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

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In the Matter of	
Access Charge Reform	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1
Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers	CCB/CPD File No. 98-63
Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA	CC Docket No. 98-157

AT&T OPPOSITION TO PETITIONS FOR RECONSIDERATION

Pursuant to Section 1.429 of the Commission's Rules, 47 C.F.R. § 1.429, and its Public Notice, Report No. 2370, published in 64 Fed. Reg. 62204 (November 16, 1999), AT&T Corp. ("AT&T") opposes the petitions for reconsideration filed by Bell Atlantic, GTE and USTA of the Commission's Fifth Report and Order and Further Notice of Proposed Rulemaking, FCC 99-206, released August 27, 1999, in the above proceedings ("Fifth Report" and "FNPRM"). In the Fifth Report (¶ 162), the Commission granted incumbent local exchange carriers ("LECs") broad pricing flexibility and further concluded that the low-end adjustment mechanism of price cap regulation is eliminated once a price cap LEC qualifies for and chooses to exercise either the Phase I or Phase II pricing flexibility granted in that order.

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Bell Atlantic and GTE seek reconsideration, contending that the Commission may not condition the availability of pricing flexibility on the elimination of the low-end adjustment mechanism, which, in their view, is necessary to guard against the risk of confiscatory rates. These petitions border on the frivolous and should be rejected. Similarly, the Commission should reject USTA's attempt to obtain premature pricing flexibility for trunk ports associated with local and tandem switching.

I. THE COMMISSION PROPERLY DECIDED TO ELIMINATE THE LOW-END ADJUSTMENT FOR ANY PRICE CAP LEC THAT OBTAINS PHASE I OR PHASE II PRICING FLEXIBILITY.

The low-end adjustment mechanism of price cap regulation simply continues to reward inefficient LECs, permitting them to raise access charges in future years to make up for their alleged earnings shortfalls in the past. Accordingly, as AT&T had urged in its July 11, 1997 Petition for Reconsideration of the Commission's Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, released May 21, 1997, FCC 97-159 ("X-Factor Order"), the Commission should eliminate the low-end adjustment altogether, *irrespective* of whether a LEC seeks pricing flexibility. There is absolutely no basis for retaining it once a LEC takes advantage of pricing flexibility.

Indeed, the premise advanced by Bell Atlantic and GTE that a LEC could be exposed to "confiscation" based on its price capped services alone is wrong. The Constitution requires only that a regulated entity have a fair opportunity to secure a reasonable return on its overall investment. See Duquesne Light Co. v. Barasch, 488 U.S. 299, 310, 312-16 (1989); Federal Power Comm'n v. Texaco, 417 U.S. 380, 391

(1974); FPC v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). A taking, moreover, cannot be found unless a rate order produces overall rates so low as to "jeopardize the financial integrity of the [regulated] companies, either by leaving them insufficient operating capital or impeding their ability to raise future capital." Duquesne Light Co., 488 U.S. at 312; Federal Power Comm'n v. Texaco, 417 U.S. at 391-92; Hope Natural Gas, 320 U.S. at 607. With pricing flexibility, the LECs will have the opportunity to earn a reasonable profit both under price caps and outside of the price cap regime.

Thus, a confiscation claim could not legitimately be asserted by reference to "price capped" earnings alone. In any event, the low-end adjustment takes effect when a LEC's interstate rate-of-return falls below 10.25% – well above any risk of confiscation or basis for constitutional concern. There is no need for the Commission to guarantee an automatic low-end adjustment whenever a LEC's price cap return falls below a rate-of-return well in excess of its current cost-of-capital.[1]

Although, as Bell Atlantic and GTE explain, the Commission's rationale for retaining the low-end adjustment mechanism had been to "guard" individual LECs against the revised X-Factor producing "unreasonably low rates" (X-Factor Order, ¶ 11), the low-end adjustment is entirely unnecessary for that purpose. Bell Atlantic and GTE

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[1] See Responsive Submission of AT&T Corp. to Prescription Proceeding, Direct Case Submissions and Reply Comments to the Notice of Proposed Rulemaking, Prescribing the Authorized Unitary Rate-of-Return for Interstate Services of Local Exchange Carriers, CC Docket No. 98-166, filed March 16, 1999 (demonstrating that a rate-of-return of approximately 8.5% would be appropriate given current conditions).

fail to recognize that even without the low-end adjustment as part of the rules, the Commission still has the power to grant relief if a LEC is in dire financial circumstances. That is, in case adverse economic conditions ever truly threaten a LEC's ability to attract capital and provide adequate service, the LEC can request a waiver of the Commission's price cap rules, submit an "above-cap" filing[2] or request other special relief. To the extent that a LEC had an underrecovery claim, the Commission could easily address that concern with a waiver procedure that would permit a LEC to demonstrate, once the commercial consequences of the competitive regime became apparent, that it was not in fact permitted the opportunity to recover its prudently incurred investment expenses from all revenue sources. The FCC has adopted a similar waiver procedure in the Local Competition Order.[3] In short, there is simply no legitimate reason why LEC allegations of potential confiscation claims require the Commission to reinstate the low-end adjustment mechanism of price cap regulation for LECs taking advantage of pricing flexibility under the Fifth Report.

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[2] Although Bell Atlantic and GTE acknowledge that they could make an above cap filing, they protest that the standard is too stringent and therefore not an effective remedy. As explained above, there is no reason why an *automatic* low-end adjustment is required and the fact that it would be difficult to demonstrate the need for such an adjustment is not a matter of constitutional significance.

[3] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, 11 FCC Rcd. 15499, ¶ 739 ("Local Competition Order") ("incumbent LECs may seek relief from the Commission pricing methodology if the LEC provides specific information to show that the pricing methodology, as applied to them will result in confiscatory rates").

In fact, the Commission articulated sound reasons and was unequivocally correct in eliminating the low-end adjustment when a LEC seeks pricing flexibility. As the Commission explained,

> "We conclude that we should eliminate the low-end adjustment mechanism once price cap LECs qualify for and choose to exercise either the Phase I or Phase II pricing flexibility we grant in this Order. We agree with AT&T that the low-end adjustment mechanism tends to blunt efficiency incentives. We conclude that this effect will be exacerbated by removing contract tariff services from price cap regulation, so that retention of the mechanism would be unreasonable for price cap LECs obtaining pricing flexibility. The low-end adjustment mechanism can create undesirable incentives for price cap LECs when they move some demand for some services out of price cap regulation. The low-end adjustment is a rate-of-return-based mechanism, and it therefore recreates some of the incentives of rate-of-return regulation. . . . Earnings from non-price cap services are currently not considered part of 'total interstate earnings' for purposes of calculating low-end adjustments. As a result, price cap LECs must remove the costs of non-price cap services in order to calculate interstate earnings, and they have an incentive to underallocate those costs in order to minimize measured earnings. Currently, this underallocation incentive is not a serious concern, because non-price cap services represent a very small fraction of the price cap LECs' federally tariffed activities, and so the effects of any underallocation are minimal. Once a LEC has removed a significant amount of demand associated with contract tariff offers from price cap regulation, however, its incentive to underallocate the costs of non-price cap services and the effects of such underallocation will be greater." Fifth Report (¶ 163).

The fact is that the low-end adjustment has been abused in the past by various LECs through such devices as manipulating year-to-year rate-of-return levels.[4] Given the cost allocation issues identified by the Commission, allowing LECs that have taken advantage

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[4] See AT&T Comments at 40-41, filed in response to the Fourth Further Notice of Proposed Rulemaking, Price Cap Performance Review for Local Exchange Carriers, 10 FCC Rcd. 13659, 13679-80 (1995).

of pricing flexibility to obtain an automatic low-end adjustment would open the floodgates for abuse.

Finally, these carriers' petitions for reconsideration are, at best, disingenuous. In their comments in the proceedings leading up to the X-Factor Order, many LECs, including Bell Atlantic, agreed that there is no need for the Commission to retain the low-end adjustment. None mounted a serious defense of the low-end adjustment mechanism, and most LECs opposed it outright.[5] The only argument that any LEC made in favor of the low-end adjustment was a plea for symmetry, i.e., if the Commission were to keep the sharing requirements, it should also retain the low-end adjustment.[6] However, because the Commission has now eliminated sharing, that argument is no longer valid.

In sum, the X-Factor Order's lopsided regulatory scheme – which permits LECs to make low-end adjustments but does not require them to share excessive earnings – is untenable, and it should not be continued as part of the price cap regime. It safeguards the LECs to the detriment of consumers. Either the present rules allowing a low-end adjustment for those price cap LECs experiencing deficient rate-of-return levels should be eliminated, or the Commission should reevaluate its decision to remove the sharing obligations imposed on LECs earning at rate-of-return levels that are too high. There is

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[5] See, e.g., Bell Atlantic Comments at 2, 6-7 (low-end adjustment rewards inefficient companies); USTA Comments at 43; BellSouth Comments at 41; U S WEST Comments at 25; U S WEST Reply at 34. As recognized in Appendix B (¶ 77) to the X-Factor Order, a "number of LECs advocated eliminating the low-end adjustment mechanism as an unneeded vestige of rate-of-return regulation."

[6] See, e.g., Southwestern Bell Comments at 34-35; NYNEX Comments at 4 n.9.

certainly no basis for reinstating the low-end adjustment for LECs that have obtained pricing flexibility under the Fifth Report.

II. THE COMMISSION SHOULD DENY USTA'S REQUEST TO ASSIGN TANDEM AND LOCAL SWITCHING FLAT-RATED TRUNK PORTS TO SECTION 69.709.

USTA asks the Commission to assign flat-rated tandem trunk ports and flat-rated local switching trunk ports to Section 69.709 of the Commission's rules,[7] so as to allow the price cap LECs to craft their competitive showings pursuant to the Fifth Report. USTA's request should be denied because these trunk ports are associated with the local switch and tandem switch rather than dedicated transport, which has different thresholds for pricing flexibility than these switching-related components.

Trunk port costs are not dedicated facilities; they are costs associated with the local and tandem *switch*. Historically, these costs were recovered through per-minute local switching charges, tandem switching charges and the TIC. In the Access Reform Order, the Commission recognized that certain switching costs were non-traffic-sensitive and thus ordered that they be recovered on a flat-rated basis, i.e., as trunk ports.[8] Nonetheless, these trunk ports are and should remain assigned to traffic-sensitive and tandem-switched transport services under 47 C.F.R. 69.713.[9]

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[7] Fifth Report, Appendix B, 47 C.F.R. 69.709.

[8] Access Charge Reform, First Report and Order, 12 FCC Rcd. 15982, ¶¶ 123, 174 (1997).

[9] Fifth Report, Appendix B, 47 C.F.R. 69.713.

Phase I triggers are less stringent for services assigned to Section 69.709 than for those services assigned to Section. 69.713. In addition, most importantly, the common line, traffic-sensitive and tandem-switched transport services under Section 69.713 have not been afforded Phase II pricing flexibility and the Commission has sought industry comment regarding the matter in its FNPRM.[10]

Accordingly, the Commission should not reassign these flat-rated local switching and tandem switching trunk port elements to dedicated transport and special access services under C.F.R. 69.709. The local switching and tandem switching flat-rated trunk ports are clearly part of the traffic-sensitive and tandem-switched transport services under Section 69.713.

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[10] FNPRM, ¶ 200.

CONCLUSION

For the reasons stated above, the Commission should deny the petitions for reconsideration filed by Bell Atlantic, GTE and USTA.

Respectfully submitted,

AT&T CORP.

By /s/ Judy Sello

Mark C. Rosenblum
Judy Sello

Room 1135L2
295 North Maple Avenue
Basking Ridge, New Jersey 07920
(908) 221-8984

December 1, 1999

FROM AT&T LAW DEPT (WED) 12. 1'99 15:07/ST. 15:06/NO. 4862446112 P 3

CERTIFICATE OF SERVICE

I, Laura V. Nigro, do hereby certify that on this 1st day of December 1999, a copy of the foregoing "AT&T Opposition to Petitions for Reconsideration" was served by U.S. first class mail, postage prepaid, on the parties named on the attached Service List.

/s/ Laura V. Nigro
Laura V. Nigro

FROM AT&T LAW DEPT (WED) 12. 1'99 15:07/ST. 15:06/NO. 4862446112 P 4

SERVICE LIST

Mark L. Evans
Geoffrey M. Klineberg
Kellogg Huber Hansen Todd &
Evans, PLLC
Suite 1000 West
1301 K Street, NW
Washington, DC 20005
Counsel for Bell Atlantic
Telephone Companies

Edward D. Young, III
Michael E. Glover
Edward Shakin
Joseph DiBella
Bell Atlantic
1320 North Court House Rd., 8th Floor
Arlington, VA 22201

Gregory J. Vogt
Daniel J. Smith
Wiley, Rein & Fielding
1776 K Street, NW
Washington, DC 20006-2304
Counsel for GTE Service Corporation
and Identified Affiliates

Gail L. Polivy
GTE Service Corporation
1850 M Street, NW, Suite 1200
Washington, DC 20036

Thomas R. Parker
GTE Service Corporation
600 Hidden Ridge, MS HQ-E03J43
PO Box 152092
Irving, TX 75015-2092

Rodney L. Joyce
J. Thomas Nolan
Shook Hardy & Bacon, LLP
600 14th Street, NW, Suite 800
Washington, DC 20005-2004
Counsel for Network Access Solutions
Corp.

Lawrence E. Sargeant
Linda L. Kent
Keith Townsend
John W. Hunter
Julie E. Rones
United States Telephone Association
1401 H Street, NW, Suite 600
Washington, DC 20005