

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION**

**Final Report to the Commission of the
Collaborative to Determine the
Adequacy and Interpretation of
Existing Accounting Procedures and
Financial Reporting Regulations for
All Telecommunications Carriers
Docket No. M-00001374**

March 15, 2001

I. INTRODUCTION

This Collaborative was created by Commission order entered September 12, 2000, at Docket No. M-00001374, to provide all telecommunications carriers and interested parties with an opportunity to participate in determining what, if any, modifications should be adopted to the Commission's accounting procedures and financial reporting requirements in response to the opening of the local and toll telecommunications markets to competition in Pennsylvania. More particularly, this same order spelled out nine specific questions (addressed later in this report) that the Collaborative participants were to address at the end of the six-month investigative process contained in the order. These questions involved resolving, *inter alia*, whether competitive local exchange carriers ("CLECs") should be held to the same reporting requirements as incumbent local exchange carriers ("ILECs"), what reports (or subparts thereof) should be treated as confidential, and whether CLECs should be required to maintain separate accounting systems for their various operations.

The Collaborative began, almost immediately, working to address the issues raised in the September 12th Order. The Collaborative consists of participants representing 14 different competitive and incumbent local exchange carriers, the Office of Consumer Advocate, the Office of Trial Staff, and various bureaus within the Pennsylvania Public Utility Commission. As discussed in greater detail in this Final Report, the end result of this collective effort is a

consensus recommendation to streamline significantly the annual financial reporting requirements for both ILECs and CLECs under 52 Pa. Code § 63.36. Further, the proposed changes to the annual financial reports, in turn, will necessitate certain amendments to the current regulations concerning classification of public utilities (52 Pa. Code § 63.31) and systems of accounts (52 Pa. Code § 63.32), which proposed amendments are also provided herein for your consideration. Finally, the participants understood that upon streamlining the reporting requirements, the Commission will likely expect and demand stricter compliance by all jurisdictional local exchange carriers (“LECs”)¹ in submitting completed reports. For non-compliant companies, they should expect more consistent and tougher enforcement efforts to ensure compliance, including the filing of complaints seeking civil penalties, the suspension or revocation of certificates of public convenience, or any other remedies deemed appropriate by the Commission.

Not surprisingly, the most difficult issue raised relating to the annual reports was whether these reports, on a going-forward basis, should be treated as confidential and proprietary. While a consensus position ultimately emerged to treat parts of the report as public and other parts as proprietary in light of the changing competitive landscape in Pennsylvania, this recommendation triggered the greatest discussion within the Collaborative. Some of the concerns raised in

¹ For purposes of this Final Report, the term “LECs” shall mean all telecommunications carriers.

regard to this issue will be discussed below in response to questions 1 and 2 posed by the September 12, 2000 Order.

In addition to the annual reports, other proposed changes to existing Commission reporting requirements were discussed by the Collaborative. These discussions led to several other proposals being included in this report as well. For example, the Collaborative proposes the consolidation of existing access-line reporting requirements filed by LECs to eliminate the filing of duplicative information. The Collaborative also recommends that 52 Pa. Code § 71.3 be revised to clarify that only ILECs are required to file financial earnings reports covered by that section and to reduce the filing requirements from a quarterly to semi-annual basis for ILECs with more than \$10 million in gross revenues.

There were other proposals raised by one or more participants, such as a proposal suggesting that the Commission engage in some type of market-share monitoring, but were not acted upon by the Collaborative. While the Collaborative concluded that such monitoring may be advisable to mark the progress and location of competition within specific geographic regions, this proposal was deemed outside of the scope of this Collaborative's directive contained in the September 12, 2000 Order.

In sum, the reporting requirement proposals recommended herein have been carefully tailored to meet the Commission's and its staff's continuing financial reporting needs for the telecommunications industry. At the same time, the proposed revisions to existing reporting requirements, if adopted, will

substantially reduce the reporting burden on competitive carriers, which may have served as a significant barrier to entry into the local telecommunications market in Pennsylvania, as well as incumbent carriers. Notwithstanding the significant progress the Collaborative has made in streamlining the existing financial reporting requirements discussed in this Final Report, the recommended product still remains among the most extensive in the country. The Commission is thus encouraged to re-examine regularly the process for financial reporting for possible further streamlining. Additional streamlining will encourage new entrants into the local telecommunications market by relieving the reporting burdens that could act, even as revised, as a barrier to entry. Such a re-examination should occur, at a minimum, after Chapter 30 of the Public Utility Code sunsets on December 31, 2003, but may be appropriate even sooner as deregulation, and, hopefully, competition takes hold in the various Pennsylvania telecommunications markets.

II. BACKGROUND

By order entered September 12, 2000, the Commission created a collaborative process to examine the adequacy and interpretation of existing accounting procedures and financial reporting regulations for all telecommunications carriers. The first meeting of the Collaborative occurred on October 10, 2000, and was well attended by industry representatives, the Office of Consumer Advocate (“OCA”), and Commission staff. At this first meeting of the Collaborative, David Freet, President of the Pennsylvania Telephone Association (“PTA”), was elected to chair the working group. To facilitate discussions on the various types of financial reports that telecommunications carriers must file with the Commission, Commission staff (“Staff”) agreed at this meeting to prepare a list of all current reports and provide copies to all participants in the Collaborative.

Subsequently, on October 13 and 27, 2000, Staff circulated the reporting forms and other relevant information as previously agreed at the October 10th meeting. The Collaborative thereafter held subsequent meetings on November 15, 2000, December 13, 2000, January 25, 2001, February 1, 2001, and February 15, 2001, and March 1, 2001. Participation varied at each meeting but over time it included 14 industry members,² the PTA, OCA, the Office of Trial Staff (“OTS”), and Staff members from the Law Bureau and the Bureau of Fixed Utility Services

² Industry members participating in the Collaborative were from Allegiance Telecom, Inc.; AT&T Communications, Inc.; CTSI, Inc.; D&E Communications, Inc.; MCI WorldCom Communications, Inc.; North Pittsburgh Telephone Co.; PaeTec Communications, Inc.; Rhythm Links, Inc.; SBC Telecommunications, Inc.; Sprint; Urban Media; Verizon-Pennsylvania, Inc.; XO Communications; and Yipes Communications, Inc.

(“BFUS”). Representatives from the Commission’s Bureaus of Audits, Consumer Services, and Conservation, Economics and Energy Planning, as well as the Office of Special Assistants, also provided valuable input to the Collaborative.

In addition, the Collaborative created several subgroups to address specific issues. These issues included evaluating how the Commission’s current access line reporting requirements could be streamlined; the effect, if any, of the Federal Communications Commission’s decision to end the filing of various ARMIS reports on the Commission’s own reporting requirements; and the drafting of this Final Report. The end result of this substantial effort was unanimous agreement on many of the issues presented to the Collaborative and consensus agreement on several issues with only one or two members in disagreement. The strong consensus reached in this Final Report is reflected in the fact that there is only one statement submitted by a participant to discuss its individual views, which statement is attached as Appendix J to this Final Report.

III. DISCUSSION

Commission Question No.1:

Should the quarterly and annual rate-of-return financial reports (52 Pa. Code §§ 71.1 - 71.9) and/or the Form M annual reports (52 Pa. Code § 63.36) be permitted to be treated as confidential and proprietary under 52 Pa. Code § 5.423?

Commission Question No. 2:

Will disclosure of the information in the quarterly and annual rate-of-return financial reports (52 Pa. Code §§ 71.1—71.9) and/or the Form M annual reports (52 Pa. Code § 63.36) cause any type of unfair economic or competitive damage to ILECs or CLECs? If yes, what are the potential types of unfair economic or competitive damage that might occur?

As discussed below, it is the consensus of the Collaborative that only a small number of the schedules contained in the proposed annual reports attached as Appendices D, E, and F should be treated in their entirety as confidential and proprietary. There is another group of schedules that contain both proprietary and public information. Finally, there are still other schedules that may be proprietary for some companies but public for others. The justification for treating any of the information in these annual reports as proprietary, however, rests on the determination that public disclosure of the sensitive information in these schedules could cause unfair economic or competitive damage to the reporting ILEC or CLEC.

Answering the second question first, the public disclosure of competitively sensitive information contained in some of the schedules in the ILECs' and CLECs' revised annual reports, if the Collaborative's reporting proposals contained herein are adopted by the Commission, could indeed cause unfair economic or competitive damage to the reporting carriers. The extensive and detailed financial disclosures that still will be required in the modified annual reports submitted to the Commission will continue to contain substantive information that competitors would find very useful in planning and executing their competitive strategies within the Commonwealth.

Knowing other ILECs' and CLECs' detailed breakdowns of their revenues, expenses, and capital investments where such information is not otherwise publicly available, for example, would permit competing carriers to determine which carriers are weak and which are strong financially. Access to this information could also allow carriers to know which of their competitors are making the infrastructure investments required to meet customers' burgeoning telecommunications needs and which are not. Finally, some of the requested information would allow competitors to determine where and how to deploy their resources based on the close scrutiny of their competitors' financial reports.

This would be especially true where a new CLEC entrant is considering, or is, locking competitive horns with a privately-owned ILEC that has a small service area. The CLEC's access to the small ILEC's detailed financial information on file with the Commission and not reported anywhere else would provide the CLEC

a veritable road map to guide unfairly its entry into the ILEC's market and siphon away the ILEC's customer base. The Commission, in an Order entered on September 28, 2000, recognized and dealt decisively with a similar danger when it accorded proprietary treatment to annual residential account reports filed with the Commission by several small ILECs (as well as by Verizon-Pennsylvania, Inc.) pursuant to 52 Pa. Code § 64.201.³ The Commission thereby prevented the public disclosure of this competitively sensitive information to a CLEC competitor that had asked the Commission for this data.

Furthermore, in a market where a CLEC and an ILEC are competing head-to-head, it would be equally unfair for the ILEC to have access to competitively sensitive nonpublic information in the CLEC's financial reports to the Commission. The ILEC could raise entry barriers in its service area by putting its thumb on the scale of competition to tip the balance in its favor.

Turning to the first question, the consensus answer is also yes, at least as to certain schedules containing information that the reporting LEC deems competitively sensitive and therefore proprietary, and that is not publicly reported or otherwise disclosed elsewhere by the LEC. At the outset, the Collaborative has identified four schedules that will be treated as proprietary and confidential under 52 Pa. Code § 5.423 for all ILECs and CLECs because of the potential economic or competitive harm that may result if the competitively sensitive information is made publicly available. They are Schedule 36 (Telephone Calls), Schedule 37

³ Petitions of Bell Atlantic-Pennsylvania, Inc., et al., Docket Nos. P-00001818/1819/1820.

(Report of Residential Service), Schedule 38 (Development of Rate Base), and Schedule 39 (Compensation of Officers).⁴

Section 5.423(a) of the Pennsylvania Code provides that a protective order to limit disclosure of confidential information shall be issued only when the party establishes that the potential harm to it if there is disclosure “outweighs the public’s interest in free and open access to the administrative hearing process.”⁵

The section then provides that the following five factors, along with other relevant factors, should be considered when determining whether to issue a protective order to keep information confidential:

(1) the extent to which the disclosure would cause unfair economic or competitive damage;

(2) the extent to which the information is known by others and used in similar activities;

(3) the worth or value of the information to the participant and to the participant’s competitors;

⁴ The schedule numbers referenced in this section of the report are those in the proposed Class A Annual Report for alternative form of regulation ILECs. One of the four schedules does not exist in the proposed Class C Annual Report and the other three schedules have different numbers in the proposed Class B and Class C Annual Reports for rate base/rate of return ILECs and CLECs, respectively.

⁵ When discussing whether the protection from disclosure of the proprietary information outweighs the public interest in having the information publicly available under 52 Pa. Code § 5.423(a), the Collaborative recognized that the cited regulation was promulgated at a time when the telecommunications industry was controlled by monopoly providers. These providers were subject to intense regulatory scrutiny because the telecommunications utilities operated under rate based, rate of return regulation. In this monopoly environment, the Collaborative recognized that the public interest in having access to the information was significantly higher than it would be in a competitive environment. As a result, the Collaborative’s consensus recommendation respecting identification of certain schedules which are to be publicly available versus those which are to be afforded confidential treatment, takes into account the evolving competitive environment and represents an appropriate and reasonable balancing of these competing interests.

(4) the degree of difficulty and cost of developing the information; and

(5) other statutes or regulations dealing specifically with disclosure of the information.⁶

By way of illustration, applying this standard to the proposed streamlined annual reports, the Collaborative found serious concerns with the public disclosure of executive compensation as this information could be used by competitors to cause economic or competitive harm to the reporting LEC. This is because competitors would unfairly be provided with benchmark compensation data for compensating their own executives, and could use this information in an attempt to lure away the reporting LEC's executives with the promise of higher compensation. Similar competitive/economic harm concerns were found to exist as to the other three schedules as well.

In addition, the Collaborative recommends that LECs, if applicable, be permitted to designate as proprietary all information not publicly reported or disclosed elsewhere (e.g., with the Federal Communications Commission ("FCC" or the Securities Exchange Commission) that is provided in Schedules 8 (Balance

⁶ The Commission's protective order rule reflects Pennsylvania court rulings that have regularly protected from public disclosure competitively sensitive information such as trade secrets and pricing and financial information, including cost information related to materials, labor, overhead, and profit margin. *See, e.g., Walker Pontiac, Inc. v. Pa. Dep't of State*, 582 A.2d 410 (Pa. Cmwlth. 1990) (holding that appellant failed to demonstrate that board abused its discretion by failing to issue subpoena for documents purportedly containing confidential or trade secrets); *Air Products and Chemicals, Inc. v. Johnson*, 442 A.2d 1114 (Pa. Super. 1982) (Opining that trial judge did not error by excluding defendant from in-camera inspection of trade secrets of plaintiff); *Hagy v. Premier Mfg. Corp.*, 404 Pa. 330, 172 A.2d 283 (1961) (holding that corporation's evidence that inspection of records was in bad faith and for purpose of disclosing confidential records and trade secrets to competitors was improperly excluded); *Huessener v. Fisher & Marks Co.*, 281 Pa. 535, 127 A. 139 (1924) (affirming trial court's refusal to compel witness to discuss secret process).

Sheet), 9 (Notes of Balance Sheet), 10 (Income and Retained Earnings Statement), 11 (Cash Flow Statement), 21 (Prepaid Taxes and Tax Accruals), and 29 (Dividends Declared). The rationale for this recommendation is that disclosure of even summary information on these key financial schedules could cause the reporting LEC substantial competitive harm.⁷

For the same reasons, and subject to the same proviso that the information to be protected is not publicly reported or disclosed elsewhere by the reporting LEC, the Collaborative reached consensus that reporting LECs be permitted to designate as proprietary all but total telecommunications plant on Schedule 12; all but total accumulated depreciation in Schedules 13 and 14; all but total information on Schedule 31 (Intrastate Operating Revenues); all but total information on Schedule 32 (Operating Expenses by Category); all but total end-user access lines on Schedule 35 (Annual Access Line Summary Report); and all but total employee information on Schedule 38 (Number of Employees).⁸

The Collaborative further recommends that immediate access to the schedules containing designated proprietary information be also provided by the reporting LEC to representatives of the OTS, OCA, and the Office of Small

⁷ The more expansive proprietary designations permitted for both summary and detailed schedule information filed by a LEC assumes that none of the financial information protected is publicly reported elsewhere by the LEC. The Collaborative proposes that the general instructions to carriers in the annual reports specify the eligibility criteria for invoking these and other proprietary designations and explain how to implement such designations (e.g., filing expurgated schedules for placement in the Commission's public files along with unexpurgated schedules stamped proprietary).

⁸ This schedule includes the competitively sensitive information which LECs file with the Commission annually pursuant to 52 Pa. Code § 64.201 and to which, as discussed above, the Commission recently accorded proprietary protection in rejecting the request of a CLEC competitor for such information.

Business Advocate (“OSBA”) whenever these public agencies agree to abide by its proprietary treatment.⁹ In addition, any state-level executive or legislative branch agency may, upon request to the Commission, receive proprietary information from any of the schedules so long as it is for official governmental use only. However, these agencies must agree not to publicly disclose the information without permission from the carrier or Commission order and that the information will only be provided to agency employees with a need to know such information. A proposed form of Confidentiality Agreement that state agencies must complete before obtaining access to any proprietary information is attached as Appendix I.

In addition, to facilitate the administration of this process by Staff, the Collaborative recommends that if proprietary designation is limited to the above-identified schedules, the reporting LEC may do so without filing a petition for protective order at the same time the LEC files its annual report. Such a petition will only be necessary if a third party subsequently challenges the proprietary designation pursuant to 52 Pa. Code § 5.423. For all other schedules not identified above for special treatment, if the reporting LEC attempts to designate any information in these other schedules as proprietary, it must immediately file a petition for protective order with its annual report. The LEC will then have the

⁹ While the OCA argued that as to ILECs, the financial reporting information deemed proprietary under the Collaborative’s proposal should be publicly available, the Collaborative reached a consensus that the public’s interest in access to such deemed proprietary information is outweighed by the competitive harm that could result from such disclosure. The consensus is also that as a practical matter there is not much public interest in either public or proprietary financial information set forth in the reports.

burden to establish at an administrative hearing why the information should be designated proprietary. Absent the petition, the information provided in these other schedules will not be accorded confidential treatment by Staff.

The protection of competitively sensitive information is of critical importance to all members of the industry, whether they are incumbent carriers or new entrants to the marketplace. The proposal regarding designation of proprietary and confidential information contained in this Final Report to the Commission represents a major concession by industry representatives with respect to their confidentiality concerns. If, for any reason, the Collaborative's designation of schedules containing confidential and proprietary information is not adopted by the Commission, industry representatives may be compelled to file protective motions to guard their competitively sensitive information to avoid irreparable competitive harm.

Turning next to the issue of proprietary treatment of the quarterly and annual rate-of-return financial reports, the consensus of the Collaborative was that the same formula for designating information as proprietary recommended for the annual reports filed pursuant to 52 Pa. Code § 63.36 should be adopted for the rate-of-return reports. In short, the information contained in the report should be treated as public unless it is not publicly reported or otherwise disclosed elsewhere by the carrier. In that case, the information must be marked as proprietary and will be accorded such treatment by Staff without the filing of a petition for

protective order, subject to later challenge by a third party pursuant to 52 Pa. Code § 5.423.

Finally, the Collaborative wants to emphasize that its proposal for deeming certain report schedules as containing proprietary information, if adopted by the Commission, does not constitute a final and binding determination that such information is in fact competitively sensitive and therefore is, in fact, proprietary information. To the contrary, to the extent the proprietary status of specific report information is challenged by any interested party, the reporting LEC will have the burden to establish that the information is proprietary under the criteria set forth in 52 Pa. Code § 5.423(a). This is the present procedure that is generally followed under protective orders entered in Commission proceedings, and it should work equally well in the financial reporting area. Similarly, any reporting LEC that believes any financial information not deemed proprietary under the Collaborative's proposal is proprietary as to it, retains the right, as discussed above, to petition the Commission to protect this information from public disclosure consistent with existing Commission practice.

In sum, the Collaborative's proposal permitting certain financial information to be deemed proprietary for reporting purposes seeks to reach a reasonable accommodation between competing public policy interests. The proposal permits disclosure of such information to those within government who need to know it while avoiding a flood of pre-report filing waiver or protective order applications from LECs.

Commission Question No. 3:

Should CLECs be held to the same quarterly and annual financial reporting requirements under 52 Pa. Code §§ 63.36 and 71.1 – 71.9 as the ILECs?

1. CLECs' Filing of Annual Reports Under 52 Pa. Code § 63.36.

Currently, the CLECs file either the Class A or Class B Annual Reports pursuant to 52 Pa. Code § 63.36, which are attached to this Final Report as Appendices A and B, respectively. The actual report filed currently depends on the number of access lines used by the CLEC and its type of operations. The large facilities-based CLECs with more than 50,000 access lines in Pennsylvania file the Class A Annual Report. The rest of the facilities-based CLECs file the current Class B Annual Report. Currently, CLEC resellers file a one-page annual financial report that is similar to the annual financial report filed by interexchange carriers (“IXCs”) and competitive access providers (“CAPs”).

The Collaborative reached a consensus that the current definitions of Class A, Class B, Class C, and Class D telephone utilities in 52 Pa. Code § 63.31 do not provide accurate demarcations of the type of annual report that should be filed by the various types of LECs. Under section 63.31, telephone utilities are now divided for reporting purposes based solely on access lines and/or minimal operating revenues. This division, however, fails to separate those carriers that are rate-deregulated, such as CLECs, for example, from those small incumbent carriers that still follow some form of rate based, rate-of-return regulation under

Chapter 30 of the Public Utility Code. Under the present system, therefore, CLECs and ILECs may be required to file the same report even though the Commission's informational needs for these two types of carriers are completely different. The Collaborative reached consensus that a more accurate categorization of carriers should be based on the amount of regulation exercised by the Commission over a specific type of carrier and the particular financial information necessary to carry out responsibly the Commission's regulatory duties.

The Collaborative, therefore, proposes that the classes be redefined based on whether a carrier is an incumbent or new entrant, and, if an incumbent, whether the utility is subject to an alternative form of regulation or some type of rate based, rate-of-return regulation. Under the Collaborative's proposal, Class A utilities would be defined as ILECs subject to an alternative form of regulation under Chapter 30, including but not limited to price cap companies and Plan A companies as defined in the Commission's Order entered January 20, 2000, at Docket No. P-00981425. Class B utilities would be redefined to include ILECs that are subject to rate base/rate of return regulation or the Plan B Simplified Ratemaking Plan as defined by the same Commission order at Docket No. P-00981425. Finally, Class C telephone utilities would be all CLECs, whether they are facilities-based, resellers, or some combination thereof. The former Class D designation would be eliminated under this proposal. Effectuation of these definitional changes will require an amendment to 52 Pa. Code § 63.31, and

attached to this Final Report as Appendix G is proposed rulemaking language incorporating these changes.

In addition to redefining the various classes, the Collaborative also recommends that the current Class A and Class B Annual Reports be modified into three separate reports for each of the new classes. The proposed reports are also significantly streamlined to eliminate a number of reporting schedules that have become outdated and/or unnecessary in an increasingly deregulated telecommunications market. The proposed three annual reports are attached herein as Appendices D, E, and F. In particular, the new Class C Annual Report requests much less information than is required in either the current Class A or Class B Annual Reports and less than is required in the proposed Class A or B reports as well.

In brief, the Collaborative reached a consensus that some of the schedules could be eliminated as detailed in Appendix C. In addition, Appendix C provides a table listing other schedules that have been modified and/or streamlined to reduce the administrative burden of completing them while still maintaining their usefulness to the Commission.¹⁰ Moreover, in response to concerns expressed by

¹⁰ In regard to the Access Line Summary Report schedule found in each annual report, this represents a consolidation of several different reporting requirements now imposed on telecommunications carriers. While most of the schedule involves the collection of data that was already being provided in other existing reports, the “TRS Surcharge Applied” column is intended to collect new data that Staff asserts is necessary to ensure the surcharge is being applied on the right access lines. Because the TRS Surcharge Applied information request imposes a new burden on industry participants, the Collaborative requests that a transition period for the current year only be allowed which will waive compliance for those companies that cannot reasonably provide the information in a timely and cost-effective manner.

CLEC participants that out-of-state CLECs do not keep detailed financial accounting records for individual states such as Pennsylvania, the Class C report provides that Pennsylvania-specific data be required only on schedules 8-12, 18, and 23-28. However, for these designated schedules, a CLEC may submit its Pennsylvania-specific information on an apportioned basis if that is how it normally accounts for this information for tax purposes. For the remaining schedules, CLECs that do not have Pennsylvania-specific data are permitted to report parent or consolidated data.

Finally, the filing of the Class C Annual Report by CLEC resellers is also recommended. This is a change from present internal practice utilized by the Commission's BFUS to allow the filing of a one-page summary report by CLEC resellers. BFUS itself recommended the change during the Collaborative process, asserting that this change is necessary to ensure the fullest use of the financial information obtained in the new Class C report. It will also allow BFUS to monitor effectively the vitality of new entry in the telecommunications markets throughout the Commonwealth if it is obtaining the same information from all CLECs. IXCs, CAPs, and toll resellers will continue to file the one-page annual report, unless they also have CLEC operations. If they have CLEC operations, they will file the new Class C Annual Report.

2. CLECs' Filing of Annual or Quarterly Rate-of-Return Financial Reports under 52 Pa. Code §§ 71.1-71.9.

Currently, few CLECs file a quarterly or annual rate-of-return financial report pursuant to 52 Pa. Code § 71.3(a) as most CLECs do not meet the gross annual intrastate revenue thresholds provided in that regulation. On a going-forward basis, the Collaborative finds no compelling reason, in an increasingly deregulated market, to require CLECs to file either quarterly or annual rate-of-return financial reports, because capturing rate-of-return data on CLECs is of no value in the Commission's efforts to regulate the telecommunications industry. Therefore, the Collaborative recommends that 52 Pa. Code § 71.3 be revised to clarify that the reporting requirements therein apply only to incumbent carriers. Proposed language accomplishing this rulemaking change is incorporated in Appendix H. In addition, the Collaborative unanimously recommends that the quarterly reports for the larger ILECs be reduced to a semi-annual basis, and this change is also reflected in Appendix H.

Commission Question No. 4:

Should the existing Commission quarterly and annual rate-of-return requirements (52 Pa. Code §§ 71.1-71.9) be modified or streamlined as a result of the transition to a competitive environment? If so, how?

As discussed in the immediately preceding section, the Collaborative participants unanimously agree that the filing requirements in 52 Pa. Code §§ 71.1-71.9 should be modified in several respects. First, the Collaborative proposes that the quarterly rate-of-return financial earnings reports of ILECs reporting more than \$10 million of intrastate gross revenues be reduced to filings on a semi-annual basis. Secondly, the Collaborative recommends that the regulation be amended to make clear that CLECs are not required to file any type of earnings reports under chapter 71 even if their gross intrastate revenues exceed the \$1 million or \$10 million thresholds. No other substantive or procedural changes to this regulation are proposed by the Collaborative at this time. The above-described proposed rulemaking changes are contained in Appendix H to this Final Report.

Commission Question No. 5:

Do the current Commission requirements that CLECs maintain separate accounting systems for their competitive access provider operations (“CAPs”), CLEC operations, and interexchange toll (“IXC”) operations impose unreasonable and unduly burdensome accounting separation and reporting requirements on the CLECs’ operations?

The primary concern identified by CLECs with respect to maintaining separate accounting systems for different operations is the fact that CLECs are not currently required by the FCC to maintain their system of accounts pursuant to the “Common Carrier Services; Revision; Uniform System of Accounts (“USOA”), Classes A, B and C Telephone Companies.” The CLECs argue, therefore, that they should not be required to maintain their accounts pursuant to the USOA by Commission regulation. CLECs in the Collaborative asserted that such a requirement, if imposed on a Pennsylvania-specific basis, could create an artificial barrier to entry in the Pennsylvania local telecommunications marketplace. This is because the cost of altering accounting systems by CLECs to implement the USOA would often be prohibitive.

The CLECs’ concerns relating to separate accounting systems and reporting requirements were addressed by the Collaborative in two ways. First, the Collaborative proposes to amend 52 Pa. Code § 63.32, System of Accounts, to recognize that CLECs not required by the FCC to conform to the USOA, must:

(1) inform the Commission of this fact on its annual financial report, and (2) state the method of accounting the utility did utilize, such as Generally Accepted Accounting Principles (“GAAP”), to compile the financial information reported. The proposed amendment to section 63.32 may be found in Appendix G.

Additionally, recognizing that many CLECs may not have Pennsylvania-specific information for certain of the designated schedules or line items, the Collaborative is recommending that CLECs be allowed to designate certain schedules or line items on its Class C Annual Report where Pennsylvania-specific information need not be provided. In those situations, the CLEC will be allowed to provide the information on either a parent or consolidated basis. If parent or consolidated information is provided, the CLEC is also obligated to provide information regarding the identity of the parent company and/or which consolidated information has been provided.

For Schedules 8-12, 18, and 23-28, however, Staff advised that the CLECs must continue to be obligated to provide Pennsylvania-specific information to maximize its usefulness to Staff. To accommodate concerns raised by the CLECs for these same designated schedules, BFUS agreed that if a CLEC normally accounts for these items on an apportioned basis, then that CLEC will be permitted to submit its Pennsylvania-specific information on an apportioned basis for these designated schedules. This proposed change is an important recognition that many of the CLECs now doing business in Pennsylvania are not Pennsylvania-specific

companies or are part of a consolidated group of companies, all of which contribute to its Pennsylvania operations.

This proposal is a reasonable compromise that recognizes the reality of the marketplace by balancing the need for regulatory oversight versus providing flexibility to CLECs in providing the needed information in a truly competitive marketplace.

Commission Question No. 6:

Should CLECs' accounts continue to be subject to our regulations concerning classification of public utilities (52 Pa. Code § 63.31) and systems of accounts (52 Pa. Code § 63.32)?

As already discussed above, the Collaborative thoroughly analyzed the regulations concerning classifications of public utilities found at 52 Pa. Code § 63.31 and unanimously agreed, after review and vigorous discussion, that separate classifications for various types of telephone public utilities remain appropriate. However, the Collaborative determined that the current classifications, based upon access lines and revenues, are outdated and no longer an appropriate measure in today's competitive telecommunications environment. Accordingly, the Collaborative proposes to maintain three separate classes of telephone public utilities, still denominated as Class A, Class B and Class C. The

new proposed definitions, however, recognize the current statutory requirements and the changing telecommunications marketplace in Pennsylvania.

Class A telephone utilities, therefore, are proposed to be defined as ILECs subject to an alternative form of regulation, including price cap companies and Plan A companies as defined in the Commission's Order entered January 20, 2000, at Docket No. P-00981245, pursuant to Chapter 30 of the Public Utility Code. Class B telephone public utilities are to be defined as ILECs subject to rate based/rate of return regulation or the Plan B Simplified Ratemaking Plan approved by the same Commission Order entered January 20, 2000, at Docket No. P-00981245. Finally, Class C telephone public utilities are all CLECs, whether they are facilities or non-facilities based, that are not the incumbent provider in any local exchange within Pennsylvania.

The Collaborative believes that these revised classifications are more appropriate because the type of financial data to be provided by a carrier will be based on the amount and degree of regulatory oversight required rather than simply based on the number of access lines served by the carrier. In short, the revised definitions (and, in turn, the streamlined reporting requirements for all classes of telephone utilities) effect a balance between the degree of regulation deemed necessary by the Commission and the lesser degree of oversight required in an industry that is moving toward competition.

Commission Question No. 7:

Should the FCC's financial reporting requirements for ILECs and CLECs, if any, be adopted by the Commission in order to reduce the regulatory burden on new entrants?

The consensus of the Collaborative is that the Commission should not adopt the FCC's financial reporting requirements but should retain its own set of financial reporting requirements. Further, it was agreed that the Commission should re-double its efforts to ensure that all LECs operating in Pennsylvania comply with the Commission's reporting requirements. In reaching this conclusion, there was a concern that the FCC's financial reporting requirements would not likely provide adequate information for the Commission to regulate properly and effectively Pennsylvania's telecommunications industry. Certainly, it is unrealistic to expect that the FCC would require reporting from LECs on issues that may be unique to Pennsylvania. For example, current FCC financial reporting requirements may not be sufficient to determine whether the LECs are complying with the provisions of Chapter 30 as provided in each LEC's previously-approved Chapter 30 alternative form of regulation plan.

Furthermore, the Collaborative considered that the FCC is likely to change its reporting requirements as it deems appropriate and this too may not adequately meet the needs of the Commission to be able to regulate properly the Pennsylvania telecommunications industry. The Commission may not be able adequately to

fulfill its statutory requirements if it were to rely solely on FCC financial reporting requirements for LECs.

The Collaborative recognizes that regulatory burdens may be further reduced, particularly for new entrants, if the Commission were to adopt the FCC's current financial reporting requirements for LECs. However, Staff believes, and the industry participants acknowledge, it is more important to ensure that the Pennsylvania-specific issues are adequately addressed by its own financial reporting requirements and not rely on FCC reporting requirements, which are likely to change again in the future. Nevertheless, the Commission should continue evaluating future FCC reporting changes to determine whether ever-changing market conditions in the state support adopting these later approved FCC reporting requirements.

Commission Question No. 8:

In the case of a telephone utility that has CLEC, CAP, or IXC services operations, or any combination of these, what combination of revenues should be used for classification purposes under 52 Pa. Code § 63.31?

Again, as discussed above in relation to Commission Question Nos. 3 and 6, the Collaborative recommends redefining the telephone utility classifications on a basis other than revenue and has proposed rulemaking language to accomplish this change. The annual reports have also been modified to make clear that if a telephone utility has a combination of CLEC, CAP, and/or IXC functions within its corporate structure, the utility will be required to report in the same annual report the revenues received from each function separately in Schedule 23 of the Class C Annual Report. On the other hand, if a telephone utility operating within the Commonwealth has a combination of CLEC, CAP and/or IXC operations organized as separate corporate entities, the company will be required to file separate annual reports for each entity. Under this scenario, the company's CLEC operations will file the Class C Annual Report, and the utility's CAP or IXC operations will file the one-page report currently used by CAPs and IXCs.

Moreover, as discussed above in regard to Commission Question No. 5, the Collaborative is also recommending that 52 Pa. Code § 63.32 be amended to allow financial reporting for CLECs to be satisfied through the use of GAAP if they do not currently use USOA. GAAP provides the necessary financial reporting detail

as required by the FCC, including the utility's revenues. However, the CLEC must clearly state on the annual report the accounting method utilized. The Collaborative believes that any additional requirements, such as reporting accounting information in accordance with USOA, is unnecessary and would merely add burdens that may seriously harm or delay competitive entry into Pennsylvania's telecommunications service markets.

Commission Question No. 9:

Should a CLEC be required to account separately for its resale operations and its facilities-based operations?

Consistent with the response to the previous question, the Collaborative recommends that if a CLEC provides service using both resale and its own facilities under one corporate entity, then the CLEC should file one annual report but should account for the resale and facilities-based revenues separately. This determination recognizes the Commission's goal of promoting telecommunications competition within the state.

In furtherance of that goal, a variety of CLECs have been certificated to provide services within the incumbent carrier's territory. These competitive entrants utilize innovative tools to match customers' needs. In doing so, some services are provided via purchase of wholesale from the local incumbent, while other services may be provisioned by the CLEC's own assets such as cable for

transport. It is also logical that a service could use a combination of both resale and the CLEC's facilities. Having to account separately for such hybrid service operations is unnecessary and could impair the speed of competition to the telecommunications market.

Therefore, in order to manage the Commonwealth's overall goal of reducing regulatory costs and administrative burdens to CLECs in order to promote competition, it is neither practical nor necessary for a CLEC to file separate annual financial reports if these combined services are provided through one corporate entity. However, consistent with present practice at the Commission, if the CLEC provides service using both resale and its own facilities through separate corporate entities, then the CLEC must file two separate Class C Annual Reports for each type of CLEC operations.

IV. CONCLUSION

The recommendations contained in this Final Report represent the joint effort of all the participants to answer the nine questions posed by the Commission in its September 12, 2000 Order. The streamlined financial reporting requirements for both ILECs and CLECs proposed by the Collaborative will reduce significantly the administrative burdens of responding to Staff's legitimate information needs, and, in turn, allow all carriers to focus more energies on competing in the local telephone markets. The success of this Collaborative is the result of all the participants' willingness to share their thoughts, ideas, and concerns in a true spirit of cooperation. This cooperative effort allowed the participants to reach consensus, if not unanimity, on all issues raised in the Commission's original order. Looking forward, we encourage the Commission to revisit these reporting requirements on a regular basis for possible further streamlining in response to Pennsylvania's evolving competitive telecommunications market.