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

REPLY COMMENTS OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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On the Comments:

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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 reply 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]

Verizon and AT&T, not surprisingly, support BellSouth's petition, but, as the Ratepayer Advocate explains in more detail below, fail to substantiate their assertions that BellSouth's petition merits the Commission's approval. Verizon also devotes much of its comments to discussing its recommendation that the Commission extend the

[1] / The Commission established a pleading cycle in Public Notice DA 05-3185, issued December 22, 2005. On January 23, 2006, the Ratepayer Advocate filed initial comments in opposition to BellSouth's Petition.

separations freeze, which is presently set to expire June 30, 2006.[2] Time Warner Telecom ("Time Warner") and the Ad Hoc Telecommunications Users Committee ("Ad Hoc") oppose BellSouth's petition for several reasons, which the Ratepayer Advocate discusses in these reply comments.

II. BELLSOUTH'S PETITION

None of the comments provide evidence to support BellSouth's attempt to railroad issues that would be addressed more appropriately in a rulemaking and/or by a Federal/State Joint Board.

AT&T not only supports BellSouth's petition, but also proposes that the Commission forbear from applying its accounting rules to all price cap local exchange carriers ("LEC").[3] The Commission should reject this attempt to use BellSouth's petition as a back-door mechanism to implement a major change in the Commission's accounting rules. As the Ratepayer Advocate demonstrated in its initial comments, this proceeding is an improper forum for assessing the merits of changes to cost accounting rules.[4]

The Commission has previously determined that cost accounting rules continue to be necessary, even in the presence of price cap regulation, and BellSouth has failed to demonstrate that the Commission should revisit these findings.

AT&T contends that the "continued enforcement of [cost assignment] rules *harms* consumers by needlessly raising the costs of providing local exchange services."[5] However, neither AT&T nor BellSouth address the fact that the unfair and uneconomic separations freeze is a more significant cause of cost increases in local exchange service than compliance with cost assignment rules. The jurisdictional separations factor

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[2]/ *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Report and Order, 16 FCC Rcd. 11382 (2001) ("Separations Freeze Order").

[3]/ AT&T at 7.

[4]/ Ratepayer Advocate at 3-4, 17-18.

[5] / AT&T at 4, emphasis in original.

requires modification in order to align ILECs' cost recovery more closely with cost causation, in light of ILECs' increasing use of the public network for interstate and unregulated services. Furthermore, as is thoroughly explained by Time Warner, BellSouth has failed to demonstrate that the Commission should abandon it prior determinations, which have included "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."[6] Time Warner identifies several specific instances in which the Commission has rejected attempts by independent local exchange carriers ("ILEC") to eliminate cost accounting requirements in a price cap environment.[7] BellSouth, Verizon, and AT&T have failed to demonstrate that the Commission should depart from its earlier findings.

Cost accounting rules are essential to enable the Commission to assess the price cap regime that governs BellSouth's and other ILECs' interstate rates.

AT&T, in support of BellSouth's petition, contends that cost assignment rules "have no applicability to the modern price cap system."[8] Time Warner explains clearly the linkage between the Commission's cost accounting rules and the Commission's assessment of the price cap indices that apply to individual price cap baskets.[9] The Ratepayer Advocate concurs with Time Warner that "[i]n any event, the dispositive response to the incumbent's argument is that some measure of costs must be the

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[6]/ Time Warner at 4.

[7]/ *Id.,* at 4-7.

[8]/ AT&T at 3.

[9]/ Time Warner at 8-10.

touchstone for regulated rates, and actual costs must in turn form the ultimate basis for any cost assessment."[10]

The Ratepayer Advocate also concurs with Ad Hoc that "[g]ranting BellSouth's petition would render the ongoing special access rulemaking meaningless."[11] As Ad Hoc explains, in order to measure whether ILECs' special access rates are reasonable, the Commission should examine ILECs' earnings, which, in turn, requires an analysis of underlying costs.[12]

Neither AT&T nor Verizon adequately address the fact that "[p]rice cap regulation as prescribed by the Commission does not sever all links between rate setting and costs."[13] Cost assignment and cost allocation rules are essential to protect consumers and to enable the Commission to ensure that rates are just and reasonable.

Cost accounting rules are essential for the establishment of TELRIC rates, and are not relevant to financial accounting requirements.

As Time Warner demonstrates, cost accounting yields information that is critical for total element long run incremental cost ("TELRIC") studies and to compute universal service report.[14] In their establishment of forward-looking inputs and values for TELRIC studies, state regulators rely in part on information gleaned from embedded cost studies. Therefore, the Commission should dismiss BellSouth's specious argument that cost accounting rules are irrelevant to TELRIC studies.

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[10]/ Time Warner, at 10.

[11]/ Ad Hoc at 4.

[12]/ *Id,* at 5-6.

[13]/ *Id.* at 14; *see also* Ratepayer Advocate at 6-10.

[14]/ Time Warner at 10-12.

Furthermore, Time Warner aptly recognizes that BellSouth's discussion of financial accounting is a red herring. As Time Warner explains, "the Commission has never placed primary reliance on the need to ensure financial transparency as a basis for retaining its cost accounting rules."[15]

Cost accounting requirements are linked inextricably to the Commission's pending review of the regulation of BOCs after Section 272 affiliate requirements sunset.

The Ratepayer Advocate urges the Commission to heed Time Warner's explanation showing that cost accounting requirements are critical to the Commission's pending regulation of Bell operating companies after the sunset of Section 272 affiliate transactions.[16] As ILECs increasingly integrate local and long distance services, cost allocation rules are essential to ensure that customers of basic service do not cross-subsidize ILECs' efforts to compete in the long-distance and bundled services markets.

Contrary to Verizon's assertion, the Commission should not extend the jurisdictional separations freeze, but rather should act expeditiously to modify the separations factor.

Verizon contends that "the Commission should immediately extend the separations freeze and confirm that the freeze precludes states from imposing inconsistent separations requirements."[17] Citing a white paper authored by the United States Telecom Association ("USTA"),[18] Verizon contends that there "is no legitimate basis for requiring carriers to incur [the] expense and disruption" of undertaking the studies necessary to

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15/ *Id.* at 12.

16/ Time Warner at 13-14, citing *Section 272(f)(10) 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, paras. 29, 35, 40 (2003).

17/ Verizon at 1.

18/ "Paving the Way for Separations Reform," CC Docket No. 80-286, filed December 13, 2005 ("USTA White Paper").

conduct jurisdictional separations.[19] Verizon seeks an extension of the freeze to prevent "undue burdens on carriers."[20]

However, the evolution of the telecommunications network from analog to digital technology does not alter the importance of assigning and allocating costs.[21] Indeed, precisely because ILECs are using a common network platform increasingly to pursue services that have been classified as interstate or unregulated underscores the importance of modifying the separations factor to correspond with a more logical and equitable split of costs between interstate and intrastate jurisdictions.

Contrary to Verizon's recommendation, the Commission should not interfere with states' authority to establish just and reasonable rates.

Verizon also contends that states not be permitted to apply cost allocation rules that differ from federal rules, and recommends that, "in conjunction with extending the freeze, the Commission should reconfirm that states cannot require carriers to perform separations studies or take other actions that are inconsistent with the separations freeze while the freeze in effect."[22] Verizon opposes any state attempts to reclassify investment from the intrastate to the interstate jurisdiction.[23] The Ratepayer Advocate disagrees strongly with Verizon's position that states should be prohibited from examining

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[19]/ Verizon at 4.

[20]/ *Id.* at 4.

[21]/ Ad Hoc at 17.

[22]/ Verizon at 4-5.

[23]/ *Id.* at 6, citing *Crockett Tel. Co. v. FCC,* 963 F.2d 1564, 15767 (D.C. Cir. 1992), which states, among other things, "[a]lthough each state has great freedom to regulate intrastate rates, once the FCC has applied its jurisdictional separation, that part of the cost base deemed to be interstate is outside the jurisdictional reach of the state regulatory agency" and also citing *Hawaiian Tel. Co. v. Public Utilities Commission of Hawaii*, 827 F.2d 1264, 1275-76 (9th Cir. 1987), *cert denied*, 487 U.S. 1218 (1988), which Verizon describes as "finding a state ratemaking methodology to be inconsistent with and thus 'necessarily preempted' by federal separations methodology."

independently the merits of the jurisdictional separations factor that now applies. As the Ratepayer Advocate stated in its initial comments in this proceeding,[24] sweeping changes, such as the granting of Section 271 authority, the classification of digital subscriber line ("DSL") and cable modem as informational services, and the classification of voice over Internet protocol ("VoIP") as an interstate service, have rendered the existing separations factor obsolete. It is untenable to expect state regulators to rely on the outdated, frozen separations factor, and, indeed, in order to fulfill their responsibility to ensure just and reasonable intrastate rates, states necessarily must ensure that only a fair share of the cost of ILECs' networks is assigned and allocated to state rates.[25] The Supreme Court has previously upheld states' authority to establish depreciation lives so that they can fulfill their state ratemaking responsibilities.[26] Similarly, and contrary to Verizon's attempt to limit states' purview, as ILECs embark on an otherwise unfettered pursuit of new services, and particularly in the absence of federal review of ILECs' cost allocation, state regulators appropriately and legitimately should assess the proper level of investment that ILECs seek to recover through state rates.

In 2001, the Commission adopted the separations freeze and referred the matter for further analysis to the Federal-State Joint Board.[27] However, federal inaction on this critical matter now is unduly constraining states' ability to establish just and reasonable rates. For this reason, the court decisions from 1987 and 1992 to which Verizon cites are no longer applicable. Unless and until the Commission revisits the separations factor,

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24/ *See, e.g.*, Ratepayer Advocate at 9-11.

25/ ILECs continue to be required to directly assign certain categories of costs the proper jurisdictions. *Separations Freeze Order*.

26/ Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986).

27/ *Separations Freeze Order,* at para. 23.

state rates and rate caps are likely excessive. Therefore, in the absence of federal action, states must assess ILECs' assignment and allocation of investment in order to establish just and reasonable rates.

As the Ratepayer Advocate stated in initial comments (at pages 10-11), re-initialization of federal and state price caps is long overdue, but cannot happen in an informed manner until and unless the Commission corrects the existing separations factor, which is misaligned with the underlying costs. Furthermore, ILECs lack an economic incentive to cooperate with such an endeavor. The 75 percent assignment of subscriber loop plant to states provides ILECs with a unique and invaluable backstop if their present investments in fiber to the home and to the curb, and other investments prove uneconomic in the future. If ILECs' efforts to market voice, data, and video to consumers fail to yield revenues to cover the cost of deploying the infrastructure that supports these new services, ILECs likely will seek recovery through increases in intrastate rates, contending that they are failing to generate a fair return on their investment. Therefore, rational cost assignment and cost allocation rules are essential to prevent consumers from bearing the risk of ILECs' ventures into new services and technologies.

Furthermore, the difficulty of modifying the separations factor does not justify neglecting to carry out this important exercise of "comprehensive reform of the Part 36 separations rules," which the Commission contemplated would occur during the five-year freeze.[28] The harm to consumers from excessive rates and ILECs' over-recovery of investment outweighs the benefits to the industry of "regulatory certainty" and reduction

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[28]/ *See e.g., Separations Freeze Order*, at paras. 9, 12.

in "regulatory burdens."[29] The present freeze places undue emphasis on stability and simplicity for the industry and inadequately protects consumers from ILECs' market power and the misallocation of costs between federal and state jurisdictions.

The Commission relied in part on the fact that the "freeze is not a permanent freeze, but rather a transitional measure," in its rationale for postponing reform of jurisdictional separations.[30] The end of the five-year transition is in sight, and, therefore, the Ratepayer Advocate urges the Commission to re-evaluate the freeze in a timely manner. Almost five years ago, the Commission recognized that commenters had expressed concern that "five years is too long and may discourage efforts toward comprehensive reform, resulting in the freeze becoming a *de facto* rule."[31] These concerns apply equally now.

Competitive forces do not yet constrain BellSouth's market power.

Verizon's contends that all services are subject to competition, including interstate, intrastate, wireline, wireless, local, long distance, basic and enhanced services, and further argues that, as a result of competitive forces, regulatory cost allocations "are not only unnecessary to protect ratepayers, but destructive of true competition."[32] Similarly, AT&T states that "increased competition from cable providers, wireless carriers, and other providers of competitive local and exchange access services further protects consumers from unjust or unreasonable rates, terms, or conditions of service."[33]

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[29] / *Id.*, at paras. 12-13, and 17.

[30] / *Id.,* at para. 17.

[31] / *Id.,* at para. 28, cites omitted.

[32] / Verizon at 7, *see also*, Verizon at 1, 6-10.

[33] / AT&T at 4.

However, data contradict the characterization of telecommunications markets as competitive. Verizon's formidable success re-monopolizing the long distance market and in selling bundled packages of telecommunications services within its home region, and its position in the wireless market undermines its assertion of competitive discipline in the market. As of the end of 2005, Verizon served 18,359,000 long distance customers, and 48,803,000 total access lines, which indicates that approximately 40 percent of its local customers *also* subscribed to its long distance service.[34] Verizon's rapid success re-entering the long distance market contrasts sharply with the minimal inroads into the local markets that competitive local exchange carriers ("CLEC") have made, which provides further evidence of ILECs' market power.

Furthermore, Verizon and other ILECs are experiencing significant success selling bundles of telecommunications services to their "home region" customers, which provides ample opportunity for anticompetitive cross-subsidization. For example, Verizon recently announced to its investors that:

> Approximately 65 percent of Verizon residential customers have purchased local services in combination with either Verizon long distance or a Verizon broadband connection, or both. This compares with approximately 55 percent in the fourth quarter 2004. In addition, Verizon now has nearly 350,000 customers who receive a Verizon DirecTV bundle. [35]

Verizon also emphasize customers' use of wireless service as evidence of competition. However, Verizon neglects to mention that Verizon Wireless had 51.3 million customers at the end of 2005, an increase of 17 percent over the previous year.

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[34]/ Verizon Communications, *Investor Quarterly*, Q4 2005, January 26, 2006. In comparison, at the end of 2003, Verizon had 15,042,000 long distance customers, and 54,826,000 access lines, yielding a penetration rate of 27 percent. Historical Financial Information, As of September 30, 2005 (at http://investor.verizon.com/financial/overview.aspx).

[35] / Verizon Communications, *Investor Quarterly*, Q4 2005, January 26, 2006, at 4.

According to CTIA, in October 2005, there were 194.5 million wireless subscribers, [36] yielding an approximate market share of 26 percent for Verizon.

The Ratepayer Advocate urges the Commission to focus on actual market share data rather than rhetoric.[37] Actual data rather than anecdotal evidence clearly demonstrate that competitive pressures do not yet effectively constrain Verizon's and other ILECs' pricing behavior. For this reason, Verizon's, AT&T's, and BellSouth's repeated incantations of competition should be afforded no weight by the Commission.

The Ratepayer Advocate also disagrees with Verizon's assertion that cost allocation and inter-affiliate transaction rules "disserve[] consumers,"[38] and with AT&T's similar assertion that "[e]nforcement of these outdated rules … affirmatively harms consumers."[39] BellSouth has failed to demonstrate harm to consumers. AT&T argues that eliminating the cost allocation requirements will liberate resources that can be used "to improve service quality and accelerate investment and innovation."[40] BellSouth has failed to indicate where its service quality is deficient and has also failed to specify the investment and innovation that cost allocation rules are thwarting. The Commission's cost allocation rules should remain intact. Instead, these rules are essential to protect consumers and competitors from BellSouth's exercise of anticompetitive behavior and

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[36]/ http://files.ctia.org/pdf/Wireless_Quick_Facts_October_05.pdf.

[37]/ Verizon and AT&T rely on and quote from several Commission orders in support of their position that in a competitive market, market forces will yield just and reasonable rates. Verizon at 9; AT&T at 4. The Ratepayer Advocate does not disagree with the observations that firms that lack market power cannot price services in an anticompetitive manner. This theoretical argument, however, is tangential to this proceeding because neither Verizon, AT&T, nor BellSouth have provided empirical data to substantiate their assertion that relevant markets are effectively competitive.

[38]/ Verizon at 10.

[39]/ AT&T at 5.

[40]/ *Id.* at 6.

excessive prices. Indeed, initial comments do not address the Ratepayer Advocate's initial assertions that BellSouth exaggerates the burden of compliance with cost accounting rules and that BellSouth ignores the importance of cost accounting to mitigate against the information asymmetry between the regulator and the regulated company.

III. CONCLUSION

For the foregoing reasons, the Commission should reject BellSouth's petition for forbearance. Also, the Commission should act expeditiously to correct the out-of-date jurisdictional separations factor that now applies to ILECs' allocation of costs between interstate and intrastate jurisdictions.

Notwithstanding the fact that the petition is without merit and should be denied by the Commission based on the reasons discussed above, the Ratepayer Advocate renews the arguments and incorporates those arguments attached hereto with respect to the constitutional infirmities associated with the Commission's forbearance authority. Specifically any exercise of the forbearance authority contained in Section 10 of the Act violates separation of powers, equal protection, 10th amendment, and 11th amendment as outlined in detail in our Ex Parte filing dated December 7, 2004 in the UNE Remand proceeding (CC Docket No. 01-338 and WC Docket No. 04-313).

Respectfully submitted,

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