Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
BellSouth Telecommunications, Inc.	)	ASD File No. 01-46
Permanent Cost Allocation Manual	)	
Petition for Waiver of Section 32.27	)	
of the Commission's Rules	)	

ORDER

Adopted: December 17, 2001 **Released: December 17, 2001**

By the Chief, Accounting Safeguards Division:

1. On August 9, 2001, BellSouth Telecommunications, Inc. (BellSouth) filed a petition[1] for waiver of the Commission's affiliate transactions rules, as codified in section 32.27.[2] In its petition, BellSouth seeks permission to record the costs for specific services it receives from certain nonregulated affiliates, including a section 272 affiliate,[3] at "less than fully distributed cost" or "no charge" in its cost allocation manual. By this order, we approve the petition for waiver in part and deny it in part.

2. Section 32.27 of the Commission's rules requires an incumbent local exchange carrier (LEC) to record transactions received from its affiliated entities at the lesser of fully distributed cost or fair market value when, as here, no tariff rate, prevailing price or publicly filed agreement exists.[4] "Fully distributed cost" includes the direct and indirect cost of providing a service. This rule was intended to ensure that the captive telephony ratepayer receives the most reasonably advantageous result from the transaction and does not subsidize the LEC's affiliate activities.

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1 BellSouth Telecommunications, Inc. Expedited Petition for Waiver, filed Aug. 9, 2001 (Petition). *See* "Comments sought on BellSouth Communications, Inc. Expedited Petition for Waiver of 47 C.F.R. § 32.27(c)," *Public Notice*, DA 01-1956 (rel. Aug. 16, 2001). No comments were filed. BellSouth also filed a letter in support of its waiver petition. *See* November 30, 2001 letter from Mary L. Henze, Executive Director, Federal Regulatory Affairs, BellSouth, to Tim Peterson, Deputy Chief, Accounting Safeguards Division, FCC.

2 *See* 47 C.F.R. § 32.27.

3 Separate affiliates required by section 272, such as affiliates for interLATA services, must conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection. 47 U.S.C. § 272(b)(5).

4 *See* 47 C.F.R. § 32.27.

3. Waiver of the Commission's rules is appropriate only if special circumstances warrant deviation from the general rule and such deviation will serve the public interest.[5] In addition, a waiver request must be consistent with the principles underlying the rule for which a waiver is requested.

4. We find that special circumstances exist for granting this waiver request with respect to transactions with certain affiliates. The Commission has recently adopted changes section 32.27(c) to permit incumbent LECs to value certain transactions with affiliates using the lower of cost or market as a ceiling.[6] For example, under our rules adopted on October 11, 2001, if a transaction is from the nonregulated affiliate to the incumbent LEC, and no tariff rate, prevailing price or publicly filed agreement exists, under certain circumstances the incumbent LEC can value the transaction at the "lower of cost or market" or lower.[7] Thus, the relief BellSouth is requesting, for affiliates that are not section 272 affiliates, will be permitted under our rules if no tariff rate, prevailing price or publicly filed agreement exists, as soon as the revised section 32.27(c) goes into effect. The transaction between the incumbent LEC and the affiliate must always comply with the Communications Act, Commission rules and orders, and must not be anti-competitive. We conclude that the recent adoption of this modification to the rule, which would grant the relief BellSouth seeks, is a special circumstance which warrants deviation from the current rule. In addition, we find that the public interest will be served by granting this waiver request. We agree with BellSouth that as a general matter, if it records services received from nonregulated affiliates at less than fully distributed cost on its regulated books of account, the cost of service would be reduced, and the ratepayer will not incur unwarranted costs associated with the various affiliate transactions. For these reasons, we grant the petition with respect to transactions with affiliates, other than the section 272 affiliate, listed in the Erratum to BellSouth's Expedited Petition for Waiver.

5. BellSouth explains that the affiliate BellSouth Long Distance, Inc. (BSLD), was created to provide interLATA services pursuant to section 272 of the Communications Act of 1934, as amended (Communications Act). All transactions between a Bell operating company and its section 272 affiliate must comply with the arm's length requirements of section 272(b)(5). BellSouth contends that it can comply with the arm's length requirements by recording the transaction at incremental cost for regulatory accounting purposes.[8] We disagree. Our rules require such transactions with section 272 affiliates, where

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[5] WAIT Radio v. FCC, 418 F.2d 1153, 1159 (D.C.Cir. 1969), *cert. denied* 409 U.S. 1027 (1972); 47 C.F.R. § 1.3.

[6] *See* 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2, CC Docket No. 00-199, *Report and Order in CC Docket Nos. 00-199, 97-212, and 80-286 and Further Notice of Proposed Rulemaking in CC Docket No. 00-199, 99-301, and 80-286*, FCC 01-305 (rel. Nov. 5, 2001) (*Phase 2 Report and Order*).

[7] *See Phase 2 Report and Order* at ¶ 92.

[8] Petition at 5.

no tariff rate, prevailing price or publicly filed agreement exists, to be recorded for regulatory accounting purposes at the higher of cost or market when the carrier is the seller or transferor, and the lower of cost or market when the carrier is the buyer or transferee.[9] BellSouth has not demonstrated how an incremental cost valuation would comply with the statutory requirement that transactions be at an arm's length basis. It is not sufficient to assert that the statutory requirement is met if the price for the transaction is recorded for financial accounting purposes at fair market value. The Commission's revision of section 32.27(c) to allow the floor and ceiling discussed above does not apply to transactions with section 272 affiliates.[10] For these reasons, we deny BellSouth's petition for waiver with respect to transactions with BSLD.

6. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 4(j), 201-205, and 218-220 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), 154(j), 201-205, and 218-220, and Sections 0.91, 0.291, 1.3, 1.106, and 32.27 of the Commissions rules, 47 C.F.R. §§ 0.91, 0.291, 1.3, 1.106, and 32.27, that the Petition for Waiver filed by BellSouth Telecommunications, Inc. IS HEREBY GRANTED IN PART AND DENIED IN PART.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran
Chief, Accounting Safeguards Division

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[9] *See* Accounting Safeguards under the Telecommunications Act of 1996, CC Docket No. 96-150, *Report and Order*, 11 FCC Rcd 17539, 17607, ¶ 147 (1996) (*Accounting Safeguards Order*), *recon.*, *Order on Reconsideration in CC Docket No. 96-150*, 14 FCC Rcd 11396 (1999), *Second Order on Reconsideration*, 15 FCC Rcd 1161 (2000). The Commission specifically held that the rules regarding valuation of affiliate transactions in effect at the time, *i.e*., fully distributed cost, may not be consistent with the section 272(b)(5) requirement for "arm's length basis" and that the higher of cost or market when the carrier is the seller or transferor, and the lower of cost or market when the carrier is the buyer or transferee was more likely to ensure that the transaction takes place on an arm's length basis. *Accounting Safeguards Order*, 11 FCC Rcd at 17607, ¶ 147.

[10] In the *Phase 2 Report and Order*, the Commission excluded transactions with section 272 affiliates from the floor and ceiling rule. *See Phase 2 Report and Order* at ¶ 92 & n.176.