

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

In the Matter of

| | | |
|---|---|----------------------|
| 1998 Biennial Regulatory Review -- |) | |
| Review of Depreciation Requirements |) | |
| for Incumbent Local Exchange Carriers |) | CC Docket No. 98-137 |
| |) | |
| |) | |
| Ameritech Corporation Telephone Operating |) | |
| Companies' Continuing Property Records |) | CC Docket No. 99-117 |
| Audit, <i>et. al.</i> |) | |
| |) | |
| |) | |
| GTE Telephone Operating Companies |) | |
| Release of Information Obtained During |) | AAD File No. 98-26 |
| Joint Audit |) | |

FURTHER NOTICE OF PROPOSED RULEMAKING

Reply Comments of New Networks Institute

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Date: April 28th, 2000

Table of Contents

Statement of Interest

Background Of The Audits --- The Vaporware Scandals.

- 1) The Bells Claim the FCC's Audit is Flawed.
- 2) The FCC's Treatment of these Audits has Not Been in the Public Interest.
- 3) The Audits Are Valid.
- 4) If The Numbers Are Valid, Then Does It Effect Rates? Yes
- 5) The FCC Should Continue to do the Other Outstanding Audits.
- 6) Virtually All Of The Proposals To Date Still Don't Reflect The Public Interest.

Conclusions

Statement of Interest

New Networks Institute ("NNI") was founded in 1992. Its mission is to explore, on a totally independent basis, the impact of the break-up of AT&T and the creation of the Regional Bells Operating Companies ("RBOCs") on telephone subscribers in general and on the deployment of new and advanced telecommunications networks. Since that time, the NNI has conducted extensive research on these topics. Titled "The Future of the Information Age," this seven-year analysis consists of over 1,900 pages in 14 volumes, with over 910 exhibits, two computer databases, and data from more than 2,000 consumer interviews, (conducted independently through Fairfield Research). We have recently updated this research in the form of a new report, *The Unauthorized Biography of the Baby Bells & Info-Scandal*, published March 1999. NNI's research is independently funded from the sales of reports, books, and databases. No company, lobbying organization, trade association or political party had any input, either editorial or financial in this filing.

Reply Comments of New Networks Institute

DO Not Absolve The Bells Of Their Vaporware Scandal. Protect The Publics' Interests By Rejecting The CALLS Proposal.

NOTE: CALLS (The Coalition for Affordable Local and Long Distance Service) is a group, mainly representing the Bell companies.

Imagine the following --- a company's accounting books contain massive amounts of non-existent equipment --- Vaporware. The company not only, year after year, continues to depreciate this phantom phone technology, said phone company uses the phantom equipment as expenses to inflate the rate of every phone service, since phone service is supposed to be based on the network costs.

And when said phone company books are revealed, the powers that be are considering to absolve the companies of all sin. No penalties, no charges of tax evasion, and no recompense to those who have been harmed through higher prices.

We respond to this filing on behalf of the Public Interest, since the Calls proposal serves only to sanction flagrant abuse of the law by the monopoly and maintain the current overcharging of ALL phone customers, from business and residential services, to even schools and libraries.

Our concern is that:

- The FCC will ignore their obligations, and not hold the Bells liable for the multiple billions of dollars that effect the cost of ALL phone services.
- Secondly, this problem did not occur overnight and it is clear that the missing equipment has been outstanding for a long time, most likely over the last decade. Therefore, all of the past inflated prices will not be readjusted and monies will not be refunded.
- Thirdly, we are worried that the other related audits will not be done. It is a fact that these audits only accounted for _ of the investments in the phone infrastructure and it is likely that the exact same problem has occurred in the other _ of equipment and wiring.

Background Of The Audits --- The Vaporware Scandals

In 1999 the FCC released a series of audits which showed that the Bells couldn't account for some \$5 billion in missing equipment. To read our summary of the audits, see: <http://newnetworks.com/fccaudit.html> As stated by the FCC: (Further Notice Of Proposed Rulemaking, 99-117 et al, 4/3/2000, page 7)

"We note that audits of the continuing property records (CPR) of the Regional Bell Operating Companies (RBOCs) are before the Commission, as are the results of a joint State-Federal audit of GTE's CPRs. The CPR audits found that, combined, these carriers could not account for approximately \$5 billion of central office equipment."

And this was only the tip of the iceberg. The Reports indicated that an additional \$13.6 billion dollars of equipment was categorized as "No Assets Found" or "Unverifiable Assets". Therefore, the audit had a total of \$18.6 billion dollars of questionable charges. In short, 19% of the Bells' total network surveyed was missing or couldn't be verified.

Total Bell Money Found in FCC Audit
(Not Counting Penalties and Interest)

| | |
|--------------------------|--------------|
| Ameritech | \$2,145,610 |
| Bell Atlantic | \$3,317,018 |
| BellSouth | \$1,920,761 |
| NYNEX | \$2,558,057 |
| Pac Bell | \$2,925,505 |
| SBC | \$2,216,603 |
| US West | \$3,527,468 |
| TOTAL | \$18,611,022 |
| <i>Source: FCC, 1999</i> | |

To put these statistics and terms in perspective, the FCC found all the Regional Bell Operating Companies (RBOCs) had massive problems with their records that were supposed to be available, based on FCC rules. In the case of BellSouth, 29% of the information required was missing, couldn't be found or had serious errors.

"252,700 of 859,800 records under review, or 29 percent of the reviewed records, contained serious errors."

And what is a serious error? The FCC wrote of Bell Atlantic's audit, that 24% of items either couldn't be matched with the FCC records, or the equipment simply wasn't there:

"Specifically, in our audit of a random sample of 1,152 line-items from Bell Atlantic's (CPR for Hard-wired) Equipment, we found that 24.1 percent of the records that we sampled contained substantial deficiencies and did not comply with the Commission's rules. Of these deficient records, 12.5 percent described equipment that could not be found by the auditors or by company representatives ("not found" equipment). The remaining 11.6 percent could not be verified with certainty because the equipment shown to the auditors could not be

matched to the record in some important respect such as location or description."

Addressing The Issues And Replying To The Comments.

1) The Bells Claim the FCC's Audit is Flawed.

The Comments presented by the Bells have reached a new height of arrogance. Not only do they deny any wrong doing, but they insist the FCC's data is flawed and that even if the data is correct, the findings don't apply to them or phone rates. As SBC put it (Reply Comments of SBC Communications LECs 10/25/99, Docket Number, 99-117)

"SBC LEC's previous filings, the SBC LECs show that because of serious problems with the way these audits were designed and conducted, the results are highly imprecise and unreliable."

"Because of the serious problems in the sampling methodology, the audit results are too unreliable to serve as the basis for any corrective action, especially the audit conclusions concerning the dollar values of the RBOC's account balances."

Worse, even if the audits were correct, SBC claims that the findings wouldn't apply to them or the rates:

"In any event, even ignoring the serious flaws in the audit results, they should not have any impact on the rates under price cap regulation and cannot be extrapolated to prior periods." (Reply Comments of SBC Communications LECs 10/25/99, Docket Number, 99-117)

2) The FCC's Treatment Of These Audits Has Not Been In The Public Interest.

We believe the FCC's auditors, The Accounting Safeguard Division (ASD), have done an important job in protecting the public interests by documenting these missing records. However, political decisions by some Commissioners have put the entire investigation into question. More incredulous is the fact that the FCC has not bothered to enforce what are clear violations of virtually every law, from the violations to keep accurate books, to having created a network of Vaporware...a phantom network of missing equipment paid for by ratepayers.

Ultimately, the FCC's treatment of these audits has NOT adequately defended the public interest. In fact, a previous FCC audit in 1994 clearly outlined identical problems, and it was never given any credibility. Of this most recent audit, the FCC has not

“endorsed” its own auditors, and instead of actually enforcing the findings, the FCC’s continues to bend over backwards to avoid taking actions.

Standing Up for the Audit’s Findings

We rely on the Reply Comments of others to show that the Bells statements are flawed.

3) The Audits Are Valid

Except for the Bell companies comments, the majority of opinion is that these audits are both valid and competently done. The New York State Attorney General’s office found the audits to be credible and thorough. (CC Docket No. 99-1 17 Comments in Response to April 6, 1999 Notice of Inquiry: ASD File No. 99-22, Audit of Continuing Property Records of the NYNEX Telephone Operating Companies Also Known As Bell Atlantic North, page 5)

“Because the audit appears to have been carried out with thoroughness and rigor and because its recommendations and conclusions have a very significant potential impact on New York residential and business phone customers, we urge the FCC to order that NYNEX/Bell Atlantic North show cause why the conclusions reached and the recommendations made by the ASD auditors should not be adopted.”

And they stand by the work, refuting the Bell’s findings. (Page 6)

“Although NYNEX/Bell Atlantic North criticizes the ASD’s (Accounting Safeguard Division of the FCC) sampling methodology and statistical analyses at some length, the company’s arguments are unconvincing.”

And regardless of all the name calling by the Bells, another New York regulator, The New York State Public Service Commission independently found identical problems with the Bells’ records and missing equipment. (Comments, New York State Public Service Commission, 9/13/99, Page 2)

“First, we preliminarily agree with the Common Carrier Bureau's finding that certain central office equipment in Bell Atlantic-New York (BA-NY’s) CPR does not exist in the BA-NY’s inventory. Upon further examination the weakness appears to be one associated with inadequate recordkeeping. BA-NY did not record retirements, location changes and did not maintain the underlying cost support.”

“Secondly, the Common Carrier Bureau’s conclusion that BA-North was unable to verify the existence of certain unspecified (undetailed and unallocated) plant investment was confirmed by our staff. Our preliminary audits confirmed the Bureau’s findings that BA-NY was unable to physically verify or prove cost support for any of this plant, which the company continued to include as assets on its books. There do not appear to be internal control associated with these entries.”

4) If The Numbers Are Valid, Then Does It Effect Rates? Yes.

The New York Attorney General was very clear about the impacts on customers --- the price of service is based on the capital investments. The AG’s office suggests that \$631 million in rates could be effected, accounting for a \$1.2 billion dollar write-off.

“The New York State Attorney General is an advocate on behalf of New York State’s residential and small business utility ratepayers, before both the FCC and the New York State `Public Service Commission (“NYPSC”). The interest of New York consumers in the FCC’s audit of NYNEX/Bell Atlantic North’s continuing property records is manifest. Approximately half of NYNEX/Bell Atlantic North’s reported costs represent capital investment recorded in the continuing property records. The FCC and the NYSPSC use these cost figures to set NYNEX/Bell Atlantic North’s rates. The audit shows that NYNEX/Bell Atlantic North’s costs are inflated. New York State telephone customers, both commercial and residential, are adversely affected if the various charges which comprise their rates are inflated because of overstated capital investment figures. In rough terms, as much as \$631 million of NYNEX/Bell Atlantic North’s New York intrastate rate base could be affected by a potential \$1.18 billion write-off of NYNEX/Bell Atlantic North’s capital investment accounts recommended by the auditors. This estimate is based upon the fact that New York Telephone Company represents approximately two-thirds of NYNEX/Bell Atlantic North’s operations and about 80% of this is contained in the intrastate jurisdiction. Thus, the auditors’ findings, if adopted by the FCC, could lead to significant adjustments in the intrastate and interstate rates paid by New York businesses and residents.”

5) The FCC Should Continue to do the Other Outstanding Audits.

The General Services Administration was very clear that the audits should be continued. Their Comments state that even though there are plans to simply let the Bells 'amortize' the bells' investment, even if these monies are non-recoverable, (meaning that they are written-off and are not recovered for the public) the General Services Administration argues that there are other 'financial books' (as distinct from regulatory books, which are different) that need investigation. (Comments of the General Services Administration, 99-117, April 14th, 2000)

"The Commission seeks comments on whether an account treatment that result in a non-recoverable amortization of a substantial portion of a carriers investment providers a legitimate basis to terminate the CPR audits.

"The write-down of the carrying value of the ILEC plant, whether immediate or by amortization, does not make the CPR audit matter moot. First of all, the central finding of the CPR audits was that the hard-wired central office equipment gross plant investment was overstated on the regulator books of the ILECs. The gross plant investment is the same on the financial books as on the regulatory books, unlike the depreciation reserve situation described above. The audits indicate, therefore, that the ILEC financial book gross plant investment is also over-stated. A depreciation rate applied to overstated plan balances results in overstated depreciation expense."

Also, the GSA states that only _ of the network has been examined and the rest may also have serious problems.

"Secondly, audits were only performed on what should be the easiest plan to keep track of: hard-wired central office equipment. Such equipment only represents about a quarter of the ILEC gross plant investment. The overstatement of portable plug-ins and outside plant facilities may be even greater. "

This was echoed by the New York Attorney General's office who recommended that the FCC continue to do the audits for the 75% of the equipment that wasn't examined yet. (Page 5)

"The New York Attorney General's office also recommends that the FCC direct the ASD to perform similar audits of the RBOCs' Plug-in Cards and Outside Plant equipment property records to determine if further adjustments to the company's capital accounts are

warranted, or that the Commission select one or more independent auditing firms to do so, with the expense borne by Bell Atlantic.”

6) Virtually All Of The Proposals To Date Still Don't Reflect The Public Interest.

The complexity of the discussions related to the audit's findings are closer to a story by Charles Dickens. However, the complexity is acting as a smokescreen that hides the truth from the public.

According to most non-Bell commentators, the Bell's/Calls proposal is to write off some \$28 billion dollars over a period of five years. (This statistic was derived from the FCC.) (Further Notice Of Proposed Rulemaking, 99-117, etc. 4/3/2000, part 15)

“We note that audits of the continuing property records (CPR) of the Regional Bell Operating Companies (RBOCs) are before the Commission, as are the results of a joint state-federal audit of GTE's CPRs. The CPR audits found that, combined, these carriers could not account for approximately \$5 billion of central office equipment and recommended that these amounts be written-off their regulatory books of account. We estimate that a five-year amortization, if applied to these carriers, would result in a reduction of approximately \$28 billion in asset value from their regulated books of accounts. Given the size of the write-off proposed by the audits, we seek comment on whether, if the RBOCs and GTE bring their regulatory book balances to the levels of their financial books.”

However, the CALLS proposal would do these write offs “above the line”, vs “below the line”---- meaning that the deductions can be made as expenses on the normal returns from telephone company customers, --- I.e., it would be an expense that would lower their earnings and payments to shareholders, as well as give the Bell major tax savings. In some drafts, it is even suggested that they would be raising local rates because of this totally artificial lowering of earnings. As you can see from the quote, the below-the-line, one-time deductions would supposedly better protect the customers.

“In contrast, the above-the-line adjustment proposed by the CALLS ILECs will artificially lower the reported earnings of the carriers. Moreover, an above-the-line adjustment could lead one to infer that the carriers' financial depreciation rates were reasonable. No such finding has been made; if an above-the-line adjustment were allowed, it should not be taken as tacit approval of the shorter lives. As the FCC concluded in the Depreciation Order, “the incumbent LECs have not

sufficiently demonstrated the validity of the assumptions underlying their proposed shorter lives for plant equipment categories other than digital switching equipment.”

“Also, the below-the-line adjustment provides assurance that customer rates will not be affected by the adjustment. The CALLS ILEC proposal already commits not to change interstate price caps or rates, and not to seek recovery of the regulatory-financial book reserve difference in customer rates or through a low-end or exogenous adjustment. While the CALLS commitment refers only to interstate amortizations, the FNPRM infers that the CALLS ILECS also intend to commit not to seek recovery, at the state level, of any portion of the amortization. The FPSC believes that a similar adjustment on the intrastate books would bring all plant records into agreement with the financial records and would provide the same assurance that there would be no impact on intrastate customer rates.”

“On the other hand, if the FCC concludes that the amortization should be recorded as an above-the-line operating expense, the specific account or accounts to which this amortization is recorded should likewise be set forth. The specific accounting treatment must be mandated to fully insure that no portion of these expenses will impact local rates, UNEs, interconnection rates, or USF cost levels.”

When you clear away the dust, the issue is that the Bells are trying to not only get out of being penalized for their deceptions, but they also want to benefit from new rulings that give them more money for their own miss-deeds.

Conclusions:

A) At a bare minimum, we agree with the Florida PSC in some required next steps, such as getting specific information about the actual write-offs (Reply Comments Of The Florida Public Service Commission, 99-117 et al, April 17th, 2000, page 7.)

“Before rendering a decision in this rulemaking docket, the FPSC believes that the FCC should quantify the overall change that will result from moving to financial depreciation rates, and require each ILEC to furnish the following information:

1. The reserve differences at December 31, 1999, between its financial and regulatory books.
2. The projected financial depreciation expense for year 2000.

3. The projected regulatory depreciation expense for year 2000 with and without the reserve amortization.
4. The depreciation method to be used for calculating financial depreciation expense.

“In order for the FCC to continue its ability to maintain realistic life and salvage factor ranges so they are available for use in universal service cost models or in states’ interconnection and unbundled network elements (UNE) cost analyses, carriers should be required to submit plant life information to satisfy the fourth criteria set forth in the Depreciation Order.”

However, this material is all forward looking and does not address the factual issue:

20% of all equipment was missing or unverifiable. This has been going on for over a decade, and this has increased ALL customer rates, including charges to schools and libraries, low income, residential and business services, and competitors alike. Incredulously, the FCC is entertaining proposals to just let it all slide.

B) The FCC’s Treatment of this Notice in Question as Well and Should be Readdressed by the Public.

Even the handling of this very Notice is questioned by many. For example, the Florida Commission notes that in order to have filed something, you had to do it with virtually no notice. (Florida Public Service Commission Comments, 99-117, et al, 4/21/00, page 11)

“We want to note that the FCC merely released this Further Notice of Proposed Rulemaking on April 3, yet is requiring comments by April 17. A state commission which holds publicly noticed meetings can barely react in this unrealistically short amount of time. Only through extra diligence can a state even keep up with all the many permutations and filings in the CALLS proposals and CALLS revisions. If the FCC sincerely wishes to include states in this very important matter, more time should be allotted for responding.(Page 11, April 21, 2000)

Secondly, claims of outside influences, including CALLs, has been leveled, even by some of the FCC’s own Commissioners. The Florida Commission commented on Commissioner’s findings of lack of public involvement.

“As Commissioner Furchtgott-Roth says, “The public generally was not notified that the CALLS negotiations were taking place, nor were a number of parties that wished to be included in these negotiations permitted at the table.” He concludes “that the process by which this

Notice has been promulgated falls short of certain fundamental principles that govern the behavior of administrative agencies.”

Therefore, the FCC should now ask the Public what should happen next, giving enough time for the process.

C) What Should Happen Next:

- 1) The CALLs proposal should be placed in the waste basket and the FCC should fine the Bells for failure to keep accurate books.
- 2) The FCC should continue to do the rest of the audits, including determining the just how long the Bell's books have been showing Vaporware, and then refunds to customers should be applied for ALL of the overcharges.
- 3) The Bells should be investigated by the IRS as well for tax evasion.

To put it bluntly, if the FCC wants to protect the Public Interest, they should not let this misguided self-interested proposal stand.