

DT 01-212

VERIZON NEW HAMPSHIRE

**Petition for Approval of the Transfer of Advanced Services
Operations Back to Verizon New Hampshire and the Discontinuance
of Advanced Services by Verizon Advanced Data, Inc.**

Order Addressing Motion to Limit Scope of Issues

O R D E R N O. 24,018

July 26, 2002

I.

BACKGROUND

This docket arises out of a petition filed by Verizon New England, Inc., d/b/a Verizon New Hampshire ("Verizon NH") petition of October 24, 2001, requesting approval to reintegrate advanced service assets (assets) from Verizon Advanced Data, Inc., (VADI) to Verizon NH. The background of the docket is detailed in the New Hampshire Public Utilities Commission (Commission) Order No. 23,913 (February 4, 2002).

VADI was created pursuant to the Federal Communications Commission (FCC) approval of the merger of Bell Atlantic and GTE Corporation. As a result, the Commission provisionally granted by Order No. 23,570 (October 24, 2000) VADI's petition to operate as a Competitive Local Exchange Carrier (CLEC) in New Hampshire and Verizon NH's request to transfer assets to VADI.

The issues before the Commission are whether to return these assets to the incumbent provider, Verizon NH and, if so, at what value. Verizon NH argues that the return of these assets to it will result in operational efficiency while still maintaining

operational parity. One question that stems from the petition concerns the terms by which the assets will be returned. Pursuant to Order No. 23,570, the assets were transferred to VADI at the higher of net book or fair market value (FMV) pursuant to accepted affiliate-pricing concepts.¹ Currently there is a disagreement between Verizon NH, the Commission Staff and the Office of the Consumer Advocate (OCA) regarding the value at which the assets will be returned to Verizon NH.

Evidencing this dispute are the motions that have been filed by the OCA on February 22, 2002, and March 8, 2002, to compel answers to data requests. These motions request that Verizon NH provide certain information through the discovery process so that OCA can ascertain the value of the assets, which Verizon NH has estimated at \$5.1 million (net book value). In Verizon NH's Opposition to the February 22, 2002 motion, it states that the OCA's first set of data requests contained 25 out of 36 questions addressing asset valuation. See Verizon March 4, 2002, Opposition, at 2.

Verizon NH's position regarding discovery is that it provided fully responsive answers to the OCA. Verizon NH also asserts that the OCA and Staff have been provided all the essential information for each asset that is being transferred.

¹ When the assets were transferred from Verizon NH to VADI they were transferred at net book value. Order No. 23,570 reveals that Verizon NH estimated the intrastate assets to be transferred to VADI at a net book value of \$2,941,283.15. The affiliate-pricing concepts are also commonly referred to as the "asymmetric pricing rule". Also see, footnote 3.

Verizon NH contends that it is the OCA's responsibility to take the information and put it in any form it desires.

On March 13, 2002, since the discovery dispute was not resolved, Staff filed a motion to postpone the settlement conference and on May 13, 2002, filed a letter asking that the hearing set for May 14, 2002, be continued.

On May 15, 2002, Verizon NH and VADI (the joint petitioners) filed a motion to limit the scope of issues in this proceeding. Verizon NH argues that VADI is a regulated affiliate and thus the value of the assets should not be determined based on an application of the asymmetric pricing rules of 47 C.F.R. §32.27(c).

On May 28, 2002, the OCA submitted its Objection to the joint petitioners' Motion to Limit the Scope of Issues, and argued that the governing accounting standard for recording the transferred assets is found at 47 C.F.R. §32.27, and that the asymmetric pricing rule does apply.

On May 28, 2002, Staff submitted comments on the Motion to Limit Scope, and stated its position that the appropriate accounting standard is found in FCC rule at 47 C.F.R. §32.27.

Finally, on June 12, 2002, Verizon NH filed a brief reply to the OCA's May 28th Opposition.

II.

POSITION OF THE PARTIES

A. Verizon NH

Verizon NH maintains that the appropriate valuation for recording the transferred assets is net book value, and that the asymmetric pricing rule does not apply. In support of this position, Verizon NH states that the asset transfer is subject to the FCC's Part 32 and NH Code of Administrative Rules, Puc 406.03, the Uniform System of Accounts (USOA). They contend these rules govern the accounting treatment for telephone plant accounts, including plant acquisitions "from an entity, whether or not affiliated with the accounting company." Verizon NH maintains that these rules require that the acquired telephone assets from VADI be reflected on Verizon NH's books at net book value. They further argue that 47 C.F.R. §32.27 defines rules for asset transfers between regulated and non-regulated affiliates, including the asymmetric pricing rules. Verizon contends that the determination of whether the rule applies, depends on the proper characterization of VADI as either a "regulated" or an "unregulated" affiliate.

The joint petitioners argue that VADI is a regulated entity for the provision of jurisdictional advanced services, and subject to FCC Title II under the Communications Act and to the Commission for intrastate advanced services.

Verizon NH comments that it provided advanced service offerings in 31 states, and has received approval in 29 of those states for the reintegration of the VADI assets, 10 of which,

like New Hampshire, are Rate of Return regulated. Verizon NH further notes that

a Commission determination ...valuing the assets ... for accounting purposes does not necessarily compel the use of net book value for *ratemaking purposes*. Thus, the determination in this proceeding for recording the transferred assets for accounting purposes in no way constrains the Commission's evaluation of the assets for ratemaking purposes in any subsequent proceeding.²

B. Office of Consumer Advocate

The OCA maintains that the appropriate valuation for recording the transferred assets is provided in 47 C.F.R. §32.27 and should be the lower of net book or FMV, and that the application of the asymmetric pricing rule does apply.³ The OCA states it objects to Verizon NH's proposed accounting treatment at net book value because it encourages the use of regulated revenues to benefit competitive affiliates and that it is inconsistent with current Commission accounting practice and FCC regulation.

The OCA argues that VADI, approved by Order No. 23,570 as a CLEC, has filed abbreviated annual financial statements subject to NH Admin. Rules, Puc 1308 and informational tariffs

² See Motion of Verizon New Hampshire and Verizon Advanced Data Inc. May 15, 2002, at 5; footnote 9.

³ Section 32.27 Transactions with affiliates.

(a) Unless otherwise approved by the Chief, Common Carrier Bureau, transactions with affiliates involving asset transfers into or out of the regulated accounts shall be recorded by the carrier in its regulated accounts as provided in paragraph (b) through (f) of this section...

b) For all other assets sold by or transferred from a carrier to its affiliate, the assets shall be recorded at the higher of fair market value and net book costs. For all other assets purchased by or transferred to a carrier from its affiliate, the assets shall be recorded at the lower of fair market value and net book costs. For purposes of this section carriers are required to make a good faith determination of fair market value.

pursuant to NH Admin. Rules, Puc 1307.01(b). The OCA contends that tariffs filed under NH Admin. Rules, Puc 1307.01 are informational only and are not subject to either Commission review or approval. OCA further contends that CLECs are not required to file tariffs under NH Admin. Rules, Puc 1600 and have not been considered regulated by either NHPUC practice or FCC rule. In support, the OCA references FCC Section 32.23, Nonregulated Activities, and contends that, based on this definition, CLECs provision of services in the local telephone markets have been preemptively deregulated by federal statute and are therefore nonregulated for accounting purposes.

The OCA proposes the use of a proxy FMV for assets originally transferred from Verizon NH to VADI and subsequently-acquired assets by VADI. Specifically, the OCA proposes the following:

a) For assets transferred from Verizon NH to VADI in Order No. 23,570, the fair market value at the time of that transfer is known; having been provided by Verizon NH based on the Titus and Mitchell⁴ appraisal. A proxy fair market value for these assets can be obtained by reducing the Titus and Mitchell fair market value by depreciation (straight line basis) for the intervening period.

b) For the new assets acquired by VADI, the proxy fair market value is proposed as the asset purchase price depreciated (straight line basis) for the time intervening since the base asset was initially purchased.

⁴ VZ contracted with the firm of Titus and Mitchell to complete a FMV analysis in docket nos. DT 00-071 and DT 00-185.

C. Staff

Staff generally concurs and supports OCA's position. Staff further asserts that the appropriate accounting standard is found in the FCC asymmetric pricing rule. Staff, in its recommendation to the Commission, points to the FCC's 1987 *Affiliate Transaction Recon. Order*, 2FCC Rcd 1298 (1987). This Order affirmed the requirement that affiliate transaction rules apply to transfers between regulated and nonregulated accounts, as well as regulated and nonregulated affiliates. Staff contends that the FCC rules are applicable because, for the entirety of VADI's New Hampshire existence, it has been an affiliate of Verizon NH, and therefore falls within the purview of 47 C.F.R. §32.27.

III. COMMISSION ANALYSIS

As described in Verizon NH's petition, VADI is a subsidiary of VZ Ventures III, which, in turn, is a subsidiary of Verizon, Inc., the parent of Verizon NH. Pursuant to the provisions of RSA 366:1, II(d), VADI is an "affiliate" of Verizon NH, and therefore terms and conditions of the proposed sale of VADI's assets to Verizon NH are subject to the provisions of RSA Chapter 366. Accordingly, in this proceeding "the burden shall

be on the public utility and affiliate to prove the reasonableness of any such contract, arrangement, purchase, or sale," and the Commission may disapprove it in whole or in part, and the payments thereunder, if it is found to be "unjust or unreasonable." RSA 366:5.

The purpose of this proceeding, according to Verizon NH, is to make a seamless transition back to pre-FCC Merger Order operations. In order to make that transition possible, Verizon NH argues that the proper accounting treatment is found under the FCC's USOA (47 CFR Part 32), Section 32.2000. This rule governs telephone plant accounts, and expressly provides that all plant acquisitions "from an entity, whether or not affiliated with the accounting company, shall be accounted for at original cost."

OCA and Staff argue that special accounting rules apply to this situation and urge us to review the FCC's USOA (47 CFR Part 32), Section 32.27, the asymmetric pricing rules. Under the cost-of-service approach to ratemaking, establishing a rate base is a crucial factor in setting rates for service. We therefore agree with the OCA and Staff that we must scrutinize the value of the assets to be transferred.

The requested ruling seeks to determine the appropriate accounting treatment to be used for valuing the transfer of intrastate assets from VADI to Verizon NH. Verizon NH argues alternatively that a Commission determination on valuing the

assets at net book value for accounting purposes does not necessarily compel the use of net book value for ratemaking purposes. They also stipulate that the Commission approval of the Petition at net book value will be without prejudice to any determination the Commission may make in a ratemaking proceeding.

Based upon the arguments and evidence before us, we are not satisfied that the proposed transfer of assets at net book value complies with all applicable state statutes and rules and federal regulations. We find, nonetheless, that the immediate accounting treatment does not affect how these assets will be treated for rate making purposes, and determine that it will be more efficient to allow the asset transfer at net book value pending a later decision on the appropriate accounting treatment and governing rules in the context of the next rate proceeding. Therefore, based on the information and representations contained in Verizon NH's filing, we find that the proposed asset transfer to Verizon NH from VADI is not adverse to the public interest, and may be booked at net book value pending further review in a later rate proceeding, and we therefore approve it, subject to the conditions outlined below.

We instruct Verizon to provide a detailed analysis of the transfer including the depreciation rates and schedules applied by VADI to the assets in question, and a schedule of the assets utilizing Verizon NH's depreciation rates applicable to

those assets. In addition, Verizon NH shall provide a detailed asset-by-asset reconciliation of the assets transferred to and from VADI, and newly acquired VADI assets. We direct our staff to determine the format and details of this reconciliation.

Based upon the foregoing, it is hereby

ORDERED, that Verizon NH's request to limit the scope of the proceeding and allow the asset transfer with VADI at net book value is GRANTED; and it is

FURTHER ORDERED, that the proposed transfer of assets will be accomplished by the return to Verizon NH of all plant and equipment (including some supporting assets) which are currently dedicated to VADI's provision of intrastate advanced services, at net book value; and it is

FURTHER ORDERED, that Verizon NH shall provide to the Commission access to all books of account, as well as documents, data, and records of Verizon NH and VADI's affiliated interests that pertain to this transaction; and it is

FURTHER ORDERED, that Verizon NH shall provide a detailed analysis of the transfer including the depreciation rates and schedules applied by VADI to the assets in question and a schedule of the assets utilizing Verizon NH's depreciation rates applicable to those assets; and it is

FURTHER ORDERED, the Commission reserves the right to review for reasonableness all financial aspects of this

transaction in any future proceeding; and it is

FURTHER ORDERED, that Verizon NH shall file, as soon as possible, and no later than September 30, 2002, copies of the final journal entries recording this transaction; and it is

FURTHER ORDERED, that within 30 days of this Order, the Parties provide the Commission an updated procedural schedule, allowing time for the resolution of all outstanding issues; including Post Return Arrangements; Assignments of Customer Contracts; Issuance of Tariffs; Resale and Unbundling Obligations; and resolution of any impacts on Carrier to Carrier Performance standards.

By order of the Public Utilities Commission of New Hampshire this twenty-sixth day of July, 2002.

Thomas B. Getz
Chairman

Susan S. Geiger
Commissioner

Nancy Brockway
Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary