video service over the same facilities used to provide regulated exchange access and local exchange services.

Furthermore, in order to "protect against improper cost allocations from one regulated activity [*i.e.*, one subject to competition] to another regulated activity [*i.e.*, one not subject to competition]," the Commission has appropriately required BOCs to treat in-region interLATA

[38] Notably, the Commission observed that cost misallocation issues were not as serious for video dialtone as they would have been if the ILECs had planned to utilize a "fiber-to-the-home architecture," (*see VDT Recon Order* ¶ 163) as at least one ILEC is now doing. The obvious point here is that such an architecture would include a much higher proportion of joint and common costs and therefore a much greater risk of cost misallocation.

[39] *See Price Cap Performance Review for Local Exchange Carriers; Treatment of Video Dialtone Services Under Price Cap Regulations,* Second Report and Order, 10 FCC Rcd 11098, ¶ 15 (1995) ("*VDT Price Cap Order*").

services provided on an integrated basis as non-regulated services under Part 64.[40] Just last year, long after the current price cap rules took effect, the Commission relied on the applicable affiliate transaction and cost allocation rules to "protect against cross-subsidization of section 272 affiliates by the BOCs' local customers."[41] Indeed, precisely because of the likelihood that the BOCs would engage in cross-subsidy if left unchecked, the Commission required that BOCs modify their cost allocation manuals to address specifically the allocation of OI&M services shared with Section 272 affiliates. *See OI&M Order* ¶ 20. The Commission also pointed out that cost allocation issues would be subject to a biennial audit. *See id.* ¶ 21.

Most recently, only *10 days ago*, the FCC held in the *Qwest IXC Dominance Order*[42] that the need for cost-allocation rules as applied to price cap carriers remains undiminished. There, the FCC reiterated that Qwest retained market power over the "bottleneck" telephone exchange and exchange access facilities in its region. *See Qwest IXC Dominance Order* ¶ 47. To ensure that the integration of its interexchange operations would not permit Qwest to misallocate its costs between competitive and non-competitive services, the Commission ruled that "Qwest still will be subject to…the Commission's accounting and cost allocation rules and related reporting requirements." *See id.* ¶ 54. For example, pursuant to Part 32 and 64 rules from which AT&T seeks forbearance, "Qwest is required to file on an annual basis a cost allocation manual…describing how it allocates costs between regulated and non-regulated activities, and to

[40] *See Accounting Safeguards Under the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 17539, ¶ 75 (1996) ("*Accounting Safeguards Order*").

[41] *See Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates,* Report and Order, 19 FCC Rcd 5102, ¶ 20 (2004) ("*OI&M Order*").

[42] *Petition of Qwest Communications International Inc. for Forbearance from Enforcement of the Commission's Dominant Carrier Rules As They Apply After Section 272 Sunsets*, Memorandum Opinion and Order, WC Dkt. No. 05-333, FCC 07-13 (rel. Mar. 9, 2007) ("*Qwest IXC Dominance Order*").

have an independent auditor audit the CAM every two years. *See* C.F.R.§§ 43.21(d), 64.901-.905; *see also* 47 C.F.R. §§ 32.23(c), 32.5280." The FCC also mandated that Qwest comply with Section 272(e)(3) and "impute to itself, at its tariffed rates, charges for access services used to provide interLATA services." *See id.* ¶ 67. "Pursuant to Section 64.903," the Commission held that Qwest must update its CAM to "include its imputation methodology, and the revised CAM [will] be subject to public comment." *Id.* The FCC concluded that the imputation requirements addressed "Qwest's incentives and ability to use its pricing of special access service to impede competition in the provision of in-region, interstate, intraLATA telecommunications services." *Id.* ¶ 69. There is no basis for concluding that the Commission's conclusions in the *Qwest IXC Dominance Order* are inapplicable to AT&T.

Forbearance from the Part 64 rules would also run-afoul of the clear congressional prohibition in Section 254(k) that ILECs may "not use services that are not competitive to subsidize services that are subject to competition." 47 U.S.C. § 254(k). As long as AT&T's rates are set directly or indirectly with reference to its costs as is the case under a price cap regime, Section 254(k) mandates the continuing operation of Part 64. Many other provisions of the Act also address the duty to prevent cross-subsidization and would be violated by the elimination of Part 64 rules.[43]

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[43] *See, e.g.*, 47 U.S.C. §§ 260(a)(1) (stating that a LEC "shall not subsidize its tele-messaging service directly or indirectly from its telephone exchange service or its exchange access"); 271(h) ("[t]he Commission shall ensure that the provision of services authorized under [section 271(g)] by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any telecommunications market"); 272(e)(4) (permitting a BOC to provide services or facilities to its interLATA affiliate "so long as the costs are appropriately allocated"); 276(a)(1) ("any Bell operating company that provides payphone service shall not subsidize its payphone service directly or indirectly from its telephone exchange service operations or its exchange access operations").

C. Any Reform Of The Accounting Rules Should Be Accomplished In A Proceeding Of General Applicability In Close Consultation With The States.

Even if certain accounting rules require reform,, such concerns should be addressed in a proceeding of general applicability in close consultation with the states.[44] In any case, in light of the continued need for cost accounting rules, demonstrated above, there is no merit to AT&T's assertion that any flaws in current accounting rules justifies their elimination.[45] If the current rules do not properly track AT&T's costs, changes can and should be made to the rules to ensure that the costs are properly captured. Indeed, NASUCA, among others, urgently advocated changes to the accounting rules because state price cap rates "cannot be considered just and reasonable" in light of rates that are based on distorted and inaccurate accounting data.[46] As the GAO has recently found, the FCC must collect more accurate information regarding ILECs' services to ensure that ILECs do not abuse their market power.[47]

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[44] In the prior BellSouth forbearance docket (05-342), the Florida PSC was the only state commission to file, and it filed very late in the proceeding. At the same time, many state commissions filed last year in the NPRM on reform of the Part 36 rules. This disparity in participation cannot be explained by the lack of interest as nearly every state commission in the Part 36 NPRM advocated retention and reform of the Part 36 rules while BellSouth's petition would gut Part 36 as well as many other accounting rules. The key difference between these proceedings was that the Federal-State Joint Board on Separations was intimately involved in the Part 36 NPRM but had no role in the BellSouth forbearance proceeding. Indeed, it appears that many state commissions were not even aware that BellSouth's petition was pending until only weeks before the statutory forbearance deadline was set to run. To ensure state participation on these issues going forward, the FCC should dismiss these petitions, and a Federal-State Joint Board brought into the process of reforming the rules.

[45] At least with respect to special access, the Commission tentatively (and correctly) rejected the argument that ARMIS data is unreliable for the purpose of determining whether ILECs have achieved substantial special access economies of scale and scope. *See Special Access NPRM* ¶ 29.

[46] *See NASUCA Comments in Dkt. No. 80-286*, Attach. A, Declaration of Susan Baldwin, ¶ 53.

[47] *See GAO, FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, at 43-44 (Washington, D.C., Nov. 2006).

The FCC has already begun the reform process in a piecemeal fashion. In the past several years, the Commission has released a series of NPRMs and Orders in consultation with the Federal-State Joint Board on Accounting to reform its Part 32 rules.[48] As then Commissioner Martin indicated in his separate statement on the 2003 Report of the Federal-State Joint Conference on Accounting, states must participate in any changes in the accounting rules: "I believe it is extremely important that a forum be developed for notifying the Commission of accounting-related concerns and for identifying issues of concern to the states. In this regard, the Joint Conference on Accounting has been extremely successful at facilitating state commission input into the Commission's decision-making process for accounting issues and for renewing and beginning to formalize a dialog on the broader issues related to accounting."[49] The report provided a forum for states to provide input as to whether and why certain Part 32 accounting rules should be retained, and others expanded, while others should be eliminated. The FCC then acted on the state recommendations the following year.

Just last year, the FCC initiated a similar proceeding to evaluate the Part 36 jurisdictional separations rules.[50] In that order, the FCC extended the separations freeze for an additional three years. The Commission released an accompanying FNPRM regarding "proposals relating to comprehensive separations reform," with a specific focus on the effect that changes to the Part 36 rules would have on state regulation. *Jurisdictional Separations Order and FNPRM* ¶ 25. Among other things, the FCC sought "comment on specific proposals for comprehensive

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[48] *See generally Phase I Report and Order; see also Phase II Report and Order*; *Federal-State Joint Conference On Accounting Issues et al.*, Report and Order, 19 FCC Rcd 11732, ¶ 2 (2004) ("*Joint Conference Order*").

[49] *Federal-State Joint Conference on Accounting Issues*, Recommendation by Joint Conference, WC Dkt. No. 02-269, Separate Statement of Commissioner Kevin J. Martin, at 2 (Oct. 9, 2003).

[50] *See generally Jurisdictional Separations Order and FNPRM.*

separations reform advanced by the State Members of the Joint Board, as well as a draft data request prepared by the State Members that is intended to elicit data that may be helpful in formulating a reformed separations process." *Id.* ¶ 26. Prior to the release of the NPRM, the state members of the Separations Joint board had authored two papers outlining the possible options for reforming the Part 36 rules and the continuing need for those rules.[51] These papers were placed out for comment as part of the NRPM.

There is no reason that the FCC cannot also initiate similar collaborative proceedings to review the continuing utility of all of its accounting rules.[52] Indeed, it is likely that the FCC *is statutorily required to* utilize a Joint Board to change any of the Part 64, 32 and 36 accounting rules through rulemaking because any changes in the manner in which regulated and non-regulated activities are categorized under Part 64 and any changes to Part 32 will flow through to jurisdictional separations under Part 36.[53] State utility commissioners favor such an approach with respect to AT&T's petitions: in its original comments on the *BellSouth Petition*, NASUCA stated that it "agrees with the recommendation of the [New Jersey Ratepayer Advocate] to refer the issues raised in BellSouth's petition to a federal-state Joint Board…given the complexity of the issues and the impact on both federal and state regulators ability to regulate, a review of these issues by both federal and state regulators is necessary. The proposals of the joint board could then be issued for comment by all interested parties." *NASUCA Comments in Dkt. No. 80-286* at

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[51] *See id.* App. A.

[52] The Joint Federal-State Joint Board on Accounting has recently been allowed to expire. The FCC should reauthorize the board so that it can address any outstanding accounting reform issues.

[53] *See* 47 U.S.C. § 410(c) ("The Commission *shall* refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations, which it institutes pursuant to a notice of proposed rulemaking….") (emphasis added).

2-3. Just last month, the Wireline Competition Bureau recommended exactly this approach.[54] The FCC should therefore dismiss AT&T's petitions and initiate a broad ranging deliberative process in partnership with the states to reevaluate its accounting rules.

III. CONCLUSION.

For the preceding reasons, AT&T's petitions for forbearance should be denied.

Respectfully submitted,
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ATTORNEYS FOR TIME WARNER TELECOM

March 19, 2007

[54] *See WCB Staff Report* at 18 ("Staff recommends that the Commission consider, in the context of the record in the Separations Freeze FNPRM proceeding, whether the Part 36 rules are necessary in the public interest and, if not, to repeal or modify any rule so that it is in the public interest.").

CERTIFICATE OF SERVICE

I, Jonathan Lechter, do hereby certify that on this 19th day of March, 2007 a copy of the foregoing "Opposition to Petitions For Forbearance" was delivered via first class mail, e-mail and electronically on the FCC's electronic comment filing system (ECFS) to the following parties:

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_____________/s/_____________________
Jonathan Lechter

APPENDIX B

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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

OPPOSITION OF TIME WARNER TELECOM

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ATTORNEYS FOR TIME WARNER TELECOM

January 23, 2006

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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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

OPPOSITION OF TIME WARNER TELECOM

Time Warner Telecom ("TWTC") hereby files its opposition in response to the Petition for Forbearance of the Commission's cost accounting rules filed by BellSouth (*Petition*) in the above-referenced proceeding.

I. INTRODUCTION AND SUMMARY

BellSouth has filed a petition seeking forbearance under Section 10 of the Communications Act from virtually every cost accounting requirement to which it is subject. There may well be individual accounting requirements that are no longer needed because of changes in regulation or technology. But BellSouth has offered no basis for reaching this conclusion in its *Petition*. BellSouth seeks forbearance based entirely on arguments that the Commission has considered and rejected in the recent past.

BellSouth relies primarily on the argument that cost accounting information is not required for carriers subject to price caps without sharing or lower cost adjustment options. But the Commission reviewed and rejected exactly this argument in the *Phase II* accounting requirements review proceeding. As the Commission found, costs still play a central role in price cap regulation. Nor can there be any doubt that the Commission will revisit the incumbent

LECs' costs in light of their unquestioned market power in the provision of such services as terminating switched access and special access. In fact, the Commission is currently in the process of conducting a review of incumbent LEC cost accounting data in its special access pricing proceeding.

BellSouth also attempts to counter the Commission's previous conclusions that cost accounting data remain necessary for purposes of forward-looking USF and TELRIC cost models. BellSouth offers nothing in support of this argument. It relies primarily on the fact that these models are forward-looking, thereby missing the point that even forward-looking models must be rooted in actual costs (a notion for which BellSouth has expressed considerable sympathy where it stood to benefit from higher UNE prices). BellSouth also states that there is cost information other than that reported pursuant to the Commission's rules that could be used for these models. In so doing, BellSouth seems to interpret the requirement that a rule be "necessary" under Section 10 as meaning that it is "absolutely required." But the D.C. Circuit has held that a regulation is "necessary" under Section 10 if there is a "strong connection" between the requirement and its intended function. There is no question that such a strong connection exists here.

BellSouth also places substantial emphasis on the argument that the Commission's cost accounting requirements are not necessary to ensure "financial transparency," but this is irrelevant. The Commission has never placed primary reliance on financial transparency as a basis for retaining cost accounting regulations. Indeed, the Commission has in the past sought to eliminate cost accounting requirements where they duplicate financial reporting requirements established by the SEC or other financial reporting requirements.

Finally, BellSouth conveniently ignores the critical role cost accounting must play in protecting competition and consumers now that Section 272 separate affiliate requirements have sunset (as is the case in all of BellSouth's states). The Part 32 cost accounting and Part 64 cost allocation rules are more critical post-272 sunset than ever before. For this reason as well, therefore, the Commission should deny BellSouth's petition.

II. DISCUSSION

In the *Petition*, BellSouth argues that the Commission should forbear from applying virtually all of the cost accounting regulations in Parts 32, 36, 43, 61, 64, 65 and 69 that currently apply to Class A carriers (i.e., the largest incumbent LECs). Apparently in the hopes that repetition will make its argument more persuasive, BellSouth reiterates over and over its central argument that the cost accounting rules were originally adopted to prevent incumbent LECs from misallocating costs under rate-of-return regulation, but are unnecessary now that federal and state price cap regulation has eliminated the risk of cost misallocation. *See, e.g., Petition* at 2-3, 10-21, 23-24, 46. BellSouth also argues that the Commission's cost accounting regulations are unnecessary to ensure "financial transparency" (*id*. at 61-62, 65-71), for setting universal service subsidies (*id*. at 55-56), or for setting TELRIC rates for unbundled network elements (*id*. at 59). In the purported absence of such benefits and in light of existing competition, BellSouth argues that the Commission should forbear under Section 10 from requiring BellSouth to incur the costs of continued cost accounting regulation.

Section 10 of the Communications Act requires that the Commission forbear from applying a statutory provision or regulation if it determines that (1) the requirement is not "necessary" to ensure just, reasonable and not unjustly or unreasonably discriminatory charges and practices; (2) the requirement is not necessary for the protection of consumers; and (3) forbearance is in the public interest. *See* 47 U.S.C. § 160(a). As BellSouth correctly states, the term "necessary" in this standard does not mean "absolutely required." *See Cellular Telecomms. & Internet Ass'n v. FCC*, 330 F.3d 502, 509-10 (D.C. Cir. 2003) (*CTIA v. FCC*). Instead, the term "necessary" means only that there is a "strong connection between what the [FCC] has done by way of regulation and what the agency permissibly sought to achieve with the disputed regulation." *See id.* at 512. Furthermore, in determining whether a regulation still serves its intended purpose, the Commission must follow the analytical framework it has used in the past or provide an explanation as to why it has departed from that framework.[1]

It may well be that certain cost accounting regulations applicable to BellSouth need not be retained, but BellSouth has offered no basis for reaching this conclusion in its *Petition*. This is because the Commission considered and rejected each of the arguments presented in the *Petition* when it decided in the recent past to retain the accounting rules at issue. *First*, BellSouth is simply wrong that the cost accounting rules are products of legacy rate-of-return regulation that are no longer needed in a price cap environment. The Commission has conducted a rigorous and detailed review of its cost accounting rules to determine whether they are still necessary once incumbent LECs are subject to price cap rate regulation and in light of increased competition and changes in technology. That review began soon after the passage of the 1996 Act in the *Accounting Safeguards Order*,[2] which was released in 1996. Later, in 2000, the Commission initiated a further detailed review of the Class A accounting requirements that apply

[1] *See AT&T Corp. v. FCC*, 236 F.3d 729, 736-737 (D.C. Cir. 2001) (overturning FCC denial of petition for forbearance from dominant carrier regulation where the FCC did not apply its traditional non-dominance analysis and failed to explain why such a departure was reasonable).

[2] *In re Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 17539 (1996) ("*Accounting Safeguards Order*").

to the largest incumbent LECs, such as BellSouth, in the *Phase I Report and Order*.[3] In that order, the Commission conducted a review of its accounting requirements "to keep pace with changing conditions as the telecommunications industry becomes increasingly competitive." *Phase I Report and Order* ¶ 1. As a result of this review, in the *Phase I Report and Order*, the Commission eliminated over *50 percent* of the accounts and sub-accounts that Class A carriers such as BellSouth were required to keep.[4] The Commission also "reduced the reporting requirements for the ARMIS 43-02 USOA Report by revising certain tables, eliminating several other tables, and establishing new threshold levels for certain reporting items." *Phase II Report and Order* ¶ 16 The establishment of "new threshold levels" for reporting resulted in the reduction of the incumbent LECs' reporting burden. *See Phase I Report and Order* ¶ 20 (increasing from $250,000 to $500,000 the threshold level for requiring a determination of fair market value for affiliate transactions involving services), ¶ 43 (establishing a threshold for reporting certain "important changes" in ARMIS 43-02, table C-5).

In the *Phase II Report and Order*, the Commission reviewed whether incumbent LEC cost reporting and other accounting requirements were "no longer necessary in the public interest as the result of meaningful economic competition between providers of telecommunications service" under Section 11 of the Act. *Phase II Report and Order* ¶ 1. The Section 11 standard

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[3] *Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase I*, Report and Order, 15 FCC Rcd 8690 (2000) ("*Phase I Report and Order*").

[4] *See 2000 Biennial Regulatory Review -- Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II et al.*, Report and Order in CC Docket Nos. 00-199, 97-212, 80-286 *et al.*, 16 FCC Rcd 19913, ¶ 16 (2001) ("*Phase II Report and Order*").

closely resembles the Section 10 standard applicable here. The Commission also considered in that proceeding whether "technological changes or changes in the law" warranted elimination of reporting requirements. *Id.* ¶ 23. In reviewing the cost accounting regulations under the Section 11 standard, the Commission carefully balanced the costs and benefits of retaining the regulations. Based on this review, the Commission reduced the number of Class A accounts (including many cost reporting requirements) by an additional 45 percent, although it added certain sub-accounts "to meet new needs." *Id.* ¶ 26. The Commission also reduced other reporting requirements by, for example, again increasing reporting thresholds (*see, e.g., id.* ¶¶ 87-90) and it scaled back the ARMIS reporting requirements (*see, e.g., id*. ¶¶ 142, 151-157). Where the Commission retained cost reporting requirements, it did so only where it determined that such requirements were "necessary" under Section 11 and in the public interest in light of changes in technology and law.

Finally, after the release of the *Phase II Report and Order*, the Commission convened a Federal-State Joint Conference on Accounting Issues for the purposes of further intense review of the cost accounting requirements that BellSouth now seeks to eliminate.[5] The Commission also suspended implementation of four of the changes adopted in the *Phase II Report and Order* to give the Joint Conference time to review those changes. *See Joint Conference Order* n.6. The Joint Conference then adopted a recommendation for further changes to the Commission's accounting rules, and the Commission sought comment on that recommendation as well as petitions for reconsideration of the *Phase II Report and Order*. In the resulting *Joint Conference*

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[5] *Federal-State Joint Conference On Accounting Issues et al.*, Report and Order, *Joint Conference Order*, 19 FCC Rcd 11732, ¶ 2 (2004) ("*Joint Conference Order*").

Order, the Commission again examined its accounting rules and made minor changes to those rules for the purpose of limiting regulatory burdens on incumbents while at the same time ensuring the regulators have access to the information needed for existing regulations.

At each stage of this review, the Commission considered the extent to which Class A cost accounting requirements are required in a price cap environment. Most recently, in the *Phase II Report and Order*, the Commission considered the extent to which cost accounting regulations applicable to Class A accounts should apply to incumbents subject to price caps that have no sharing component and where the incumbent has "waived low-end formula adjustments." *Phase II Report and Order* ¶ 46. Those are precisely the same price cap regulations currently applicable to BellSouth. Then, as now, BellSouth (and other incumbent representatives) argued that price cap regulation obviates the need for Class A accounting requirements. *See* BellSouth Comments, CC Docket No. 00-199 at 2, 4-5 (Dec. 21, 2000); *see generally* BellSouth Reply Comments, CC Docket No. 00-199 (Jan. 30, 2001). *See also* USTA Comments CC Docket No. 00-199 at 8 (Dec. 21, 2000), USTA Reply Comments, CC Docket No. 00-199 at 1, 3, 7 (Jan. 30, 2001).

The Commission rejected this argument and held that "the cost accounting data reported in Part 32 accounts are . . . currently used to determine interstate access charges." *Phase II Report and Order* ¶ 12. To repeat, the Commission concluded that this was the case even for carriers like BellSouth that are ineligible for the low end adjustments. As the Commission found, such carriers must still rely on Part 32 cost information in claiming exogenous adjustments based on actual cost changes. *See id.* ¶ 46. Exogenous adjustments are granted for changes to a carrier's costs due to government or administrative action beyond the carrier's control, but the *amount* of the adjustment is still based on the carrier's actual costs. Indeed, BellSouth has itself sought and been granted exogenous adjustments to its interstate access price cap index based on costs recorded in Part 32.[6] The Commission emphasized further that price cap carriers must rely on costs reported in Part 32 when seeking rates above the levels permitted by the price cap indices based on a showing that the authorized rate levels will produce earnings that are so low as to be confiscatory. *See id.* ¶ 12. The Commission also pointed to the fact that Class A cost information is needed for reviewing proposed tariff revisions and as the basis for setting subscriber line charges. *See id*. ¶ 46.

Moreover, although it has at times been reluctant to acknowledge it, the Commission has relied, *and will undoubtedly be required to rely in the future*, on costs recorded pursuant the Commission accounting rules as the basis for reassessing the level of the price cap indices applicable to individual price cap baskets. The Commission did precisely this in the CALLS proceeding, where it relied on accounting costs to rebalance the price cap indices for the usage-sensitive, transport and common line baskets.[7] Furthermore, in the *Phase II Report and Order*, the Commission stated that further changes in intercarrier compensation, including access charge reform post-CALLS, require continued availability of the information reported in ARMIS Report 43-04 (Separations and Access Report). *See Phase II Report and Order* ¶¶ 148-149. In fact, so

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[6] *See, e.g., id.* n.18 (citing to BellSouth 2001 Annual Access Charge Tariff Filing, Transmittal No. 592, Description and Justification, section 6).

[7] *See Access Charge Reform*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; and Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 ¶¶ 158, 167 (2000) (targeting x-factor reductions to those service baskets where the ILECs were receiving excessive rates-of-return so that prices would move closer to the ILECs' costs); *see also id.* ¶ 171 ("…price cap LECs' basket earnings are significantly higher for traffic-sensitive services than for common line services. Therefore, we find it reasonable to target reductions to traffic-sensitive services rather than to common line services.").

long as incumbent LECs retain market power in the provision of terminating switched access services (to say nothing of special access, discussed below), the Commission is statutorily bound to keep track of incumbent LEC costs to ensure that switched access charges remain just, reasonable and not unjustly discriminatory as required by Sections 201(b) and 202(a).[8]

In fact, pursuant to that duty, the Commission is currently relying on cost data reported by BellSouth and other incumbents to determine whether it should re-impose price cap regulation on incumbent LEC special access services subject to *Phase II* pricing flexibility. In the NPRM in WC Docket No. 05-25, the Commission used ARMIS data to examine "the relationship between demand growth and growth in expenses and investment" to determine if incumbent LECs had achieved economies of scale and scope that warrant a reexamination of

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[8] It is also important to emphasize that the continued reference to costs in rate-making makes the cost allocation rules, especially the Part 64 rules, necessary to ensure compliance with the numerous statutory prohibitions against cross-subsidy. Those statutory prohibitions include (among others) the requirements in (1) Section 254(k) that a "telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition;" (2) Section 260(a)(1) that an incumbent LEC "shall not subsidize its telemessaging service [i.e., voice mail, voice storage, certain live operator services and similar services] directly or indirectly from its telephone exchange or its exchange access;" (3) 271(h) that the provision of in-region interLATA services on an integrated basis "not adversely affect telephone exchange service ratepayers or competition in any telecommunications market;" (4) 272(e)(3) that a BOC impute to itself charges for access service levied on unaffiliated carriers; and (5) Section 276(a)(1) that a BOC "not subsidize its payphone service directly or indirectly from its telephone exchange service operations of its exchange access operations." In the *Accounting Safeguards Order*, the Commission concluded that the cost allocation and affiliate transaction rules in Part 64 were necessary to enforce these statutory requirements. *See Accounting Safeguards Order* ¶ 56 (telemessaging), ¶ 73 (integrated provision of out-of-region and in-region interLATA services), ¶ 86 (Section 272(e)(3) imputation rule); ¶ 100 (payphone service). Moreover, as TWTC and others have explained at length elsewhere, the Commission has held that Part 64 cost allocation rules are especially important where incumbents deploy converged, broadband networks capable of offering many services subject to different types of regulation and different levels of competition. *See generally*, Joint Comments of TWTC *et al.*, WC Docket No. 04-405 (Jan. 28, 2005).

special access rates.[9] The Commission also examined ARMIS data in connection with whether it should adopt a "g" factor in the special access price cap index formula. *See id*. ¶ 40. To be sure, the incumbents have argued that the Commission cost-allocation and separations rules yield unreliable cost information and should not be the basis for regulatory findings regarding future special access pricing. But the Commission tentatively (and correctly) rejected this conclusion for purposes of determining whether ILECs have achieved substantial economies of scale and scope. *See id*. ¶ 29. In any event, the dispositive response to the incumbent's argument is that some measure of costs must be the touchstone for regulated rates, and actual costs must in turn form the ultimate basis for any cost assessment.

Of course the Commission's statutory mandate to ensure that access rates remain just, reasonable and not unjustly unreasonable extends only to interstate rates. Under Section 2(b) of the Communications Act, (47 U.S.C. § 152(b)) the states have jurisdiction over charges for intrastate services, including intrastate access charges. In *Smith v. Illinois Bell Tel. Co.*, the Supreme Court has held that some form of jurisdictional separations system, such as Part 36 (in combination with Parts 32 and 64), is *required* to enable the respective jurisdictions to carry out their respective ratemaking tasks to the extent those are performed by referenced to the regulated company's costs. *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148-51 (1930).

Second, BellSouth offers no basis for the Commission to reverse its prior determination in the *Phase II Report and Order* that cost accounting information is necessary for setting

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[9] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, 20 FCC Rcd 1994, ¶ 29 (2000) ("*Special Access NPRM*")

subsidies for non-rural carriers. BellSouth states only that "high cost distributions from the USF will not be impacted by forbearance as they are based on a *hypothetical* cost model -- not the kind of embedded carrier cost structure contained in Parts 32 or 64." *Petition* at 56 (emphasis in original). But, as explained in the *Phase II Report and Order*, the "Commission used accounting data to develop many of the input values" for *the forward-looking cost model* that determines subsidies for non-rural LECs. *Phase II Report and Order* ¶ 11. As this (and the discussion of TELRIC below) illustrates, BellSouth is incorrect that reliance forward-looking cost models obviates the need for cost accounting. A regulated, uniform accounting scheme is therefore important to advancing the goal of keeping non-rural subsidies at reasonable levels. *See id.* ¶¶ 51-52. The Commission has in many cases retained cost reporting requirements expressly for the purpose of obtaining accurate information for the forward-looking cost model for universal service. *See id.* ¶ 29 (retaining separate accounting for "[b]uried cable costs[] used to develop inputs for the universal service high-cost model for non-rural carriers"); ¶ 40 (retaining Account 6613 for product advertising because "the expenses recorded in Account 6613 are required to develop inputs for the universal service model"); ¶ 45 (describing the "critical" role of the cost data collected in the Class A accounts and reported through ARMIS "to the calculation of high-cost support for non-rural carriers").

Third, BellSouth has also offered no basis for the Commission to reverse its prior determination that Class A cost information is necessary to establish inputs for TELRIC cost models. As with universal service, BellSouth lamely states that embedded cost information is not needed for forward-looking cost models like TELRIC. *See* Petition at 59. But as the Commission has found, states unquestionably rely on Class A accounting data and ARMIS reporting for setting TELRIC rates. *See Phase II Report and Order* ¶¶ 49-50, 179; *Joint*

Conference Order ¶¶ 14, 18. Moreover, at least two states from the BellSouth region, North Carolina and Florida, were among those describing their continued reliance on Class A reports for this purpose. *See Phase II Report and Order* nn.85, 86, 90, 91 (citing, among others, comments filed by Florida and North Carolina Public Staff). BellSouth apparently thinks that costs other than those retained in Part 64 could be used for setting TELRIC (*see Petition* at 59-60), but this could only justify elimination if "necessary" meant "absolutely required" in Section 10. It does not. A "strong connection" between the regulations and its objective are all that is required, and the states' unrefuted testimony establishes such a connection.

Fourth, BellSouth provides an extensive discussion of its financial accounting practices and legal obligations in support of its point that Commission cost accounting regulations are unnecessary for ensuring financial transparency. *See id.* at 65-71. But this is a red herring. Unless sound policy dictates otherwise, the Commission has eliminated or refused to adopt cost accounting requirements where the information at issue would be included in reports filed with the SEC. *See Phase I Report and Order* ¶ 40. In any event, the Commission has never placed primary reliance on the need to ensure financial transparency as a basis for retaining its cost accounting rules.

Fifth, although not mentioned in the *Petition*, the Commission has held that it is necessary for incumbent LECs to keep cost subsidiary records for data "needed in pole attachment formulas." *Id.* ¶ 10. Section 224 of the Communications Act requires that utilities, including incumbent LECs like Bellsouth, charge rates for access to poles, ducts, conduits and rights-of-way based on the "cost" of usable and unusable space (the allocation of costs is slightly different for telecommunications carrier attachers and cable television system attachers). *See* 47 U.S.C. § 224(d)-(e). Pole attachment rates are set by the FCC under formulae that "rely on Class

A accounting data" (*Phase II Report and Order* ¶ 48) unless a state exercise its "reverse preemption" rights under Section 224(c), in which case they are set by states.

Finally, BellSouth also conveniently ignores the importance of cost accounting requirements to the Commission's pending review of the appropriate regulation of BOCs after the sunset of Section 272 affiliate requirements. In the NPRM adopted in WC Docket No. 02-112, the Commission initiated its review of regulatory requirements needed to address the threat that incumbent LECs will have increased opportunities to engage in "cost-misallocation" and "predatory price squeeze[s]" in the absence of Section 272 structural safeguards.[10] For example, the Commission sought comment on whether "cost allocation rules, which are intended to prevent cross-subsidization and cost misallocation for regulated and nonregulated activities and competitive and noncompetitive services, serve as an effective alternative to a separate affiliate requirement." *See Sec. 272 Sunset FNPRM* ¶ 48. Given the Commission's conclusions in the *Accounting Safeguards Order* that cost allocation rules were necessary even where the separate affiliate requirement applied (*see* footnote 8 *supra*), it is hard to see how the cost accounting requirements can be eliminated after Section 272 affiliate requirements sunset.[11] In fact, where incumbent LECs have in the past been permitted to provide either in-region or out-of-region long distance services on an integrated basis, the Commission has concluded that cost misallocation

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[10] *See Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review - Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules*, Further Notice of Proposed Rulemaking, 11 FCC Rcd 10914, ¶¶ 29, 35, 40 (2003) ("*Sec. 272 Sunset FNRPM*").

[11] As TWTC has explained, the Commission should retain Section 272 separate affiliate requirements that it has allowed to sunset without any analysis of the consequences. *See generally,* TWTC Comments, WC Docket No. 02-112 (Aug. 5, 2002); TWTC Reply Comments, WC Docket No. 02-112 (Jul. 28, 2003).

could most effectively be prevented by treating the long distance services as non-regulated activities under the Part 64 rules. *See Accounting Safeguards Order* ¶¶ 74-75. Obviously, this approach would not be possible if cost allocation rules in Part 64 were eliminated.

III. CONCLUSION

The Commission should deny the Petition for the reasons explained herein.

Respectfully submitted,

__________/s/_____________

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ATTORNEYS FOR TIME WARNER TELECOM

January 23, 2006

CERTIFICATE OF SERVICE

I, Jonathan Lechter, do hereby certify that on this 23rd day of January, 2006, I caused to be served a true and correct copy of the foregoing opposition by delivering a copy thereof via first class mail to the following:

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