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Decision 99-02-038 February 4, 1999

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service.	Rulemaking 95-04-043 (Filed April 26, 1995)
Order Instituting Investigation on the Commission's Own Motion Into Competition for Local Exchange Service.	Investigation 95-04-044 (Filed April 26, 1995)

OPINION

By this decision, we relieve competitive local carriers (CLCs) which are not part of an incumbent local exchange carrier (ILEC) corporate entity from the requirement to keep their books of account in conformance with the Uniform System of Accounts (USOA), as discussed below.

Background

On September 2, 1997, a Petition for Modification of Decision (D.) 97-08-085 was filed by Sprint Communications Company L.P. (Sprint) in which it was granted a certificate of public convenience and necessity (CPCN) to provide local exchange service as a CLC. Sprint sought a modification of the decision to eliminate the requirement that Sprint keep its books and records in accordance with the USOA specified in Title 47, Code of Federal Regulations, Part 32. Sprint requested that it not be required to conform with the USOA, but that it be permitted to keep its books and records in accordance with generally accepted accounting principles (GAAP). Sprint argued it is unduly burdensome and serves no public or business purpose to keep its books in accordance with the USOA.

Without prejudging the substantive merits of Sprint's arguments, we denied Sprint's Petition for Modification in D.98-02-109 with the proviso that this issue would be addressed generically in the Local Competition dockets. Because Sprint raised this issue in the limited context of its own CPCN authority, we were concerned that there had not been an adequate notice of the potential change in our Local Competition rules, with an opportunity for all interested parties to be heard on the implications of such a change. Hence, we directed the assigned Administrative Law Judge (ALJ) to issue a ruling in the Local Competition dockets calling for comments addressing whether there is a continued regulatory need for the USOA requirement for CLCs on a generic basis.

In accordance with D.98-02-109, an ALJ ruling was issued on February 27, 1998, soliciting comments on the proposed elimination of the USOA reporting requirement for CLCs. Opening comments were filed on March 20, and reply comments were filed on April 3, 1998.

Comments were filed by the California Telecommunications Coalition (Coalition),[1] Cox California Telcom, Inc. (Cox), GTE California (GTEC), Office of Ratepayer Advocates (ORA), Citizens Telecommunications Company of

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[1] The Coalition members joining the filing were AT&T Communications of California, Inc. (AT&T); California Association of Competitive Telecommunications Companies (CALTEL); California Cable Television Association (CCTA); Correctional Communications Corporation; ICG Telecom Group, Inc. (ICG); MCI Telecommunications Corporation (MCI); NEXTLINK California, LLC (Nextlink); Northpoint Communications, Inc.; Sprint Communications Company L.P. (Sprint); Teleport Communications Group of Los Angeles; Teleport Communications of San Diego; Teleport Communications Group of San Francisco; Teligent, Inc.; Time Warner AxS of California, L.P.; Time Warner Connect; WorldCom Technologies, Inc. and Working Assets Funding Servie, Inc. In addition, the Telecommunications Resellers Association jointed with the Coalition in the comments.

California (CTC), and The Telephone Connection. Reply comments were also filed by Pacific Bell (Pacific), Roseville Telephone Company (RTC), and Sprint.

Parties' Positions

USOA Requirements for CLCs Not Affiliated with an ILEC

Most parties filing comments agree that at least those CLCs not affiliated with an ILEC should not be required to keep their books according to USOA rules, and that no public or business interest is served by enforcement of this requirement. Parties believe it is unduly burdensome for CLCs to keep their books and records in accordance with the USOA.

The Federal Communications Commission (FCC) established the USOA in 1935 to provide uniformity in accounting procedures and reporting for the traditional franchised telephone companies that were, at the time, monopoly suppliers. The USOA was intended to facilitate the calculation of rate base and rate of return for regulated operations. In recognition of the fact that CLCs do not provide monopoly services, do not serve captive customers, and do not have control of any bottleneck facilities which would afford them market power, the Commission previously has determined that there is no need to impose cost-of-service regulation on CLCs. Parties generally argue, therefore, that the underlying regulatory rationale for requiring USOA accounting for CLCs does not exist, and that the Commission should eliminate the requirement that CLCs maintain their financial records in accordance with the USOA.

Parties argue that USOA accounting rules are unduly burdensome, and require significantly more detailed accounting records than most CLCs need for strictly business purposes. For example, the USOA mandates cable and wire accounts to be delineated into aerial, burial and underground, while most CLCs would have no business reason to distinguish between the placement characteristic of the cable. In the area of construction costs, most CLCs would not need to distinguish between direct labor and overhead labor costs, while USOA does.

The Coalition argues that elimination of USOA accounting for CLCs will not impede any of the Commission's necessary regulatory functions, nor hinder the Commission's ability to verify the proper collection of user fees. CLCs will still maintain accounting records in accordance with GAAP.

ORA agrees that the Commission should allow CLCs not affiliated with an ILEC to keep their books in any acceptable accounting manner they choose, but also recommends that the CLCs be required to translate their books into USOA form in making financial filings with the Commission, such as annual financial reports or reports on Universal Lifeline Telephone Service (ULTS) funding flows. ORA understands that such a transition is fairly simple to accomplish. Sprint disagrees, arguing that the translation to which ORA refers is complex and expensive, and is exactly the requirement from which CLCs seek to be relieved. Sprint claims no legitimate regulatory purpose is served by this proposed translation, and urges that the ORA proposal be rejected.

USOA Requirements for ILECs

Pacific agrees the USOA requirements should be eliminated for CLCs, but argues that the USOA requirement should be eliminated for ILECs, as well. Pacific claims that because its prices for monopoly and partially competitive services are capped and its shareholders bear the risk of revenue changes, there is no reason to require USOA because misreporting cannot result in higher prices or revenues.

Pacific claims that leaving only ILECs with the USOA requirement imposes a cost on ILECs that CLCs would not have, leading to ILEC cost structures higher than they would otherwise be and preventing ILECs from competing fairly. Pacific claims economic efficiency is harmed because if the ILEC is the most efficient supplier, its prices cannot fully reflect those efficiencies. Consumers end up paying higher prices.

Sprint argues that the Commission need not address at this time the proposal by Pacific and Citizens that ILECs be relieved of the requirement that they keep their books in USOA form. Sprint claims the FCC requires the ILECs to keep their books in USOA form for purposes of filings with the FCC, and that no added burden is added by this Commission's mirroring of that requirement.

USOA Requirements for CLCs Affiliated with ILECs Operating in California

The ALJ ruling sought comment on whether elimination of the USOA accounting requirement should be extended to include CLCs which are owned by or affiliated with an ILEC. The Coalition argues that the elimination of USOA requirements for a CLC affiliated with an ILEC operating in California raises issues of the Commission's continuing regulation of the affiliated ILEC and any transactions between the ILEC and its affiliate.

The Coalition recommends that any action in this proceeding to eliminate USOA reporting requirements for CLCs be limited to those CLCs that are not owned or affiliated with an ILEC with operations in California. The Coalition believes that a CLC which is affiliated with an ILEC with operations in California and seeks elimination or waiver of the requirement to maintain its books in accordance with USOA should request such authority by separate application, or in its initial application for certificate authority.[2]

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[2] Similarly, the Coalition suggests that the imposition or removal of USOA requirements for a California long distance carrier affiliated with an ILEC with operations in California should be dealt with in a separate company-specific proceeding.

ORA believes the Commission should continue for some time to require CLCs that are affiliates of ILECs to make financial filings under USOA rules, at least until the local exchange market for residential as well as business customers is reasonably competitive. While structural separation of ILECs and their affiliates may mitigate some of its concerns, ORA does not believe the Commission has a sufficient record to make such a finding.

ORA argues that requiring conformity between the ILECs and their affiliates will better enable the Commission to monitor and prevent the occurrence of cross-subsidization from regulated to nonregulated activities. Conformity of ILEC and affiliate accounting also will facilitate comparisons and audits, which the Commission still is required to perform pursuant to the Public Utilities (PU) Code. (*See* § 314.5.)

Sprint generally agrees with Cox that nondominant CLC affiliates of an ILEC need not keep their books and records in accordance with the USOA provided that other safeguards have been established, such as requirements that the affiliate be a structurally separate entity, keep its own books, and not own switching or transmission equipment in common with its ILEC affiliate. Sprint believes the appropriate safeguards may depend on the individual circumstances of each CLC/ILEC relationship.

Pacific disagrees that USOA reporting of CLCs affiliated with ILECs is necessary so that cross-subsidization can be monitored and prevented. Pacific's CLC operation that competes in other ILECs' territories is not a separate affiliate, but part of Pacific. Pacific believes the only requirement should be that a separate income statement and balance sheet be maintained and reported for Pacific's CLC operations. In any case, Pacific claims USOA reporting by affiliates is irrelevant for monitoring and preventing any cross-subsidies, and that Pacific has no incentive to cross-subsidize because it cannot raise any prices by providing affiliates free services.

Pacific argues that the Commission's existing affiliate transaction rules are sufficient, requiring payment for and setting the prices of all services Pacific provides to affiliates. No Commission rule requires affiliates to maintain their accounts in accordance with USOA.

GTEC operates its CLC operations through a separate corporate affiliate under the name GTE Communications Corporation (GTECC). As an affiliate of GTEC, (i.e., an ILEC), GTECC conforms to the requirements set forth in decision FCC 97-0142, the *Second Report and Order in CC Docket 96-149* and *Third Report* and *Order in CC Docket No. 96-01*, released on April 18, 1997.[3] Pursuant to these FCC requirements, an affiliate of an ILEC who offers in-region, interstate interexchange services may do so only through a separate affiliate that satisfies the FCC requirements established in CC Docket 79-252 (the Fifth Report and Order requirements). These requirements are that the affiliate (GTECC in this case) maintain separate books of account, not jointly own transmission or switching facilities with the ILEC; and acquire any services from its affiliated exchange companies at tariffed rates, terms and conditions or at rates, terms and conditions contained in interconnection agreements approved by state commissions.

Given its separate entity status, GTEC argues that there is no reason for its CLC affiliate, GTECC, to be required to keep its records according to USOA. GTEC believes its CLC affiliate should be treated as any other CLC and allowed to utilize other formats which meet generally accepted accounting practices.

[3] These rules are set forth in 47 C.F. R. §§ 64.1902-1903.

USOA Requirements for NDIECs

The Coalition believes that the rationale for elimination of USOA accounting requirements for CLCs applies equally to nondominant interexchange carriers (NDIECs) since they are not subject to rate-of-return regulation.[4]

Commission orders granting interLATA authority to NDIECs in the 1980s and early 1990s did not always specify that NDIECs follow USOA or any other specific accounting practices. However, many NDIEC certification orders include language requiring the NDIEC in question to keeps its books in accordance with the USOA.

ORA argues that proposals to relieve NDIECs of the USOA bookkeeping requirement, as recommended by the Telephone Connection of Los Angeles (TCLA) and the Coalition, might be reasonable in the abstract but are beyond the scope of the ruling. The services NDIECs provide, interLATA and intraLATA toll services, by definition are not covered by the Local Competition docket. ORA thus believes the Commission should simply disregard comments pertaining to NDIEC financial filing requirements.

Pacific agrees with ORA that the Commission cannot legally grant the request to eliminate the USOA requirement for NDIECs, since this proceeding

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[4] The Coalition notes that AT&T presents a unique case of the application of requirements that require that AT&T keep books in accordance with USOA. By the nature of its history, AT&T has been required to keep its books in accordance with USOA. The Commission in D.97-08-060 declared AT&T to be nondominant in the interLATA toll market, and relieved AT&T of earnings and rate regulation for its toll services. However, certain unique reporting requirements imposed on AT&T by the Commission in that Decision require AT&T to retain some measure of USOA accounting practices. AT&T does not seek relief from the reporting requirements of D.97-08-060 in this docket, not any accounting requirements necessary to fulfill those requirements. The Coalition, however, sees no reason for this Commission to additionally require AT&T to maintain its books in accordance with the USOA for its operations as a CLC in California.

has to do with local competition, not the rules for long distance competition. Parties had no prior notice in the Commission decision granting rehearing or in the ALJ ruling that the issue of USOA reporting by NDIECs would be reviewed here. For these reasons, Pacific argues it would violate due process to grant NDIECs the exemption requested.

Discussion

We find parties arguments to be persuasive that CLCs which are not part of an ILEC corporate entity should be relieved of the obligation to keep their books and records in accordance with the USOA. While the USOA is an appropriate accounting and reporting system in the context of our present regulation of ILECs, it does not provide essential information necessary for the Commission's limited regulation of such CLCs. Because individual CLCs lack significant market power, we have permitted CLCs to set their prices based upon market considerations. While we still require CLCs to file tariffs with the Commission and to adhere to our Consumer Protection Rules, we do not impose traditional cost-of-service regulation on the prices included in the CLCs' tariffs.

We conclude that the cost and resources of keeping books and records in accordance with the USOA pose an administrative burden on the CLC that is not justified. The additional level of detailed information called for under the USOA, beyond what is required under GAAP, is not essential either for the business operations of CLCs or for the regulatory functions of the Commission. In the interests of removing any unnecessary regulatory burdens on CLCs, we shall therefore no longer require that the books and records of CLCs which are not part of an ILEC corporate entity be kept in conformance with the USOA, effective with the date of this order. We shall, however, require that such CLCs maintain their books and records in accordance with GAAP, and make their accounting records available to the Commission upon demand pursuant to PU Code § 581.

As long as these CLCs adhere to GAAP in keeping their books and records, there should be sufficient accounting documentation to support the various financial filings which are required by the Commission.

We shall not adopt ORA's recommendation to impose a requirement that CLCs translate the data contained in certain financial reports filed with the Commission into USOA categories. The necessity for such an accounting translation to enable the Commission to understand or make use of the reports is not explained in ORA's comments. While ORA claims this translation would be relatively easy, Sprint disagrees. We are concerned that such a reporting requirement would perpetuate the very sort of unnecessary administrative burden on CLCs which we are seeking to relieve by eliminating the USOA requirement, without any demonstration of benefit.

The ILECs have also asked to be treated as the CLCs and likewise be relieved of the USOA reporting requirement. We deny the request of the ILECs at this time to relieve them of their obligation to keep their books and records in accordance with the USOA. It is premature to eliminate the USOA requirement for the ILECs in view of the current status of regulation of the ILECs. While local exchange service has been opened to competition, the competitive local exchange market is still in its infancy. The ILECs still remain the dominant providers of local exchange service. Although we have taken steps to move beyond traditional rate-of-return regulation of the ILECs, we still retain certain rate-of-return reporting requirements. In D.98-10-026, we modified certain elements of NRF regulation for Pacific and GTEC, including suspension of the sharing mechanism for the present time. We did not, however, permanently eliminate the sharing mechanism, but allowed for a subsequent evaluation of whether it should be continued in the future. Moreover, we continue to require the annual earnings review filing on April 1 of each year, as well as other monitoring reports to be submitted by Pacific and GTEC. We retained these requirements recognizing that some risks remain that market power problems will materialize, and that competition will not evolve as expected, or that the ILECs' rates of return will become truly unreasonable. Since we are thus continuing to monitor rates of return for Pacific and GTEC for the present time, it is appropriate that the ILECs be required to continue to keep their books in accordance with the USOA.

In the event that an ILEC and a CLC share common ownership, but are operated through separate corporate affiliates, we shall not require the CLC affiliate to maintain its separate books in accordance with the USOA. The Commission already has rules in place for dealing with transactions between GTEC and its affiliates (see Resolution T-15950). We conclude that the Commission's rules governing affiliate transactions provide sufficient safeguards against cross-subsidization and self-dealing abuses so that we shall not require USOA accounting for GTEC's CLC affiliate which operates as a separate corporate body, distinct from that of its affiliated ILEC business unit. Pacific's CLC business unit, however, is not a separate subsidiary, but operates within the same corporate structure as does Pacific's ILEC. In the latter case where no separate corporate division exists between the ILEC and its CLC business unit, the appropriate safeguards required in the case of a separate affiliate may not necessarily be in place. We are not convinced that sufficient safeguards against self-dealing abuses are assured merely by requiring a separate income statement and balance sheet for the CLC operations. Without a consistent system of accounting between the ILEC and its CLC unit, it is unclear how the Commission could independently validate the reliability of such financial statements purporting to reflect separation of Pacific's ILEC and CLC operations. Accordingly, in those instances where an ILEC operates as a CLC with no separate corporate subsidiary, as in the case of Pacific, we shall continue to require that the CLC operations be accounted for in accordance with the USOA.

We finally consider the proposal of certain parties asking that the Commission eliminate the USOA requirement not only for CLCs, but also for NDIECs. These parties argue that the rationale warranting elimination of the USOA requirements apply equally to NDIECs. This proposal has logical appeal. Many CLCs are also NDIECs, and elimination of USOA requirements for only the local exchange operations of such entities would, in practice, continue to require such CLCs to keep their books and records in USOA format. Accordingly, we shall exempt such CLCs, subject to the other limitations discussed herein, from USOA requirements for both their local exchange and interexchange operations.

While some parties object to extending the USOA exemption to NDIECs, claiming that there was no notice that NDIEC rules were to be considered in this proceeding, we conclude this limited exemption is within the scope of the record in the Local Competition Docket. We have previously noted the close similarities between CLCs and NDIECs generally using the NDIEC rules as a guide in crafting certification requirements for CLCs in D.95-07-054. We have also routinely granted carriers combined certificate authority to offer both local exchange and interexchange service within the Local Competition Docket. We properly noticed our solicitation for comment on the USOA exemption to all entities that have combined certificates as CLCs and NDIECs. Parties had the opportunity in their reply comments to address the Coalition proposal to include NDIEC operations within the USOA exemption. Thus, the record in this docket adequately supports extending the USOA exemption to CLCs for both their local exchange and interexchange operations. We will not at this time, however, exempt pure NDIECs from requirements to keep their books in accordance with the USOA, but may rather consider such requirements in another docket.

We shall exclude AT&T from the USOA exemption with respect to its interexchange operations (although it shall be relieved of the USOA obligation for its CLC operations). As noted in the comments of the Coalition, AT&T presents a unique case with respect to USOA requirements in view of the unique reporting requirements imposed on AT&T by D.97-08-060. We shall continue to require USOA accounting for AT&T's interexchange operations only to the extent required to comply with the reporting requirements of D.97-08-060.

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with PU Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on January 25, 1999, and reply comments were filed on January 28, 1999. We have reviewed the filed comments and incorporated them, as appropriate, in finalizing the decision.

Findings of Fact

1. Under current Commission rules, all CLCs are required to keep their books and records in accordance with the Uniform System of Accounts (USOA) specified in Title 47, Code of Federal Regulations, Part 32.

2. Some business entities that are certificated as CLCs are also certificated as NDIECs.

3. While CLCs and NDIECs still file tariffs with the Commission, they are not subject to cost-of-service regulation on the prices included in those tariffs.

4. While the USOA is an appropriate accounting and reporting vehicle in the context of our current regulation of ILECs, the USOA does not provide essential information necessary for the limited regulation generally applicable to CLCs and NDIECs.

5. It is unduly burdensome and serves no essential public or business purpose to continue to require CLCs to keep their books in accordance with the USOA for their local exchange and interexchange operations.

6. AT&T presents a unique situation in the application of USOA requirements in view of the unique reporting requirements imposed on AT&T in D.97-08-060.

7. The Commission continues to impose regulatory requirements on Pacific and GTEC as incumbent local exchange carriers which are different than those imposed on CLCs. In particular, the Commission continues to monitor rates of return for Pacific and GTEC for the present time pursuant to D.98-10-026.

Conclusions of Law

1. CLCs (other than AT&T) which are not part of an ILEC corporate entity should be relieved of the obligation to keep their books and records for their CLC and NDIEC operations in accordance with the USOA, but should still be required to keep their books and records in accordance with GAAP.

2. CLCs are still required to make their books and records available to the Commission and its staff for inspection if or when found necessary pursuant to PU Code § 582.

3. AT&T should continue to be subject to USOA accounting for its interexchange operations (but not face is CLC operations) to the extent required to comply with the D.97-08-060 reporting requirements.

4. Since the Commission continues to monitor rates of return for Pacific and GTEC for the present time pursuant to D.98-10-026, it is appropriate that the ILECs continue to keep their books in accordance with the USOA.

5. The Commission's affiliate transactions rules provide sufficient safeguards against cross-subsidization and self-dealing abuses so that no separate requirement is necessary for USOA accounting for a CLC which operates as a separate corporate entity, distinct from that of an affiliated ILEC.

6. Since Pacific's CLC operations are not a separate subsidiary, but operate within the same corporate structure as Pacific's ILEC operations, the safeguards required of a separate subsidiary would not necessarily be in place.

7. In those instances where an ILEC operates as a CLC with no separate corporate subsidiary, the CLC operations should still be accounted for in accordance with the USOA.

8. It is beyond the scope of this proceeding to order a change in the rules governing the accounting requirements of "pure" NDIECs (i.e., those which are not also certified as CLCs).

ORDER

IT IS ORDERED that:

1. Competitive Local Carriers (CLCs) (other than AT&T) which are not part of an incumbent local exchange carrier (ILEC) corporate entity are hereby exempted from the requirement to keep their books and records for their CLC and NDIEC operation in accordance with the Uniform System of Accounts (USOA) specified in Title 47, Code of Federal Regulations, Part 32.

2. AT&T shall be relieved of the USOA obligation only with respect to its CLC operations, but not for its NDIEC operations pursuant to the reporting requirements of D.97-08-060.

3. The request of Pacific Bell and GTE California to be relieved of USOA reporting requirements for their ILEC operations is denied.

4. The separate CLC affiliate GTE Communications Corporation shall be relieved of its obligation to keep its CLC operations subject to USOA reporting requirements.

5. Any CLC that is operated within the corporate structure of an ILEC shall remain subject to the USOA reporting requirements of the ILEC.

6. A copy of this order shall be served by mail on all CLCs.

This order is effective today.

Dated February 4, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Certified as a True Copy
of the Original

ASST. EXECUTIVE DIRECTOR, PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA