

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

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

REPLY COMMENTS OF VERIZON¹

Introduction and Summary

Changes in the communications marketplace and advances in technology obviate the need to continue many legacy regulations that today serve no purpose and operate only to inhibit desirable gains from competitive markets. Contrary to the claims of opponents of AT&T's petition, therefore, for all providers the Commission should move toward eliminating cost assignment rules that are or become unnecessary and concurrently preempt any inconsistent state requirements.

I. The Emergence Of Competition Has Transformed The Communications Marketplace Since The Commission's Cost Assignment Rules Were Adopted.

Several commenters advocate continued application of the Commission's cost assignment rules without regard to the robust competition that has fundamentally altered the market for communications services. As the Commission acknowledged nearly six years ago, the original justification for certain of its accounting rules "may no longer be valid" once

¹ The Verizon companies participating in this filing ("Verizon") are the regulated, wholly owned subsidiaries of Verizon Communications Inc.

competition takes hold, and “the question is not whether further deregulation should occur, but rather when.”²

The Telecommunications Act of 1996 has been “fully implemented,”³ and incumbent local exchange carriers face stiff competition, especially from new intermodal competitors. Most consumers now have access to telephony services from cable companies, wireless carriers, and VoIP providers. Each of the four major incumbent cable operators – Cablevision, Time Warner, Comcast, and Cox – offers competitive voice services in its service territories, and these four companies alone claim to pass more than 75 percent of all domestic households with their networks.⁴ Collectively, cable companies are expected to serve more than 13 million lines by year-end 2007,⁵ and analysts predict that they will offer service to 95 percent of U.S. households

² *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements & ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2; Amendments to the Uniform Sys. of Accounts for Interconnection; Jurisdictional Separations Reform & Referral to the Fed.-State Joint Bd.; Local Competition & Broadband Reporting*, Report & Order in CC Docket Nos. 00-199, 97-212, & 80-286, Further Notice of Proposed Rulemaking in CC Docket Nos. 00-199, 99-301, & 80-286, 16 FCC Rcd 19,911, 19,985 (¶ 206) (2001).

³ *Pet. of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metro. Statistical Area*, Mem. Op. & Order, 20 FCC Rcd 19,415, 19,439-40 (¶¶ 52-53) (2005), *aff'd*, *Qwest Corp. v. FCC*, No. 05-1450, 2007 U.S. App. LEXIS 6755 (D.C. Cir. Mar. 23, 2007).

⁴ Press Release, Comcast, *Comcast Reports 2006 Results and Outlook for 2007* (Feb. 1, 2007), available at <http://www.cmcsk.com/phoenix.zhtml?c=118591&p=irol-newsArticle&ID=956792&highlight=>; Press Release, Time Warner Inc., *Time Warner Inc. Reports Results for 2006 Full Year and Fourth Quarter* (Jan. 31, 2007), available at <http://ir.timewarner.com/downloads/4Q06earnings.pdf>; Press Release, Cablevision, *Cablevision Systems Corporation Reports Third Quarter 2006 Results* (Nov. 8, 2006), available at http://www.cablevision.com/pdf/Q306_earnings.pdf; Press Release, Cox, *Cox Communications Announces Updated Customer Statistics Following System Sales & Acquisitions: New Customer Additions in First Quarter 2006 Best in Company's History* (June 14, 2006), available at <http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=872824&>.

by the end of 2007.⁶ Wireless companies also are offering competing telephony service. Ninety eight percent of the total U.S. population already has access to three or more different wireless providers in the counties in which they live.⁷ Wireless service has grown so spectacularly that of the 389 million voice lines counted by the Commission at the middle of 2006, over 217 million – more than 55 percent – were wireless,⁸ which represents a 13 percent growth rate in wireless subscribers over the past year alone.⁹ And independent VoIP providers also continue to add new customers. Analysts estimate that the number of lines served by over-the-top VoIP providers increased by 63 percent in 2006.¹⁰

⁵ Craig Moffett, *et al.*, Bernstein Research, *VoIP: The End of the Beginning* at Exhibit 8 (Apr. 3, 2007).

⁶ *Id.* at Exhibit 3.

⁷ See *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report & Analysis of Competitive Market Conditions With Respect to Commercial Mobile Servs.*, Eleventh Report, 21 FCC Rcd 10,947, 10,964 (¶ 41) (2006) (proceeding terminated). According to the same report, “94 percent of the U.S. population, live[s] in counties with four or more mobile telephone operators competing to offer service . . . 51 percent of the U.S. population, live[s] in counties with five or more mobile telephone operators competing to offer service, . . . [and] 18 percent of the population, live[s] in counties with six or more mobile telephone operators competing to offer service.” *Id.*

⁸ See FCC, Wireline Competition Bureau, Industry Analysis & Technical Division, *Local Telephone Competition: Status as of June 30, 2006*, at Tables 1 & 14 (Jan. 2007) (“2007 Local Competition Report”), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270128A1.pdf.

⁹ *Id.* at Table 14.

¹⁰ See Craig Moffett, *et al.*, Bernstein Research, *VoIP: The End of the Beginning* at Exhibit 1 (Apr. 3, 2007). Skype, a subsidiary of eBay, quickly gained over 171 million VoIP users. Press Release, Skype, *Skype Means Business - Saving Money is Just the Start* (Jan. 25, 2007), available at http://about.skype.com/2007/01/skype_means_business_saving_mo.html. SunRocket also recently announced that it has “buil[t] a 200,000 subscriber base from scratch in a relatively short period of time.” Press Release, SunRocket, *SunRocket Breaks Through 200,000 Subscriber Mark* (Apr. 2, 2007), available at

Intramodal competition has risen steadily as well. ILECs now face pressure from carriers leasing unbundled network elements and also from facilities-based CLECs that own their own “last-mile” facilities.¹¹ CLECs have substantially increased their market share; the number of CLEC-served access lines has more than quadrupled between 1999 and today.¹²

Claims by commenters that insufficient competition exists in certain segments of the market to warrant regulatory relief are unfounded – and ultimately irrelevant.¹³ The Commission has previously found extensive competition in all facets of the telephony market.¹⁴ And, in any event, a fully competitive market is not a prerequisite to the elimination of burdensome

<http://www.sunrocket.com/about/mediaroom/releases/2007/200/> (statement by SunRocket President and CEO Lisa Hook).

¹¹ More than 35 percent of CLEC end-user lines are CLEC-owned. See FCC, Wireline Competition Bureau, Industry Analysis & Technical Division, *Trends In Telephone Service*, at Table 8.3 (Feb. 2007), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-270407A1.pdf.

¹² 2007 Local Competition Report at Table 1.

¹³ See, e.g., Opposition of the AdHoc Telecommunications Users Committee at 16-18 (Mar. 19, 2007) (“Opp’n of AdHoc”).

¹⁴ See *Verizon Commc’ns, Inc. & MCI, Inc. Applications for Approval of Transfer of Control*, Mem. Op. & Order, 20 FCC Rcd 18,433, 18,436 (¶ 3) (2005) (noting “the rapid growth of intermodal competitors – particularly cable telephony providers (whether circuit-switched or voice over IP (VoIP) – as an increasingly significant competitive force in [the mass] market,” anticipating “that such competitors likely will play an increasingly important role with respect to future mass market competition”); *id.* at 18,482-83 (¶ 91); *SBC Commc’s, Inc. & AT&T Corp. Applications for Approval of Transfer of Control*, Mem. Op. & Order, 20 FCC Rcd 18,290, 18,321 (¶ 56) (2005) (finding “strong competition” for medium and large enterprise customers because they “are sophisticated, high-volume purchasers of communications services that demand high-capacity communications services” that are served by “a significant number of carriers competing in the market”); *id.* at 18,292-93 (¶ 3).

regulations that impact only a few among many competitors. “Forbearance need not await the development of a fully competitive market when the section 10 criteria are otherwise satisfied.”¹⁵

As for the Commission’s cost assignment rules themselves, they are a byproduct of a communications era vastly different from today’s marketplace. The Commission’s first separations rules were adopted in 1947.¹⁶ The Commission’s cost allocation rules, designed to separate the costs of regulated and nonregulated activities and to govern transactions between a carrier and its affiliates, were established in the 1980s.¹⁷ The primary purpose of these rules was to determine a carrier’s rate base and its rates under rate-of-return regulation. These rules are unnecessary where there is no reliance on them in ratemaking, and no commenter contends otherwise.

II. Maintaining Burdensome Rules That Apply Only To A Few Among Many Competitors Unfairly Handicaps Those Carriers.

AT&T’s petition makes clear, and no commenter disputes, that many of the Commission’s cost assignment rules are extraordinarily complex and inherently burdensome. Yet this complexity and these burdens impact only a small number of price cap carriers – each of

¹⁵ *Pet. for Forbearance of the Verizon Tel. Cos. Pursuant to 47 U.S.C. § 160(c)*, Mem. Op. & Order, 19 FCC Rcd 21,496, 21,509 (¶ 28) (2004).

¹⁶ *See generally Am. Tel. & Tel. Co. & the Associated Bell Sys. Cos.; Charges for Interstate & Foreign Comm’n Serv.*, Mem. Op. & Order, 3 FCC 2d 307, 309-311 (¶¶ 11-16) (1966). In 1969 the Commission adopted the separation rules found in 47 C.F.R. Part 36. *See Prescription of Procedure for Separating & Allocating Plant Inv., Operating Expenses, Taxes, & Reserves Between the Intrastate & Interstate Operations of Tel. Cos.*, Report & Order, 16 FCC 2d 317 (1969).

¹⁷ *Separation of Costs of Regulated Tel. Serv. from Costs of Non-regulated Activities; Amendment of Part 31, the Uniform Sys. of Accounts for Class A & Class B Tel. Cos. to Provide for Non-regulated Activities & to Provide for Transactions between Tel. Cos. & Their Affiliates*, Report & Order, 2 FCC Rcd 1298 (1987).

which is today just one among many competitors in its territories. The end result distorts competition by handicapping only a few among many competitors to the detriment of those companies and their customers.¹⁸ The Commission cannot and should not continue to maintain rules that are not demonstrably necessary to ensure just and reasonable rates, protect consumers, and advance the public interest, particularly when those rules apply to only a small subset of competitors in the market.¹⁹

III. The Commission Should Preempt States From Imposing Their Own Cost Assignment Rules Once The Commission Decides To Eliminate These Regulations At The Federal Level.

As the Commission moves away from legacy cost assignment rules, it must also ensure that the policy judgment to eliminate these rules is carried through to the states by affirmatively

¹⁸ In other contexts, the Commission has acted to eliminate distortions in competition resulting from regulation. *See, e.g., Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, Declaratory Ruling, WT Docket No. 07-53, 2007 FCC LEXIS 2340, at *69 (¶ 53) (FCC Mar. 23, 2007) (declining to construe mobile wireless broadband Internet access service as CMRS information service because doing so would result in “disparate treatment” that “would introduce competitive distortions in the marketplace”); *Implementation of the Local Competition Provisions in the Telecomms. Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand & Report & Order, 16 FCC Rcd 9151, 9153-55 (2001), *remanded, WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002); *see also Pet. for Declaratory Ruling that AT&T’s Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, Order, 19 FCC Rcd 7457, 7468 (2004).

¹⁹ *Cf. Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities; Universal Serv. Obligations of Broadband Providers; Review of Regulatory Requirements for Incumbent LEC Broadband Telecomms. Servs.; Computer III Further Remand Proceedings: Bell Operating Co. Provision of Enhanced Servs.; 1998 Biennial Regulatory Review – Review of Computer III & ONA Safeguards & Requirements; Conditional Pet. of the Verizon Tel. Cos. for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Servs. Provided Via Fiber to the Premises; Pet. of the Verizon Tel. Cos. for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Servs. Provided Via Fiber to the Premises; Consumer Protection in the Broadband Era*, Report & Order & Notice of Proposed Rulemaking, 20 FCC Rcd 14,853, 14,877-78 (¶¶ 44-45) (2005) (eliminating *Computer Inquiry* requirements for wireline broadband Internet access services offered by RBOCs, noting that such requirements impose “additional costs” that deter network investment by one set of competitors, which was contrary to the Commission’s desire to “regulate like services in a similar manner”).

preempting inconsistent state regulations. The Commission's regulatory accounting decisions are indeed binding on the states. *See* 47 U.S.C. §§ 221(c), 410(c); *Crockett Tel. Co. v. FCC*, 963 F.2d 1564, 1567 (D.C. Cir. 1992) (“Although 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.”); *id.* at 1573 (“[W]hen the Commission has prescribed an applicable separation methodology, states are not free to ignore it.”); *see also Hawaiian Tel. Co. v. Pub. Utils. Comm'n of Haw.*, 827 F.2d 1264, 1275-76 (9th Cir. 1987) (finding a state ratemaking methodology to be inconsistent with and thus “necessarily preempted” by federal separations methodology).

Moreover, once the Commission eliminates cost assignment requirements, states are not free to impose their own rules. *See Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 348 (2001) (finding preemption where “somewhat delicate balance of statutory objectives” could “be skewed by allowing” state-law claims). A decision that cost assignment requirements are no longer necessary is no less an assertion of federal authority than the imposition of specific rules. For example, the Commission's determination in *Computer II* to deregulate customer premise equipment on a preemptive basis was upheld on appeal,²⁰ as was the Commission's action in *Computer III* to preemptively eliminate structural separation requirements for enhanced services.²¹ Accordingly, once the Commission finds that cost assignment rules are no longer necessary, that determination forecloses the states from adopting their own requirements.

²⁰ *Amendment of Section 64.702 of the Comm'n's Rules & Regulations (Second Computer Inquiry)*, Final Decision, 77 FCC 2d 384 (1980), *aff'd*, *Computer & Commc'ns Indus. Ass'n v. FCC*, 693 F.2d 198 (D.C. Cir. 1982)..

²¹ *Amendment of Section 64.702 of the Comm'n's Rules & Regulations (Third Computer Inquiry); & Policy & Rules Concerning Rates for Competitive Common Carrier Servs. &*

IV. The Desire Of Competitors To Use ARMIS Data To Challenge The Reasonableness Of Special Access Prices Is Improper And Misguided.

Some commenters support continued application of the Commission's cost assignment rules because of the special access returns reported in ARMIS.²² As Verizon and other carriers have repeatedly explained, these segment-specific ARMIS data are *not* accurate reflections of a carrier's actual returns, but rather are artifacts of the Commission's rules for allocating network investment among services.²³ The need to allocate shared and common costs means that this process will inevitably yield arbitrary results. As the Commission has acknowledged, accounting rates of return reported in ARMIS do "not serve a ratemaking purpose."²⁴

Facilities Authorizations Thereof; Commc'n's Protocols Under Section 64.702 of the Comm'n's Rules & Regulations, Report & Order, 104 FCC 2d 958 (1986), subsequent history omitted.

²² Opposition of Sprint Nextel Corp. at 14-19 (Mar. 19, 2007); Opp'n of AdHoc at 2-9.

²³ See, e.g., Declaration of Alfred E. Kahn & William E. Taylor, On Behalf of BellSouth Corp., Qwest Corp., SBC Communications, Inc., & Verizon (Exhibit 1 to Comments of BellSouth, RM No. 10593 (Dec. 2, 2002)), at 6-7 ("use of accounting profit rates ... based on fully distributed costs to demonstrate that individual services are overpriced is economic nonsense"); Reply Declaration of William E. Taylor (Attachment A to Reply Comments of Verizon, Docket No. 05-25 (July 29, 2005)).

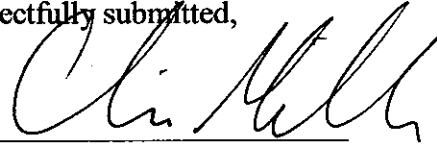
²⁴ *Policy & Rules Concerning Rates for Dominant Carriers*, Order on Recon., 6 FCC Rcd 2637, 2730 (¶ 199) (1991). In any event, Verizon has thoroughly refuted claims that special access rates are excessive, conclusively establishing in its various filings in Docket No. 05-25 that: (1) Verizon's overall special access revenues per line have dropped by 16.6 percent per year in real terms since 2001; (2) DS1 and DS3 prices paid by customers fell by 5.7 and 7.6 percent per year between 2002 and 2004 respectively in real terms; and (3) Verizon offers special access discount plans with price breaks of 40 percent or more off month-to-month rates and individually negotiated contract tariffs with total discounts of up to 70 percent off of month-to-month rates.

Conclusion

The Commission should move toward eliminating cost assignment rules that are or become unnecessary and concurrently preempt any inconsistent state requirements.

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