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

In the Matter of

The Southern New England Telephone Company's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs — AAD 7-1700

MEMORANDUM OPINION AND ORDER

Adopted: January 31, 1989; Released: February 7, 1989

By the Chief, Common Carrier Bureau:

I. INTRODUCTION AND BACKGROUND

1. On September 15, 1988, we released a *Memorandum Opinion and Order* [1] disapproving the cost allocation manual submitted by the Southern New England Telephone Company (SNET). We concluded that that manual was deficient because it incorporated two "adaptations"[2] that violated the Commission's rules, and contained cost apportionment tables that lacked sufficient detail to determine whether SNET was complying with the *Joint Cost Order.* [3] Furthermore, we found that the manual's sections concerning affiliate transactions, incidental activities and time reporting mechanisms were deficient, and we required SNET to provide additional information relating to each of these areas. We directed SNET to file a revised manual no later than November 14, 1988.

2. SNET filed its revised cost allocation manual on November 9, 1988. In a cover letter accompanying the manual,[4] SNET states that it has made major changes in its manual, including the elimination of the two "adaptations" and the incorporation of additional information concerning affiliate transactions, incidental activities, and employee time reporting. On November 10, 1988, we issued a Public Notice inviting parties to file comments on the revised manual no later than November 28, 1988. No comments on the revised manual were filed.

3. For the reasons set forth below, we conclude that SNET's revised manual is consistent with the Commission's requirements for cost allocation manuals and provides assurance against the misallocation of costs and revenues. We therefore approve SNET's cost allocation manual subject to the filing of additional information and revisions specified herein. We require SNET to submit any revisions to the manual that result from the instant Order to be made effective, to the maximum extent possible, retroactive to January 1, 1988, and to identify, with justification, in the transmittal to its filing which changes, if any, it cannot reasonably implement retroactively.[5]

II. DISCUSSION

A. Overall Sufficiency of the Manual

4. In the *SNET Order*, we indicated that our primary concern with SNET's manual was the incorporation of two "adaptations" to the *Joint Cost Order* which fit SNET's particular circumstances but were in clear violation of the Commission's rules. The first "adaptation" involved the use of a "capital carrying charge" for jointly-used regulated non-network support assets, which, according to SNET, would recover the cost of depreciation, provide a return on investment, and would be charged to nonregulated activities for the use of regulated support assets such as land and buildings. The second "adaptation" was SNET's use of separate books of accounts for its nonregulated, nonstructurally separate divisions.

5. We have reviewed SNET's revised manual and find that it has removed the two "adaptations." SNET's revised manual apportions costs either directly or indirectly between its regulated and nonregulated activities and eliminates the use of separate books of accounts. We find that SNET's revised manual contains cost accounting procedures that are adequate to meet our requirements and that are at a level of detail necessary for us to conclude that the manual's procedures will discourage cross subsidy. Moreover, we believe that, overall, SNET's revised manual will provide an adequate basis for Commission mandated audits. Although there are a number of revisions, as well as additional information required by this Order, we do not believe that these defects require rejection of the manual. Instead, we will permit SNET to continue to implement its revised manual, while requiring it to make revisions. Our approval of SNET's revised manual, therefore, is conditioned upon the timely submission of revisions and information discussed in this Order.

B. Nonregulated Activities

6. SNET's initial manual contained the requisite description of its nonregulated activities,[6] but, in violation of the *Joint Cost Order*, used separate books of accounts to record the costs and revenues associated with these services. We directed SNET to amend its manual to conform to the requirements of the *Joint Cost Order*, and, as stated previously, SNET has eliminated the use of separate books of accounts. We also required SNET to clarify that it does not engage in customer premises equipment (CPE) or inside wire activities,[7] but SNET's revisions do not address this matter. In its further revisions, SNET must state whether or not its offerings include these activities.

C. Incidental Activities

7. In its initial manual, SNET provided a list of nonregulated activities that are offered on an incidental basis to regulated activities. It did not state, however, as required by the *Joint Cost Order*, whether the total of all its incidental activities accounted for less than one percent of its total revenues. In the *SNET Order*, we directed SNET to address this matter.[8] In addition, we required SNET to clarify that "rental of surplus space on SNET premises" meets the Commission's requirements for incidental activities and is not an activity provided to affiliates. The revised manual specifically states that the aggregate revenues derived from incidental activities is less than one percent of the Company's total regulated and nonregulated revenues.[9] Additionally, SNET states that

none of its incidental activities are transactions with affiliates.[10] Moreover, the description of the rental of surplus space complies with our requirements in that it is an outgrowth of regulated operations, has traditionally been treated as regulated for ratemaking purposes, is not pursued as a separate line of business and requires minimal incremental resources. We find this responsive to our concerns.

D. Affiliate Transactions

8. Our review of the affiliate transactions section of SNET's initial manual led us to conclude that it was impossible to determine if SNET was following the Commission's affiliate transactions rules. SNET did not explain whether any of the transactions among affiliates involved assets or services, nor whether SNET was receiving or providing the asset or service. Moreover, it provided no information concerning the terms or frequency of the transactions. SNET's revised manual contains a 12-page section on affiliate transactions.[11] This section contains a description of the services provided by SNET to affiliates and to SNET from affiliates, along with the terms and frequency of each of these transactions. It also contains a description of the asset transfer rules that SNET will adhere to in the event assets are transferred between SNET and affiliates. Our review of this section satisfies us that SNET has complied with the affiliate transaction requirements of the *Joint Cost Order.*

E. Employee Time Reporting

9. As part of our review of SNET's initial manual, we identified three problems with SNET's explanation of its time reporting methods. First, we required SNET to be more specific about which groups of employees use the various time reporting methods. We were unclear whether the non-tariff employees working in Plant, Switching, and Support Services were reporting on a positive or exception basis. We also directed SNET to identify the "variety of groups" that use time reports under the heading of "Supplemental Time Reporting," and to explain which groups of employees use each of the time reporting systems and why. In addition, we required SNET to state whether any of its employees would be exempt from time reporting, and if so, the basis for the exemption. Second, we ordered SNET to provide more detail on its "Supplemental Time Reporting," which included listing and explaining all of the time reporting systems that it utilizes, with a full description of its special studies. Third, we required SNET to describe how the costs of nonproductive time are apportioned between regulated and nonregulated activities.

10. In its revised manual, SNET has eliminated the use of the terms "Plant, Switching, and Support Services" and "Supplemental Time Reporting." SNET now proposes to use two time reporting methods: positive time reporting and exception time reporting, the latter of which is subdivided into assigned apportionment and survey apportionment. Both types of reporting use SNET's Functional Accounting System Codes (FAS Codes), which support SNET's Financial Analysis System (FAS). The FAS is a computer-based system used to identify and track costs and provide information regarding the employment and deployment of resources, and permits SNET to analyze expenditures by organization, by discrete function, and by type of expenditure.

11. Under positive time reporting, employees report 100% of their time incurred in a day using FAS codes which describe the work activities performed and charge the associated costs to regulated or nonregulated activities. Time sheets are used by personnel and reviewed by supervisors. SNET also indicates that "additional validation techniques are utilized in the further processing of time within the Company's systems."[12] In its further revisions, SNET should identify these additional techniques and describe the basis for their validity.

12. SNET lists the major divisions in its company that utilize positive reporting and assigned or survey apportionment which support exception time reporting.[13] The only major type of employees that appear to be omitted from the chart is executives. SNET should revise the chart to indicate the type of reporting used by executives.

13. In regard to nonproductive time, SNET's revised manual states that "such time is apportioned to regulated and nonregulated cost objectives through the distribution of the employee's productive hours."[14] The phrase "through the distribution of . . . hours" is not clear. If SNET means in proportion to the distribution of hours, then we understand what is meant and would require SNET to revise its manual accordingly. If, however, this is not what SNET has in mind, we require SNET to explain fully the procedure it will employ in order to allocate nonproductive time between regulated and nonregulated costs.

F. Cost Apportionment Methodology

14. We found that SNET's cost apportionment information contained in its initial manual did not provide the detailed information necessary for us to conduct a meaningful review of SNET's cost apportionment process. The primary concern was that SNET did not explain the meaning of each phrase or term, that is not otherwise apparent, as used in its cost apportionment tables. SNET's revised manual describes in detail the methods it proposes to use to derive cost pools and to apportion costs between regulated and nonregulated activities. Section 7 of the manual contains a 28-page presentation of the format, definitions, and cost apportionment bases used in the apportionment tables.[15] This is followed by the cost apportionment tables that contain detail on all the appropriate Part 32 accounts. Generally, we find SNET's tables meets the requirements of the *Joint Cost Order.* We have identified, however, several issues relating to specific accounts.

G. Specific Accounts

Account 2112 - Motor Vehicles and Account 6112 - Motor Vehicle Expense

15. SNET proposes four cost pools for Account 2112: Regulated, Common, Pool Vehicles and Nonregulated. In the associated expense account, Account 6112, SNET will have two cost pools: Regulated and Nonregulated. SNET should explain why it requires a cost pool entitled "Pool Vehicles" in Account 6112, when the other three pools appear to cover the entire range of activity. Additionally, SNET must explain why it does not have a "Common" or "Pool Vehicles" cost pool in Account 6112.

Account 2124 - General Purpose Computers

16. SNET proposes several cost pools for this account. One is for "Data Processing - Nonregulated" and another for "Nonregulated." SNET should explain the difference in these cost pools. For the cost pool entitled "Other," SNET states that this pool represents computer investment not located at the Company's Information Technology Center. In its revisions, SNET should explain why investment not located at the Center should affect the type of cost pool that is used.

Account 2682 - Leasehold Improvements, Account 3420 - Accumulated Amortization - Leasehold Improvements, and Account 6563 - Amortization Expense - Tangible Leasehold Improvements

17. SNET proposes three cost pools for Account 2682: regulated, nonregulated and common, with the former two being directly assignable and the latter being indirectly attributable based on total company salaries and wages. For Account 3420, SNET proposes one cost pool, directly attributable, based on relative investment value of leasehold improvements. In Account 6563, SNET proposes four cost pools: regulated, nonregulated, common and leasehold improvements, with the former three pools assigned on the same basis as Account 2682 and the fourth pool assigned on the same basis as Account 3420. It is not apparent to us why SNET has chosen to use different cost pools for related investment and expense accounts. Therefore, SNET should explain the reason for having different cost pools for these accounts.

Account 3600 - Accumulated Amortization - Other

18. SNET proposes one cost pool for this account based on a direct assignment to regulated activities. SNET should explain why there is no allocation to nonregulated activities.

Account 5302 - Uncollectible Revenue - Other

19. Again, SNET proposes to use one cost pool for this account and directly assigns costs to regulated activities. SNET should explain why no revenues are allocated to nonregulated activities.

Account 6115 - Gararge Work Expense, Account 6116 - Other Work Equipment, Account 6122 - Furniture and Artwork Expense, and Account 6123 - Office Equipment Expense

20. SNET proposes two cost pools, regulated and nonregulated, for Accounts 6115, 6116, 6122 and 6123. For the investment accounts associated with these expense accounts, *i.e.*, Account 2115 - Garage Work Equipment, Account 2116 - Other Work Equipment, Account 2122 - Furniture, and Account 2123 - Office Equipment, SNET proposes three pools: regulated, nonregulated and common. SNET should explain why it excluded a common cost pool from Accounts 6115, 6116, 6122 and 6123.

Account 6725 - Legal Expense

21. In its manual, SNET proposes to have three cost pools for this account: regulated, nonregulated, and common - corporate. The first two pools are directly assigned, the third is allocated based on the general allocator. The common legal expense includes both common legal expenses and overhead expenses. SNET indicates that the common cost pool does not contain overhead costs for legal. We would expect, however, that SNET incurs overhead expenses, such as law library and general research costs. In its further revisions, SNET should indicate how it accounts for such overhead costs.

Account 7150 - Gains and Losses From Disposition of Land and Artworks

22. SNET has put the entire Account 7150 into one cost pool. This account contains the gains and losses from assets disposed of in Account 2111 (Land) and Account 2112 (Furniture). Since SNET was able to disaggregate Account 2111 and Account 2112 into a least three cost pools -- regulated, nonregulated and common -- it should be able to identify the cost pools where transactions in these accounts arise. It is appropriate, therefore, for SNET to identify similar cost pools for Account 7150. We require SNET to further revise its manual to disaggregate Account 7150 into cost pools similar to those used for the associated assets - Account 2111 and Account 2112.

III. PROCEDURAL ISSUES

23. In this section we address two procedural issues affecting SNET's revised cost allocation manual. These issues are: (a) the submission of a further revised manual in compliance with this Order, and (b) the routine submission of future amendments to the manual.

24. *Further Revised Manual.* We have required SNET to submit several amendments clarifying and changing many of its cost apportionment procedures. We have also directed SNET to submit additional information concerning nonregulated activities and time reporting mechanisms. In these cases, the additional information requested is needed to form a judgment concerning the reasonableness of SNET's proposed methods.

25. We will evaluate the proposed further revisions before issuing an order approving or disapproving these revisions. If we disapprove a proposed revision, we shall take whatever further action is required, including specific allocation methodologies or other procedures, consistent with our delegated authority to implement cost allocation manuals. In addition, to facilitate our review of the updated manual and its availability to the public, SNET shall file two updated copies of its further revised manual with the Commission in looseleaf form within 60 days of the release date of this Order.[16]

26. *Routine Amendments.* The procedures that SNET will follow when updating its cost allocation manual will be the same as the requirements that we imposed on the Bell Operating Companies (BOCs).[17] As we have determined in the BOC context, we recognize that the accuracy of different sections of the manual will have different effects on our ability to monitor the cost allocation process. Therefore, we will apply the following requirements for the update of SNET's manual. First, because it is important for the Commission to obtain current information on the cost categories and how these are allocated between regulated and nonregulated activities, several categories of information require our attention before changes in the manual are implemented. These are: (1) changes to the cost categories and their allocation mechanisms, and (2) changes in the way employee time, including nonproductive time, is allocated. Each of these changes in the cost manuals must be submitted at least 60 days prior to implementation. Parties seeking to comment on the proposed amendments will be provided an op-

portunity to do so prior to implementation and will be notified by public notice of the comment dates. The proposed amendments to the manual will be deemed accepted unless the Bureau, pursuant to its delegated authority, rejects or stays the effectiveness of the change.[18]

27. Second, because other information, such as corporate structure, may not be quite as critical for cost allocation monitoring purposes, we require that SNET file such changes in a timely manner.[19] A modification to a carrier's cost manual to reflect a corporate reorganization does not require our advance approval and, therefore, does not need to be filed prior to the corporate restructuring. Finally, all other changes to the manual should be submitted quarterly, on March 31, June 30, September 30 and December 31 of each year.

28. We believe that these procedures will ensure that the ongoing process of implementing cost allocations will continue to be conducted according to the requirements in the *Joint Cost Order*. At the same time, they minimize the number of times SNET must seek prior Commission approval before implementing a change and provides a system to ensure timely review of SNET's proposals.

IV. ORDERING CLAUSES

29. ACCORDINGLY, IT IS ORDERED, pursuant to Section 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. Section 154(i), that the Cost Allocation Manual filed by SNET IS APPROVED, subject to the conditions noted in this order.

30. IT IS FURTHER ORDERED that further revised copies of the Cost Allocation Manual shall be submitted within 60 days from the release date of this Order.

FEDERAL COMMUNICATIONS COMMISSION

Gerald Brock
Chief, Common Carrier Bureau

FOOTNOTES

[1] The Southern New England Telephone Company's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 3 FCC Rcd 5625 (1988) (*SNET Order).*

[2] These "adaptations" are explained in paragraph 4, *infra.*

[3] Separation of costs of regulated telephone service from costs of nonregulated activities, *Report and Order*, 2 FCC Rcd 1298 (1987) (*Joint Cost Order), modified on reconsideration*, 2 FCC Rcd 6283 (1987) (*Order on Reconsideration), modified on further reconsideration*, 3 FCC Rcd 6701 (1988) (Further Order on Reconsideration), *petitions for review pending*, Southwestern Bell Tel. Corp. v. FCC, D.C. Circuit No. 87-1764 (filed December 14, 1987); National Tel. Cooperative Ass'n v. FCC, D.C. Circuit No. 87-1771 (December 15, 1987).

[4] *See* Letter from William F. Werwaiss, Assistant Vice President, Southern New England Telephone, to Ms. Donna R. Searcy, Secretary, Federal Communications Commission, dated November 9, 1988.

[5] With regard to those revisions that SNET claims it cannot make retroactively, we reserve the right to require either retroactivity or subsequent adjustments to reflect the impact of the lack of retroactivity on 1988 operations.

[6] In its initial manual SNET listed "SNET Voice Messaging" and "SNET ConnNet Enhanced Services" as its two nonregulated activities. The revised manual lists "Enhanced Services Planning and Development" as a third nonregulated activity.

[7] *SNET Order,* 3 FCC Rcd at 2, para. 9, n. 12.

[8] *Id.* at paragraph 11.

[9] SNET Revised Manual at Section 4.4.

[10] *Id.* at Section 4.1.

[11] *Id.* at Section 6.

[12] *Id.* at Section 8.2.

[13] *Id.* at Exhibit 8-1.

[14] *Id.* at Section 8.5.

[15] *Id.* at Section 7-1 to 7.4-17.

[16] One copy will be made available in the Accounting and Audits Division reference room, while the other will be maintained for staff use.

[17] *See, e.g.* Pacific Bell's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 3 FCC Rcd 287 (1988).

[18] A stay of the effectiveness of a proposed change will not extend beyond 180 days.

[19] Of course, changes to corporate structure that also affect cost categories need to be filed in advance of implementation, as discussed *supra.*