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

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

COMMENTS OF THE
NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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On the Comments:

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Date: January 23, 2006

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I. INTRODUCTION

Pursuant to the pleading cycle established by the Federal Communications Commission ("Commission" or "FCC"), the New Jersey Division of the Ratepayer Advocate ("Ratepayer Advocate") submits these initial comments regarding the petition filed by BellSouth Telecommunications, Inc. ("BellSouth" or "BST") for forbearance under 47 U.S.C. § 160 from enforcement of certain of the Commission's cost assignment rules.[1]

A. INTEREST OF THE RATEPAYER ADVOCATE IN THE INSTANT PROCEEDING.

The Ratepayer Advocate is an independent New Jersey State agency that represents and protects the interests of all utility consumers, including residential, business, commercial, and industrial entities. The Ratepayer Advocate participates

[1] / The Commission established a pleading cycle in Public Notice DA 05-3185, issued December 22, 2005. Reply comments are due February 13, 2006.

actively in relevant Federal and state administrative and judicial proceedings. The above captioned proceeding is germane to the Ratepayer Advocate's continued participation and interest in implementation of the Telecommunications Act of 1996.[2] The New Jersey Legislature has declared that it is the policy of the State to provide diversity in the supply of telecommunications services, and it has found that competition will "promote efficiency, reduce regulatory delay, and foster productivity and innovation" and will "produce a wider selection of services at competitive market-based prices."[3] Although New Jersey ratepayers do not reside or work in BellSouth's territory, the Commission's deliberations in this proceeding affect New Jersey households and businesses because the policies that the Commission establishes in response to BellSouth's Petition may set a precedent for the resolution of any future petitions submitted by Verizon.

B. OVERVIEW OF PETITION

BellSouth's Petition is premature, and the Commission's comment cycle is unreasonably abbreviated.

On December 6, 2005, BellSouth filed a petition for forbearance pursuant to section 10 of the Communications Act of 1934, as amended ("Act") from the Commission's cost allocation rules.[4] BellSouth's Petition includes nine appendixes, which provide details about the rules affected by its Petition, an overview of the price cap rules which govern its intrastate rates, details on its cost allocation methodology, the

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[2]/ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Act"). The 1996 Act amended the Communications Act of 1934. Hereinafter, the Communications Act of 1934, as amended by the 1996 Act, will be referred to as "the 1996 Act," or "the Act," and all citations to the 1996 Act will be to the 1996 Act as it is codified in the United States Code.

[3]/ *N.J.S.A.* 48:2-21.16(a)(4) and 48:2-21.16(b)(1) and (3).

[4]/ *Petition of BellSouth Telecommunications, Inc. for Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules* ("BellSouth Petition").

impact of its petition on ARMIS reporting, and information about oversight of accounting and financial matters. Given the complexity and significance of the filing, the deadlines set forth in the pleading cycle are remarkably and inexplicably abbreviated. Furthermore, BellSouth's extensive reliance on the existence of price cap plans as support for its petition (which the Ratepayer Advocate addresses later in these comments) is itself compelling evidence that this proceeding is premature. The interstate price cap system that governs BellSouth's rates (and upon which BellSouth relies in an attempt to substantiate its claim that certain cost allocation rules are irrelevant) is directly implicated by the Commission's pending investigation of special access rates in WC Docket 05-25. Until the Commission renders a decision in WC Docket 05-25, which, among other things, entails an examination of the supracompetitive prices being charged by incumbent local exchange carriers ("ILEC"), faith in the interstate price cap system's ability to yield just and reasonable rates would be seriously misplaced.[5]

Furthermore, as a threshold matter, the Ratepayer Advocate recommends that the Commission defer BellSouth's Petition to the Federal-State Joint Conference on Accounting Issues, to the Federal-State Joint Board on Separations, or to a specially formed Federal-State Joint Board on Cost Allocation.[6] Such a deferral is warranted for

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[5] / Pursuant to the Commission's pleading cycle in WC Docket No. 05-25, initial comments were filed on June 13, 2005, and reply comments were filed on July 29, 2005. The matter is pending Commission review.

[6] / The Commission has, in the past, relied on a federal-state joint conference on accounting issues. *See Federal-State Joint Conference on Accounting Issues*, Notice of Proposed Rulemaking, FCC 03-326 (rel. Dec. 23, 2003). The Commission convened the Federal-State Joint Conference on Accounting Issues on September 5, 2002 to "to provide a forum for an ongoing dialogue between the Commission and the states in order to ensure that regulatory accounting data and related information filed by carriers are adequate, truthful, and thorough." *Federal-State Joint Conference on Accounting Issues*, WC Docket No. 02-269, *Order* (rel. September 5, 2002). The Joint Conference is a relevant forum for the Commission to use to address the matters that BellSouth raises in its Petition. The Commission has extended the Joint Conference until March 1, 2007. *Federal-State Joint Conference on Accounting* Issues, WC Docket No. 02-269, Order, (rel. February 16, 2005).

several reasons. First, it is entirely inappropriate to up-end a complex system of regulatory cost allocation and reporting, upon which both federal and state regulators rely, through a petition submitted by a single regional Bell operating company ("RBOC") for forbearance. Second, BellSouth's Petition bears directly on states' access to valuable data and information, and, therefore, the Commission's deliberations in this proceeding could affect states' ability to carry out their regulatory responsibilities. As has been the Commission's long tradition, states and the Commission should work collaboratively on matters of such complexity and importance to interstate and intrastate ratesetting. Third, the Petition raises matters that potentially affect all ILECs, and, therefore, these matters would be better aired in a rulemaking, that would be informed by the recommendations of a federal-state joint board. Indeed unless the Commission intends to refer the matters raised by BellSouth's Petition to a more detailed analysis conducted with federal-state cooperation, it would be imprudent for the Commission to limit the review of BellSouth's Petition to the abbreviated comment cycle in the instant proceeding.

Despite the Ratepayer Advocate's serious misgivings about the fundamentally inappropriate forum in which BellSouth's Petition is being considered, the Ratepayer Advocate provides a preliminary assessment of BellSouth's Petition in these initial comments.

II. ANALYSIS OF PETITION

BellSouth has failed to demonstrate that its Petition meets the Act's three-part test.

Federal and state regulators are responsible for protecting ratepayers from anticompetitive behavior by ILECs. ILECs continue to dominate the local markets that they have traditionally served, and are rapidly re-gaining control of the long-distance market as well as the emerging broadband market. ILECs continue to exert control over bottleneck local facilities. Regulatory accounting records are essential to monitor ILECs and to detect market power abuse by ILECs. Regulatory accounting continues to be necessary to protect consumers and competitors from incumbent local carriers' anticompetitive behavior.

Section 10 of the Act includes a three-part test that governs whether the Commission shall forbear from applying any regulation or provision of its act. In broad terms, the three-part test requires the Commission to address the following:

1. Is the regulation necessary to ensure that the rates for the relevant services are just and reasonable?
2. Is the enforcement of the regulation necessary to protect consumers?
3. Would forbearance from applying the regulation be consistent with the public interest?[7]

In these initial comments, the Ratepayer Advocate will demonstrate that the cost accounting rules are necessary to ensure that rates are just and reasonable and to protect consumers. Furthermore, the Ratepayer Advocate will demonstrate that forbearance from

[7]/ 47 U.S.C. § 160.

applying the cost accounting regulations would be inconsistent with the public interest. Finally, the Ratepayer Advocate submits that BellSouth's unsupported assertions coupled with the lack of empirical support simply are insufficient to sustain BellSouth's burden of proof.

The rates that have been set through state and federal price cap regulation have not been demonstrated to be just and reasonable.

According to BellSouth, the "Commission's cost assignment rules create a regulatory chokepoint in the development of broadband networks and services."[8] BellSouth contends that these "regulatory chokepoints" are a major reason that the U.S. lags other wealthy countries in the provision of advanced telecommunications services.[9] BellSouth contends that the Commission's cost assignment rules are not necessary to ensure just, reasonable, and non-discriminatory rates, and, similarly are unnecessary to protect consumers. BellSouth further asserts that forbearance is consistent with the public interest. According to BellSouth, the Commission's cost assignment rules "stand in the way of technological innovation, efficiency and competitiveness by maintaining a rigid regulatory barrier between 'regulated' and 'nonregulated' services that technology and consumers no longer recognize."[10] However, BellSouth offers no empirical support for these blanket assertions.

Furthermore, according to BellSouth, under price cap regulation, "costs are not part of the ratemaking equation," and, therefore, "there is no 'incentive' to inflate,

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[8] / BellSouth Petition at 1.

[9] / *Id*., at 4.

[10] / BellSouth Petition at 2.

misallocate or manipulate costs, and thus the cost assignment rules are not necessary to protect consumers from that behavior or similar conduct."[11] BellSouth implies that it is regulated by a well-functioning price cap system that yields just and reasonable rates, describes its thwarted opportunity to innovate,[12] and bemoans its restricted ability to compete.[13] BellSouth implies that if the Commission were to eliminate cumbersome cost allocation rules, rates would be just and reasonable and BellSouth would innovate at a pace and scope not now possible.

BellSouth's chief argument (that the prevalence of price cap systems throughout the states it serves and for its interstate operations obviates the need for cost data and reporting) suffers from a serious deficiency, as well as from a lack of empirical support. BellSouth equates theory with reality. *Theoretically*, the purpose of price cap regulation is to yield rates that would exist in an effectively competitive market. However, in reality, price cap systems differ (with varying productivity factors, basket designations, rules for price changes, etc.), which is evidence of the fact that there is no "perfect" price cap system. Instead, any particular price cap system corresponds with the regulators' best efforts to design a mechanism that will create the proper incentives for investment and yield just and reasonable rates.[14]

Furthermore, although BellSouth is subject to price cap regulation in all of the

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[11] / BellSouth Petition, at 3.

[12] / *See, e.g.*, BellSouth Petition at 4 stating that "[r]egulatory chokepoints, like the Commission's cost assignment rules, retard the flow of valued, innovative products and services to the marketplace."

[13] / BellSouth Petition, at 25.

[14] / *Id.*, at Appendix 2.

states in which it operates (Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina and Tennessee),[15] periodically, state public utility commissions may decide to review and/or modify the plans. For example, in Kentucky, the price cap plan was adopted in 2004, and while "permanent" it is subject to a formal review in five years.[16] BellSouth's response to the fact that the state price cap plan in Kentucky requires BellSouth to file cost information is: "Continuation of the cost allocation and cost separations rules are not necessary for BellSouth to provide the cost data for a tariff filing. BellSouth can calculate and retain this information on an internal basis without the requirements of these rules." [17] Appendix 2 of BellSouth's filing clearly shows that the regulatory plans under which it operates are always subject to review by regulators in each state, and plans and requirements often change.

Furthermore, in WC Docket 05-25, the Commission is examining compelling evidence that RBOCs are earning supracompetitive profits under the existing interstate price cap system.[18] Although RBOCs contend that they are simply reaping the profits intended by a price cap system, the Ratepayer Advocate is more persuaded by the evidence that RBOCs, by virtue of their monopoly position, are able to extract monopoly

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[15] / *Id*., at 22

[16] / BellSouth Petition, Appendix 2, at 8.

[17] / *Id.,* footnote 23.

[18] / The estimated average RBOC special access rate of return for year end 2004 was 53.7%, and for BellSouth was 81.9 percent. WC Docket 05-25, Declaration of Susan M. Gately, on behalf of Ad Hoc, filed June 13, 2005, para. 9.

rents through their special access rates, and that, furthermore, the prevailing special access rates are *not* those that would prevail in a competitive market place.[19]

It is not surprising that as BellSouth successfully enters new lines of business and continues to earn supracompetitive profits from its special access services, it would urge the Commission to eliminate the tools that would allow regulatory oversight of BellSouth's market practices and market power.

BellSouth questions the link between cost allocation rules and the Commission's goal of just, reasonable, and nondiscriminatory rates.[20] BellSouth's logic appears to be that price cap plans (apparently any plan that is labeled as a price cap plan suffices for this exercise) *necessarily* yield just, reasonable, and nondiscriminatory rates. The Ratepayer Advocate urges the Commission to reject this overly simplistic logic. As the Maine Supreme Court held, in order to ensure that alternative regulation plans yield just and reasonable rates, it may be necessary to conduct a comprehensive examination of costs and revenues.[21] Cost data are essential to such an examination.

Furthermore, as is discussed earlier in these comments, many have called into question the purported justness and reasonableness of RBOCs' special access rates, despite the fact that they are established through the Commission's price cap system. The mere fact that rates are established through a price cap system does not prove that

[19] / *See* Ratepayer Advocate Initial and Reply comments, filed June 13, 2005 and July 29, 2005, respectively, in CC Docket 05-25.

[20] / BellSouth at 9.

[21] / See Office *of Public Advocate et. al. v. Public Utility Commission, et. al*., 2005 WL 182826 Me., (January 26, 2005) wherein the Court set aside an alternative rate plan for this very reason.

they are reasonable. The Ratepayer Advocate acknowledges that a goal of price cap regulation is to de-link costs and rates.[22] However, despite their best efforts to design price cap regulation, regulators periodically need to re-assess price cap plans. With the numerous and major changes in the market (such as the granting of Section 271 authority, the classification of digital subscriber line ("DSL") and cable modem as informational services, the classification of VoIP as an interstate service, pending proposals to revise intercarrier compensation, and proposed universal service reform), rate caps need to be re-initialized at both the state and federal levels. The availability of the cost data necessary for the re-initialization of rate caps depends upon the cost allocation rules that BellSouth seeks to abandon. To jettison these rules would be contrary to the public interest.

Unless and until the Commission updates and revises the separations process, rate caps at the federal and state level cannot be considered just and reasonable.

The fact that rates may not increase is not sufficient evidence that they are reasonable. The existing jurisdictional split of costs is based on a network of the past. If a fair share of the common network were allocated to the interstate jurisdiction, based on decisions such as the treatment of DSL and broadband services, state costs would decline and state rate caps should similarly decline. The Ratepayer Advocate acknowledges but respectfully disagrees with the Commission's rejection in its *Wireline Broadband Order* of the argument made by the National Association of Regulatory Utility Commissioners

[22] / *See* Bellsouth's explanation of a price cap index on pages 18-20 of its Petition. The Ratepayer Advocate does not contest the mechanics of price caps, nor does the Ratepayer Advocate contest the fact that BellSouth need not rely on cost data in order to adjust its rates in routine annual price cap filings. The Ratepayer Advocate does, however, disagree with the implication that once a price cap system is in place, regulators need never examine it again. Indeed many state price cap systems are of limited duration, which underscores the fact that they represent best efforts, but not perfect mechanisms. BellSouth Petition, Appendix 2.

("NARUC") and the State Consumer Advocates that the Commission must "require incumbent LECS to reallocate a portion of their joint and common loop costs from 'universal services' as a group to wireline broadband Internet access transmission."[23] The Commission stated that:

> State Consumer Advocates argue that the need to assign costs among all services using the loop will become even more important as incumbent LEC networks are engineered to deliver a variety of integrated services. … We conclude instead that as more services are offered over a single loop, cost allocations are likely to become more arbitrary and thus less reasonable.[24]

With the shifting of costs to the interstate jurisdiction, state rate caps should decline, and, furthermore, re-initialization is necessary at state and federal levels.

BellSouth's attempt to minimize the importance of cost data is unpersuasive.

BellSouth contends that "unless there is a *'strong connection* between what the [Commission] has done by way of regulation and what the agency *permissibly sought* to achieve with the disputed regulation," regulatory requirements should not be deemed "necessary."[25] BellSouth portrays cumbersome yet seemingly useless[26] cost assignment rules that result not in rate-setting "but rather the population of certain ARMIS reports (and various state informational reports), which are not used for ratemaking purposes."[27]

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[23]/ *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, et al*, CC Docket No. 02-33, et al., *Report and Order and Notice of Proposed Rulemaking*, FCC 05-150, released September 23, 2005 ("*Wireline Broadband Order*"), at para. 140.

[24]/ *Id*., at note 434.

[25]/ BellSouth at 9, citing *CTIA*, 330 F.3d at 512 (emphases added by BellSouth).

[26]/ *See, e.g.,* BellSouth Petition at 25 which states that "[w]hile its unencumbered competitors can take services directly from the drawing board to their customers, BST must go from the drawing board to a cumbersome cost assignment analysis…"

[27]/ BellSouth Petition at 23.

The implication of BellSouth's comments is that the cost forms are simply for regulatory "bean counters" who, BellSouth would have the Commission believe, have no legitimate interest in how BellSouth assigns its costs between state and interstate jurisdictions, between regulated and unregulated services, and among services. Contrary to this unsupported assertion, cost data are necessary for re-initializing rate caps, and to provide regulators with the informational tools necessary to detect anticompetitive pricing practices.

Although BellSouth contends that cost allocation rules impede its ability to bring products to markets, no empirical evidence is offered and the anecdotal evidence suggests that BellSouth is successfully entering new product areas.

Although BellSouth expresses dismay about its inability to innovate as rapidly as its competitors,[28] Figure 1 shows BellSouth's undeniable success in delivering broadband services to its customers. As bothersome as cost studies may be, they are a small price to pay considering the significant market power that BellSouth enjoys. Figure 1, attached, shows the rapid rate at which BellSouth is penetrating the broadband market with its DSL service, despite cost accounting requirements. The Commission's decision to regulate DSL as an interstate service underscores the need to adjust the now-frozen separations factor. BellSouth presently enjoys the best of both worlds – its DSL revenues are considered interstate and unregulated and yet the vast majority of the costs of the common network that enables BellSouth to offer this service are recovered through intrastate rates.

[28] / *Id.*, at 25.

According to BellSouth:

> The artificial divisions that legacy cost assignment rules require are not only unrelated to determining rates in a price cap environment, but also represent a formidable obstacle to meeting the demands of the evolving marketplace and giving consumers the innovative products and services they desire.[29]

As examples of such products, BellSouth asserts that cost assignment rules get in the way of its desire to migrate new ATM and Frame Relay customers to its Regional IP Backbone.[30] BellSouth indicates that it can write cost allocation software to distinguish between regulated and non-regulated uses, "but doing so serves no network or consumer functionality."[31] The only specific product that BellSouth describes that never made it to market, purportedly because of the delay ensuing from the cost allocation process is its Intelligent Data Service Unit ("IDSU").[32] The loss of a single customer for a single product is not compelling evidence of thwarted innovation. Although the Ratepayer Advocate does not recommend cost allocation simply as an exercise in paperwork, until such time as effective competition disciplines BellSouth's market power, regulators require adequate data to detect anticompetitive pricing behavior. The purported loss to consumers associated with products that do not make it to market is offset by the gain in consumer protection.

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[29] / *Id.,* at 32.

[30] / *Id*., at 33.

[31] / *Id.*

[32] / *Id.,* at 34-35.

In a competitive market, a firm would track product-specific costs in order to assess the profitability and viability of the offering.

BellSouth discusses at some length the detailed cost assignment it presently must undertake.[33] However, if BellSouth operated in a competitive market, it is likely that costs and revenues for products and services would need to be tracked, gathered, and reported to distinguish between profitable services and non-profitable ones. Assignments of various costs (or "charge-backs") would need to occur so that BellSouth could spend money prudently on those services for which expected revenues exceeded expected costs. In other words, some of the "cumbersome" book-keeping processes would be necessary for any company seeking to focus on financially lucrative products and to discontinue the less profitable ones. The fact that cost allocation is difficult does not render it useless.

Furthermore, the burden that Bellsouth describes is outweighed by the benefit to the regulator of having access to data. There is a serious asymmetry between the information to which regulators have access and the information that BellSouth possesses. Granting BellSouth's petition would exacerbate this asymmetry to the detriment of consumer protection.

BellSouth places undue significance on the Commission's reasoning in the *Wireline Broadband Order*.

BellSouth relies in part on the Commission's cost allocation determinations in the *Wireline Broadband Order* in support of its petition.[34] Among other things, the Commission stated:

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[33] / *Id*., at 32-46.

[34] / *Wireline Broadband Order*

> During the period since the adoption of the part 64 cost allocation rules, our ratemaking methods and those of our state counterparts have evolved considerably. This evolution has greatly reduced incumbent LECs' incentives to overstate the costs of their tariffed telecommunications services. Based on the record, we find that this reduction in incentives diminishes the need for incumbent LECs to apply detailed and burdensome procedures to exclude the costs of providing broadband Internet access transmission from their regulated costs. A nonregulated classification therefore would generate at most marginal benefits.[35]

The Commission also states:

> Our ruling here with respect to the accounting treatment of broadband Internet access transmission provided on a non-common carrier basis does not change the accounting treatment that applies to broadband Internet access service provided to end users. That is, and always has been, an information service. An incumbent LEC that offers this service must continue to account for it as a nonregulated activity.[36]

Section 254(k) of the Act states that telecommunications carrier "may not use services that are not competitive to subsidize services that are subject to competition."[37] The Joint Board is considering the approach that should occur after the five-year separations freeze presently in effect expires.[38] The Ratepayer Advocate concurs that our nation's infrastructure is heading toward a broadband platform, but we have not yet arrived there. Furthermore, the broadband platform is being deployed more quickly for some than others.[39] Accordingly, the Ratepayer Advocate urges the Commission to retain cost accounting requirements to ensure that noncompetitive services are not subsidizing

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[35] / *Id*., at para. 133, notes omitted.

[36] / *Id*., at para. 136.

[37] / 47 U.S.C. § 254 (k).

[38] / *Wireline Broadband Order*, at para. 144, citing *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382 (2001).

[39] / *See* Initial Comments of the New Jersey Division of the Ratepayer Advocate, WC Docket 05-271, filed January 17, 2006.

competitive services and furthermore to assist the Commission in analyzing such issues as the cost of expanding universal service support to encompass a broadband platform.

In light of BellSouth's enormous success remonopolizing the "traditional" telecommunications market as well as emerging broadband markets, it is not surprising that BellSouth would like to keep regulators in the dark about its costs.

BellSouth has been extremely successful in re-monopolizing the long distance market with its "BellSouth Answers" bundle to customers. The bundle combines local telephone service, multiple convenience features, BellSouth Long Distance, Cingular Wireless services, Internet services, and DIRECTV digital satellite television services. By the third quarter of 2005, BellSouth Answers served more than 4.8 million customers (with a 42.5 percent penetration of primary residential access line base). This amount represents an increase from 4.4 million customers at the end of 2004 (37 percent penetration), and 3 million at the end of 2003 (24.1 percent penetration).[40]

BellSouth is also extremely successful garnering customers for its DSL as Figure 1 shows. Also, as discussed above, over-priced special access rates are generating substantial profit for ILECs. In light of BellSouth's market power and supracompetitive rates, it is not surprising that BellSouth would prefer to eliminate the tools available to regulators to detect anticompetitive pricing. BellSouth's analysis is fundamentally flawed because it equates the existence of a price cap system with just and reasonable rates. Although the *objective* of price cap regulation is just and reasonable rates, price cap systems are imperfect and therefore require periodic examination. This review requires regulators' access to detailed cost reporting.

[40] / BellSouth Corp. Form 10-Q filed October 3, 2005, page 25; BellSouth Corp. Form 10-K filed March 8, 2005, at 27; BellSouth Corp. Form 10-K filed February 24, 2004, at 31. BellSouth's rapid gain of significant market share in new markets contrasts sharply with CLECs' negligible inroads into ILEC markets.

Indeed, the Commission has previously determined that the existence of price cap regulation does not eliminate the need for accounting safeguards:

> The fact that an incumbent local exchange carrier subject to the Commission's price cap regulation does not currently have a potential sharing obligation does not obviate the need for rules governing their allocations of costs between regulated and nonregulated activities. As described above, our interim price cap rules permit incumbent local exchange carriers to select the productivity factor they will use to determine annual adjustments to their price cap indices. Incumbent local exchange carriers may select among three productivity factor choices, two of which impose sharing obligations if the local exchange carrier's interstate earnings exceed specified benchmarks and permit low-end adjustments if interstate earnings fall below specified benchmarks. In addition, our price cap rules permit incumbent local exchange carriers to file rate increases that exceed their applicable price cap indices, provided they can satisfy a stringent cost showing. Consequently, our current system of interstate price cap regulation does not eliminate the need for cost allocation rules. Moreover, because these incumbent local exchange carriers' intrastate services may be subject to cost-of-service regulation or to a form of price cap regulation that involves potential sharing obligations or periodic earnings reviews, the incumbent local exchange carriers may still have an incentive to assign a disproportionate share of costs to regulated accounts. We recognize that changes in the competitive conditions of local telecommunications markets in the future may cause us to re-examine the continued need for our Part 64 cost allocation rules; but, based on the record in this proceeding, those rules remain important to our efforts to ensure that the rates for regulated services are just, reasonable, and non-discriminatory.[41]

[41] / *In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, Order*, 11 FCC RCD 17539 (1996), para. 271, notes omitted.

The Commission has demonstrated its willingness to consider modifications to reporting requirements in the context of rulemakings, informed by Federal-State Joint Boards.

The Commission has demonstrated its willingness to consider suggestions for streamlining ILECs' reporting requirements.[42] The Ratepayer Advocate fully supports the Commission's periodic and careful examination of reporting requirements, but such a review should not be occurring in the context of an ILEC's petition for forbearance. Indeed, the Commission has stated: "Commenters have requested that we address such issues as establishing different regulatory accounting requirements for rate-of-return and price cap carriers, … and various other regulatory accounting relief for the RBOCs. We appreciate the responses we have received. The Joint Conference and the Commission will continue to examine these issues."[43] The Commission should dismiss BellSouth's attempt to do an end-run around the Commission's examination of these issues with its petition for forbearance.

In an earlier decision, issued in 2001, the FCC has also demonstrated its willingness to consider the merits of modifications to reporting requirements. Among other things, the Commission stated:

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[42] / The periodic assessment of ways in which to streamline reports and to ensure that they provide useful informational tools for state and federal regulators is appropriate. *See, e.g., In the Matter of Federal-State Joint Conference on Accounting Issues*, WC Docket No. 02-269, *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II, CC Docket No. 00-199, Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Local Competition and Broadband Reporting*, CC Docket No. 99-301, *Report and Order*, FCC 04-149, released June 24, 2004, in which the FCC addresses Part 32 Accounts, affiliate transaction rules, and reporting requirements.

[43] / *Id.*, at para. 64, citing, among others, BellSouth Comments at 5.

> In adopting these rule changes, we have attempted to steer a course that avoids both deregulation simply for its own sake and the countervailing temptation to retain rules that may no longer be necessary. Thus, we decline to adopt the proposal of the USTA to move even the largest LECs to the less detailed, Class B system of accounting. As we describe below, this decision is motivated by our conclusion that the higher level of detail of Class A accounts is necessary for the Commission to continue meeting its statutory obligations with respect to universal service. For similar reasons, we have chosen not to fully collapse the Class A accounts to the extent that USTA has advocated.[44]

It would be premature to dismantle cost accounting safeguards for BellSouth.

BellSouth also bemoans the effort it expends to comply with cost allocation rules as they pertain to BellSouth's advertising.[45] BellSouth advertises regulated and unregulated services in an integrated manner (as do many ILECs).[46] Indeed, BellSouth's position as the incumbent provider of basic local service gives it a formidable edge over its competitors. If the cost of compliance is as great as BellSouth contends, the Ratepayer Advocate recommends that BellSouth simply assign 100 percent of advertising costs to unregulated services because BellSouth's unregulated services are benefiting directly from the goodwill of the association with BellSouth's local services, an advantage that BellSouth uniquely possesses in its serving territory.

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[44] / *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, Amendments to the Uniform System of Accounts for Interronnnection; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, CC Docket NOs. 00-1999, 97-212, 80-286, and 99-301, *Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286; FurtherNotice of Proposed Rulemaking in CCDocket Nos. 00-199, 99-301, and 80-286*, FCC Rcd 19,1911, at para. 6.

[45] / BellSouth Petition, at 35-37 and Appendix 4.

[46] / *Id.*, at 36.

Similarly, BellSouth laments the effort it must expend to implement cost assignment rules in its time reporting.[47] According to BellSouth, the results of its statistical sampling and allocation efforts "are only used to populate the ARMIS 43-03 report, but are not used for ratemaking purposes."[48] A company operating in a competitive market might reasonably undertake time reporting in order to allocate costs to various products and to assess the relative cost-benefit of the expenditure of various efforts. BellSouth has failed to demonstrate that the cost accounting requirements are unduly burdensome.

Affiliate transaction rules should not be eliminated.

BellSouth questions the usefulness of Part 32.27 regarding affiliate transactions,[49] because, among other things, the cost of the affiliate transactions "has no impact on BST's prices set *via* price caps."[50] BellSouth also questions the need, pursuant to Section 64.904 to have an audit of its compliance with affiliate transaction rules.[51] It is premature to discontinue rules governing affiliate transactions. With the increasing concentration in the telecommunications market,[52] the prospects for effective competition are diminishing, and therefore regulators require access to data to prevent and detect anti-competitive behavior by the ILECs. When confronted with Verizon's request to discontinue the

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[47] / *Id.*, at 37-38 and Appendix 6.

[48] / *Id.*, at 38.

[49] / *Id.*, at 40-42.

[50] / *Id.*, at 41.

[51] / *Id.*, at 42-43.

[52] / *In the Matter of Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control, WC Docket No. 05-75; In the Matter of SBC Communications Inc. and AT&T Corp. Applications for Transfer of Control*, WC Docket No. 05-65.

auditing condition of the Bell Atlantic/GTE merger, the FCC appropriately stated:

> We reject Verizon's claim that these compliance requirements obviate the need for the independent auditor condition. As previously stated, the Commission found that the compliance program protected the public interest, but only in conjunction with the independent auditor condition. A quarterly report or compliance reports is not a substitute for an independent auditor condition. Verizon's obligations to file unaudited quarterly and compliance reports do not provide an independent review of Verizon's performance. During the audit process, the Commission staff, state commissions, and independent auditor have access to the working papers, supporting materials, and interpretations underlying Verizon's compliance assertions that may not be disclosed in the performance reports or available to third parties. Finally, when contemplating the merger, the Commission considered the independent auditor condition a useful tool to supplement its usual investigative authority. In view of the foregoing, we find no reason to alter our prior conclusion that the compliance mechanisms discussed in Verizon's request are not substitutes for the independent auditor condition.
>
> Lastly, Verizon contends that we should discontinue the audit requirement because "the audits for the years 2005 and beyond would cost at least one million dollars," and "the burdens of continued audits clearly outweigh any possible benefits." We find this contention unpersuasive. The Commission specifically found that "the audit requirement establishes an efficient and cost-effective mechanism for providing reasonable assurance of Bell Atlantic/GTE's compliance with the conditions." Verizon has not provided substantial evidence to contradict this finding. We conclude that, therefore, Verizon has not demonstrated that discontinuing the independent auditor condition would serve the public interest.[53]

The Commission should similarly retain auditing requirements for BellSouth's affialte transactions.

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[53]/ *In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer of Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License*, CC Docket No. 98-184, EB File No. EB-04-IH-0143, *Order*, released January 7, 2005, paras. 7-8, footnotes omitted. The FCC also recently rejected SBC's request to discontinue the independent auditor condition of its merger with Ameritech. *In the Matter of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer of Control*, CC Docket No. 98-141, EB File No. EB-04-IH-0216, *Order*, released January 7, 2005, paras. 8-9, footnotes omitted.

Jurisdictional Separation (Part 36) is long overdue for modification.

BellSouth contends that the Commission should grant BellSouth forbearance from the Part 36 separations rules because of technological change and the existence of price cap regulation.[54] BellSouth asserts that when both federal and state regulators adopted price cap regulation, there was no longer a need for a separations process.[55] In further support of its position, BellSouth refers to the fact that, based on the recommendation of the Federal-State Separations Joint Board, the Commission adopted an interim freeze on jurisdictional separations rules effective July 1, 2001.[56]

Through its petition, BellSouth seeks to show a "disconnect" between the "cost assignment exercise" and the original purpose of the cost assignment rules as part of a framework established to ensure just and reasonable rates. BellSouth argues that even if the cost assignment rules are vaguely beneficial to "some broader array of evolving goal," their relationship to the original goals for which they were developed is "weak or remote."[57] The Ratepayer Advocate disagrees strongly with BellSouth's characterization of the cost accounting standards' connection to the establishment of just and reasonable rats as "weak." Absent a comprehensive assessment of BellSouth's costs and revenues, neither the Commission nor state public utility commissions can determine whether rate caps are just and reasonable.

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[54] / BellSouth Petition, at 42-44.

[55] / *Id*., at 43.

[56] / *Id.*, citing *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Recommended Decsion*, 15 FCC Rcd 13,160; *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Report and Order*, 16 FCC Rcd 11,382 (2001) ("Separations Freeze Order").

[57] / *Id*., at 9.

The Ratepayer Advocate urges the Commission to deny BellSouth's request for forbearance from Part 36 separations rules. The Ratepayer Advocate also is concerned that jurisdictional allocation is long overdue for correction. Among other things the excessive allocation of costs to the state jurisdiction is subsidizing inappropriately ILECs' interstate and unregulated offerings. Until the Commission corrects the separations factor, state rate caps cannot be considered just and reasonable.

Contrary to BellSouth's assertions, cost accounting data is a useful tool in TELRIC and universal service proceedings.

BellSouth contends that cost assignment is unnecessary for determination of rates for unbundled network elements ("UNEs") because cost assignment looks at historical costs, while the rates for UNEs are based on forward-looking costs.[58] In their determination of forward-looking costs, states rely, in part, on historic cost data that ILECs track and compile. Therefore the Commission should reject BellSouth's argument on this point.

BellSouth also contends that cost assignment rules are not intended to guard against price squeezes, and cites to the Commissions *Joint Cost Order* for support:

> The pricing of individual non-regulated products and services does not fall within our statutory mandate. Complaints about predatory pricing in non-regulated markets are the province of the antitrust laws. The proper purpose of our cost allocation rules is to make sure that all of the costs of non-regulated activities are removed from the rate base and allowable expenses for interstate regulated services. It is not our purpose, nor should it be our purpose, to seek to attribute costs to particular non-regulated activities for purposes of establishing a relationship between cost and price.[59]

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[58] / *Id*., at 59-60.

[59] / BellSouth Petition at 56-57, citing *Joint Cost Order*, 2 FCC Rcd at 1304, para. 140.

BellSouth also asserts that the cost assignment rules do not guard against, and are not intended to guard against, accounting scandals such as those that occurred at Enron and Worldcom, and that financial regulators rely on financial reporting mechanisms.[60] According to BellSouth, concerns that forbearance in cost assignment will reduce financial transparency and accountability are unfounded, as these issues are overseen by the Securities and Exchange Commission and regulated through financial reporting requirements.[61]

BellSouth claims that forbearance is consistent with the public interest because it removes "antiquated regulatory barriers."[62] According to BellSouth, compliance with these rules is time- and resource-intensive, and slows "the process of getting innovative, integrated services to customers."[63] BellSouth also refers to statistics about competitive entry and comments, "As the market becomes more competitive, the public interest is served by jettisoning outdated accounting rules."[64] BellSouth concludes its Petition by claiming that granting the Petition promotes competition,[65] stating: "Each competitor should be free to deploy its resources, to the maximum extent possible, toward positive activities that generate consumer benefit. A significant portion of BST's resources, as described herein, are deployed in rules-mandated activities that do not produce value to

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[60] / *Id*., at 61.

[61] / *Id*., at 4.

[62] / *Id*., at 62.

[63] / *Id*., at 63.

[64] / *Id*., at 72.

[65] / *Id*., at 76.

consumers."[66] BellSouth's assertions lack any empirical support in the record. As a result, in the first instance, BellSouth has not sustained its burden of proof.

III. CONCLUSION

There is no evidence that state and federal price caps are just and reasonable rates, and, therefore, the Commission should reject BellSouth's reliance on the existence of price cap systems as support for its petition for forbearance from cost accounting requirements. Any burden that BellSouth bears is more than outweighed by regulators' need to have access to cost data. The Ratepayer Advocate urges the Commission to either reject BellSouth's petition or to defer BellSouth's Petition to a federal-state board, and, based on their recommendation, to initiate a rulemaking. The Commission should address the changes sought by BellSouth through a rulemaking so all stakeholders may have a chance to be heard. If, however, the Commission, contrary to the Ratepayer Advocate's recommendations, grants BellSouth's petition, the Commission should carve out an explicit authority to states that enable them to impose independently cost accounting requirements and affiliate transaction rules on ILECs.

Respectfully submitted,

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[66] / *Id*., at 76.