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November 15, 2000

**REDACTED – FOR PUBLIC INSPECTION**

Magalie Roman Salas  
Office of the Secretary  
Federal Communications Commission  
445 12th Street, SW  
Washington, D.C. 20554

Re: Joint Application by SBC et al for Provision of In-Region InterLATA  
Service in Kansas and Oklahoma  
CC Docket No. 00-217

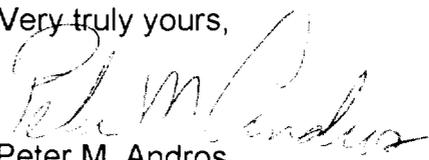
Dear Ms. Salas:

Enclosed for filing please find the Comments of AT&T Corp. In Opposition to SBC Inc.'s Section 271 Joint Application for Kansas and Oklahoma. Pursuant to the Public Notice issued October 26, 2000, AT&T is submitting the original and one (1) copy of its comments and supporting exhibits in redacted form.

AT&T is also submitting under seal the portions of supporting exhibits that contain material designated as confidential pursuant to the Protective Order in this matter. These pages bear a legend indicating that they are confidential.

Please let me know if any additional information is required. Thank you.

Very truly yours,

  
Peter M. Andros  
Legal Assistant

Encl.

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

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In the Matter of	)
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Joint Application by SBC Communications Inc.,	)
Southwestern Bell Telephone Company,	)
and Southwestern Bell Communications	)
Services, Inc. d/b/a Southwestern Bell Long	)
Distance for Authorization to Provide In-Region	)
InterLATA Services in Kansas and Oklahoma	)
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COMMENTS OF AT&T CORP. IN OPPOSITION  
TO SBC COMMUNICATION, INC.'S  
SECTION 271 JOINT APPLICATION FOR  
KANSAS AND OKLAHOMA

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Filed: November 15, 2000

ORIGINAL

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**FCC ORDERS CITED**

<b>SHORT CITE</b>	<b>FULL CITE</b>
<i>Ameritech Michigan Order</i>	Memorandum Opinion and Order, <i>Application of Ameritech Michigan Pursuant to Section 271 to Provide In-Region, InterLATA Services in Michigan</i> , 12 FCC Rcd. 20543 (1997).
<i>BA-New York Order</i>	Memorandum Opinion and Order, <i>Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York</i> , CC Dkt. No. 99-295, 15 FCC Rcd. 3953 (1999).
<i>Local Competition Order</i>	First Report and Order, <i>Implementation of the Local Competition Provisions of the Telecommunications Act of 1996</i> , 11 FCC Rcd. 15499 (1996), <i>aff'd in part and vacated in part by Iowa Utils. Bd. v. FCC</i> , 120 F.3d 753 (8th Cir. 1997), <i>aff'd in part and rev'd in part by AT&amp;T Corp. v. Iowa Utils. Bd.</i> , 119 S. Ct. 721 (1999).
<i>Texas 271 Order</i>	Memorandum Opinion and Order, <i>Application by SBC Communications Inc., et al Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Texas</i> , CC Dkt. No. 00-65, 1999 WL 870853 (rel. June 30, 2000)
<i>Universal Service Order</i>	Report and Order, <i>Federal-State Joint Board on Universal Service</i> , CC Dkt. No. 96-45, 12 FCC Rcd. 8776 (1997)

**MISCELLANEOUS PLEADINGS CITED**

ALJ Report	Amended Report and Recommendation of the Administrative Law Judge, <i>Application of Cox Oklahoma Telecom, Inc., for a Determination of the costs of, and Permanent Rates for the Unbundled Network Elements of Southwestern Bell Telephone Company</i> , Cause No. PUD 970000213 (June 30, 1998)
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<p>KCC Final Order</p>	<p>Final Order Establishing SWBT's Prices for Interconnection and UNEs, <i>In the Matter of the Joint Application of Sprint Communication Company, L.P., United Telephone Company of Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of South Central Kansas, and United Telephone Company of Southeastern Kansas for the Commission to Open a Generic Proceeding on Southwestern Bell Telephone Company's Rates for Interconnection, Unbundled Elements, Transport and Termination, and Resale</i>, Docket No. 97-SCCC-149-GIT (February 19, 1999)</p>
<p>KCC Inputs Order</p>	<p>Order Setting Inputs for Cost Studies, <i>In the Matter of the Joint Application of Sprint Communication Company, L.P., United Telephone Company of Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of South Central Kansas, and United Telephone Company of Southeastern Kansas for the Commission to Open a Generic Proceeding on Southwestern Bell Telephone Company's Rates for Interconnection, Unbundled Elements, Transport and Termination, and Resale</i>, Docket No. 97-SCCC-149-GIT (November 16, 1998)</p>
<p>KCC NRC Order</p>	<p>Order Regarding Non-Recurring Charges for Unbundled Network Elements, <i>In the Matter of the Joint Application of Sprint Communication Company, L.P., United Telephone Company of Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of South Central Kansas, and United Telephone Company of Southeastern Kansas for the Commission to Open a Generic Proceeding on Southwestern Bell Telephone Company's Rates for Interconnection, Unbundled Elements, Transport and Termination, and Resale</i>, Docket No. 97-SCCC-149-GIT (November 3, 2000)</p>
<p>KCC Recon. Order</p>	<p>Order on Reconsideration, <i>In the Matter of the Joint Application of Sprint Communication Company, L.P., United Telephone Company of Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of South Central Kansas, and United Telephone Company of Southeastern Kansas for the Commission to Open a Generic Proceeding on Southwestern Bell Telephone Company's Rates for Interconnection, Unbundled Elements, Transport and Termination, and Resale</i>, Docket No. 97-SCCC-149-GIT (September 1, 1999)</p>

VZ-MA DOJ Eval.	Evaluation of the United States Department of Justice, <i>Application by Verizon New England, Inc. et al for Authorization to Provide In-Region InterLATA Services in Massachusetts</i> , CC Dkt. No. 00-176 (October 27, 2000)
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Before the  
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In the Matter of )  
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Joint Application by SBC Communications Inc., )  
Southwestern Bell Telephone Company, ) CC Docket No. 00-217  
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Services, Inc. d/b/a Southwestern Bell Long )  
Distance for Authorization to Provide In-Region )  
InterLATA Services in Kansas and Oklahoma )  
)

**COMMENTS OF AT&T CORP.**

Pursuant to the Commission's Public Notice, AT&T Corp. respectfully submits these comments in opposition to SBC's joint application for long distance authority in Kansas and Oklahoma.

**INTRODUCTION AND SUMMARY**

Kansas and Oklahoma are two states in which there is no, or virtually no, use of unbundled network elements ("UNEs") to provide local services. Turner ¶¶ 8, 10. The reason is that, while Oklahoma and Kansas established very different rates for UNEs, each set some or all UNE rates at levels that are excessive under TELRIC and that jeopardize the profitable use of UNEs to offer exchange and exchange access services, particularly to residential customers.

Like Verizon's Massachusetts application, SBC's joint application for Kansas and Oklahoma thus raises the fundamental question that will determine the future course of local competition for residential customers. Will the Commission now disapprove long distance applications when, as here, the rates for unbundled network elements ("UNEs") do not satisfy TELRIC and do not provide sufficient margins to allow new entrants viably to offer local

services over the UNE-Platform (“UNE-P”)? Or will the Commission ignore its commitment in the *Ameritech Michigan Order* to independently review UNE rates, defer to whatever pricing determinations have been made by the state commissions, notwithstanding the plain language of the Commission’s TELRIC rules and the very purpose of the Act?

Indeed, SBC’s decision to file a joint application for Oklahoma and Kansas has starkly presented this fundamental choice for the Commission. Because Oklahoma and Kansas are each “predominantly rural States” (SBC Br. i) all parties have conceded that SBC’s economic costs of providing UNEs in the two states are virtually identical, and SBC and other CLECs submitted the same or virtually the same cost evidence to both the Oklahoma and the Kansas Commissions. Yet while each commission professed to be applying TELRIC, the two Commissions made radically different assumptions and reached radically different results. The Oklahoma Commission established recurring rates for the loop, switching, and port elements that squarely foreclose the economic use of UNE-P and that are from about 35% to more than 200% higher than the recurring rates that Kansas approved for these same elements. If Kansas had also established nonrecurring charges for new elements that satisfy TELRIC – as it unfortunately has not – the recurring rates in Kansas would appear themselves to provide sufficient margins for UNE-P based competition to develop.

The Commission thus patently cannot find that TELRIC was properly applied by both the Kansas and Oklahoma Commissions – at least, not if TELRIC retains any substantive meaning. And it is plain that the recurring and other UNE rates established by the Oklahoma Commission represent flagrant violations of TELRIC. For example, whereas the Kansas Commission attempted to examine and resolve each disputed recurring pricing issue with reference to TELRIC principles, the Oklahoma Commission did not. It upheld the decision of an

Administrative Law Judge that simply lifted rates from a settlement between SBC and a single CLEC (with its own agenda) and imposed those rates on all CLECs. These stipulated rates were supported by no cost study or other evidence that they are cost-based. The ALJ attempted to rationalize this decision on grounds that are flatly contrary to TELRIC. The ALJ relied on the fact that the approved rates fell between the rates that had been proposed by SBC (based almost exclusively on backward-looking input assumptions that violate TELRIC) and those proposed by AT&T (based on forward-looking assumptions). In this regard, the ALJ erroneously concluded that to set rates that reflected the efficient forward looking costs of providing network elements would impermissibly require SBC to provide “superior quality” interconnection. The net result of these errors is that Oklahoma’s recurring UNE rates violate TELRIC and foreclose competitive entry.

While the Kansas Commission did an exemplary job establishing recurring charges for UNEs, SBC was able to exploit the Kansas Commission’s processes to force the approval of permanent nonrecurring charges that are not only excessive but that violate both TELRIC and the Kansas Commission’s own prior orders. In particular, in prior proceedings, the Kansas Commission had reviewed SBC’s nonrecurring charges, identified a number of errors, and ordered SBC to submit new rates that corrected the errors and reduced the “overstated” rates accordingly. However, SBC thereupon submitted higher rates which, the Kansas Commission expressly found, did not correct the errors it had identified. But because the Kansas Commission had publicly committed to support SBC’s § 271 application and to have in place permanent non-recurring charges by a certain date, SBC had the Kansas Commission over a barrel. It thus accepted SBC’s proposals for many of its nonrecurring UNE charges and adopted a split the baby approach for others – without determining that any of the rates are cost-based. The net

result in Kansas is that, notwithstanding the existence of cost-based recurring charges, the nonrecurring charges violate TELRIC and jeopardize economic UNE-based entry.

Given these circumstances, if the Commission were to approve SBC's joint application for Oklahoma and Kansas, it would necessarily signal that TELRIC is now merely a label, without substantive meaning, that state commissions may affix to any pricing result they deem proper. As AT&T explained in its reply comments in opposition to Verizon's Massachusetts application, that would be the final repudiation of the Commission's *Local Competition* and *Ameritech Michigan* orders. It would also represent the Commission's abandonment of the jurisdiction that Congress gave it to advance compelling national interests, and that the Supreme Court upheld in *Iowa Utilities Board*. Such a decision would effectively put an end to the efforts of AT&T and others to pursue UNE-based entry in those states that are unable or unwilling scrupulously to enforce TELRIC. The reality is that the prospect of such entry depends on this Commission's commitment further to define and enforce its pricing rules, and to deny section 271 authority to BOCs whose UNE rates do not satisfy TELRIC and do not allow competition to develop.

Conversely, by denying the joint application, the Commission would confirm that TELRIC is not merely an empty acronym, but a set of concrete pricing rules with which BOC UNE rates must comply. And if the Commission were to reaffirm the commitments it made in the *Local Competition* and *Ameritech Michigan* orders and reiterate that TELRIC requires similar rates in locales having similar cost characteristics, the result would be a renewed and broadened commitment by CLECs to pursuing local residential entry through UNEs that alone today can provide ubiquitous alternatives to the LECs' exchange and exchange access services. The reality is that the economics of UNE-based entry depend just as critically on the existence of

rates that precisely reflect the economic costs that the incumbent LEC in fact incurs when it uses the facilities as it does on the availability of nondiscriminatory access to OSS. Even the most advanced and reliable OSS will do nothing to promote CLEC entry if entry remains unprofitable. Because even seemingly small deviations from TELRIC can cripple the use of UNEs as competitive entry vehicles, the strict enforcement of TELRIC by a committed expert body is essential if this entry is to occur and to be effective.

The remainder of these comments is divided into three parts. Part I describes why neither the Oklahoma nor the Kansas rates comport with TELRIC. It demonstrates that the recurring UNE rates that were approved in Oklahoma rest on grounds that conflict sharply with TELRIC principles, and that were themselves rejected by the Kansas Commission when it confronted the same issues. Because of the nature of the conflicting assumptions that underlie each state commission's rate decisions, AT&T will also demonstrate why it is impossible for this Commission to defer to the rates set by each state commission – unless TELRIC is stripped of any substantive meaning. Part I further demonstrates that SBC's nonrecurring charges in Kansas violate TELRIC and were nominally "approved" only as a result of a ploy by SBC.

In Part II, AT&T demonstrates that SBC still refuses to provide CLECs with the practical ability to interconnect at any technically feasible point, including – if a CLEC so chooses – at a single point within each LATA. Although SBC nominally has changed its policy to permit CLECs to establish a single point of interconnection ("POI"), SBC still denies CLECs the practical benefits of such an arrangement by imposing transport charges on all traffic on SBC's side of the POI while simultaneously refusing to compensate CLECs for the use of CLEC facilities for traffic originating from SBC's own customers. SBC's unlawful interconnection policies defeat the essential purpose of the statutory right to interconnection at any technically

feasible point – which is to relieve CLECs of having to bear the burden of transporting traffic to less efficient points of interconnection within the incumbent LEC’s network. And by imposing intrastate access charges on calls within a local calling area, SBC’s policies also deny CLECs the right to just and reasonable reciprocal compensation arrangements in accordance with section 252 and checklist item (xiii).

Finally, Part III reiterates a point that was also made in AT&T’s reply comments in opposition to Verizon’s Massachusetts application: that effective UNE competition simply will not develop unless the Commission rejects the instant application and adheres stringently to the commitments it made in the *Local Competition* and *Ameritech Michigan* orders. In this regard, the Commission need not await the filing of § 271 applications to begin taking an active role in assuring that UNE prices in fact satisfy TELRIC. As it committed to do in 1996, the Commission can readily – and should – use its rulemaking and declaratory ruling authority to specify the requirements of TELRIC in further detail and to prescribe how it should and should not apply in particular circumstances. If the Commission does so, federal district court review of state decisions can achieve its intended function, and it will be an easy matter for BOCs to develop rates that satisfy the Act and for the Commission to conduct the required review of UNE rates during the statutory 90-day period in future § 271 proceedings. By contrast, if the Commission fails vigorously to enforce TELRIC in § 271 and other proceedings, BOCs will continue to capitalize on the perceived failure of the Commission to adhere to these commitments, and any hope of broad-based local residential entry in the foreseeable future will evaporate. In sum, unless the Commission now acts decisively to enforce its pricing rules, it will simply be assuring the failure of the 1996 Act.

**I. THE KANSAS AND OKLAHOMA UNE RATES DO NOT COMPLY WITH TELRIC.**

The joint application may be approved only if SBC proves that the UNE rates set in both Kansas and Oklahoma each comport with TELRIC. As is now typical with BOC 271 applications, SBC makes only a token effort to carry its burden of proof on this point. SBC merely asserts, without meaningful analysis, that its originally submitted cost-model complied with TELRIC, and that the prices that each state Commission adopted are necessarily TELRIC-compliant because they are lower than SBC's proposals. In particular, SBC offers no rebuttal to the findings of the Kansas commission that SBC's cost-model and proposed rates conflicted with TELRIC. SBC's lack of analysis is itself reason to reject the application.

It is also plain, however, that SBC's assertions are baseless. The cost studies that it submitted in Oklahoma and Kansas were virtually identical, and each pervasively relied on backward looking inputs that violate TELRIC and that would produce wildly inflated rates for both recurring and non-recurring charges. It is similarly plain that the recurring and other UNE rates in Oklahoma and the nonrecurring charges in Kansas violate TELRIC. Indeed, both points are starkly confirmed by the findings of the Kansas Commission which explained why SBC's cost studies violate TELRIC and why the specific rates in question are contrary to TELRIC.

First, although the costs of service in the two states are conceded to be virtually identical, the recurring loop, switching, port, and other charges in Oklahoma are from 35% to 200% higher than those in Kansas. Indeed, Oklahoma's recurring charges alone are so far above the rates that use of TELRIC would produce that they themselves preclude any profitable use of UNE-P to offer residential service in that state. Oklahoma's excessive and unlawful recurring charges reflect the simple reality that, in contrast to the Kansas Commission, the Oklahoma Commission did not apply TELRIC. Rather, it approved its rates through highly irregular procedures and

sought to justify them on grounds that violate TELRIC and that were properly rejected by the Kansas commission. Because it is plain that Oklahoma and Kansas did not apply the same substantive standards, the Commission could not conclude that both states applied TELRIC without robbing this pricing standard of all meaning.

Second, with respect to non-recurring rates, the Kansas Commission frankly conceded that the SBC proposals it used in calculating nonrecurring charges violated core TELRIC principles. But because of the Kansas Commission's public commitment to support SBC's section 271 application, it approved nonrecurring charges that violate TELRIC.

**A. SBC's Oklahoma Recurring UNE Rates Do Not Comply With TELRIC.**

SBC's Oklahoma UNE rates plainly are not TELRIC-compliant. The Oklahoma Commission failed to follow TELRIC principles in setting the rates. Instead, it chose to adopt rates agreed to by a single CLEC, and then justified that decision after the fact by observing that the negotiated rates fell between those proposed originally by SBC and AT&T.

The Kansas Commission, by contrast, rejected SBC's proposed rates, and attempted independently to set rates based on TELRIC principles. As a result of these different methodologies, the Oklahoma rates are in some cases *more* than twice the Kansas rates (*e.g.*, local switching). Given the recognition by all parties that the relevant costs for the two states are about the same, at least one conclusion is inescapable: If TELRIC is more than just an empty term, then the Kansas and Oklahoma recurring UNE rates cannot *both* be consistent with TELRIC. The record leaves no doubt that the errant state is Oklahoma.

**1. SBC's Original Cost-Model Was Not Forward-Looking.**

Although SBC asserts that the UNE prices it originally proposed were based on forward-looking costs, it makes no effort to support that assertion, and it is plainly false. From a TELRIC perspective, SBC's original cost-model was rife with obvious methodological errors. For

example, SBC's cost-model was based not on the costs of an efficient, forward-looking network, but on the costs of SBC's embedded network architecture, technologies, processes, and costs. *See* Baranowski/Flappan ¶¶ 35-63. Thus, in setting a host of crucial inputs, such as the fill factor for loops and transport, depreciation rates, switch discounts, common costs, and the extent to which CLEC orders would be manually or electronically processed, SBC ignored the guiding TELRIC principle that rates should be based upon the technologies and processes that an efficient, cost-minimizing provider would deploy today. *See id.*

These errors were common to both the Oklahoma and the Kansas cost-models. Indeed, SBC used the same cost model in Oklahoma and Kansas, and, not surprisingly, given the two states' similar characteristics, estimated similar network element costs in Oklahoma and Kansas. *See* Baranowski/Flappan ¶¶ 16, 69. Notably, original *Local Competition Order* and National Exchange Carrier Association Data likewise estimate very similar costs for the two states and, indeed, lower costs in Oklahoma. *See, e.g., Local Competition Order* ¶ 690-93; *and see* Lieberman Exhibit 2; *KCC NRC Order* at 2 (recognizing that “[p]rices should be similar for similarly defined elements, especially for those cost elements that use common resources within the five SWBT states”). Indeed, given the similarity in the cost estimates, it is particularly ironic that, in a number of instances, SBC's proposed rates for Kansas actually exceeded those for Oklahoma, suggesting that, at least in SBC's view, to the extent TELRIC mandated any difference between Oklahoma and Kansas rates, the Oklahoma rates should be lower. Baranowski/Flappan ¶¶ 16, 69.

Of course, that is not what happened. The Oklahoma recurring rates are far higher than those set in Kansas. *Id.* ¶ 20, Attachment and Table 2. The Kansas and Oklahoma Commissions adopted dramatically different rate-setting methodologies, with the Kansas Commission rejecting

SBC's cost-model as inconsistent with TELRIC. *Id.* ¶¶ 36-63. In the face of this rejection, and the overwhelming evidence of methodological errors in SBC's original cost-model, SBC's failure to mount any defense here of that model, combined with the absence of any such defense by the Oklahoma Commission, necessarily means that SBC has not shown and cannot show that its original cost-model complies with TELRIC.

## **2. Oklahoma's Unsupported, Negotiated Rates Violates TELRIC.**

The only remaining question is whether the rates adopted in Oklahoma can be defended on any ground other than that they are lower than SBC's proposed rate. They cannot. Indeed, the only arguments that the Oklahoma ALJ put forth in support of the negotiated rates that Oklahoma adopted were that they were lower than SBC's proposed rates, and that AT&T's proposals were inconsistent with SBC's current, embedded costs and processes. Neither rationale provides a valid basis for approving these rates. Baranowski/Flappan ¶¶ 13, 39.

For the most part, the Oklahoma rates were defended below as TELRIC compliant because they were lower than the original rates that SBC proposed. SBC's proposed rates were thus presumed to be consistent with TELRIC, and used as a benchmark to defend the unsupported, negotiated rates that the Oklahoma Commission ultimately did adopt.

As explained in a report issued by an ALJ, and affirmed without modification by the Oklahoma Commission, the UNE rates that the Oklahoma Commission imposed upon all CLECs were in fact the rates agreed to in a stipulation by one cable-based CLEC, Cox Communications, and the Oklahoma Commission Staff, and not opposed by SBC. Cox's entry strategy depended extensively on use of its cable facilities, and it is clear that, as a cable-based CLEC, Cox would have no incentive to negotiate low rates for elements, such as loops, that it would not use and that could benefit only its competitors. Despite the fact that Cox's needs for access to unbundled network elements were not representative of CLECs' needs more generally, the Oklahoma

Commission denied AT&T's request for discovery as to how the stipulated rates were set. In fact, these rates were adopted even though no supporting cost study or analysis was ever placed in the record. Thus, even the consulting firm hired by the Staff could not support the agreed-to rates as cost-based, prompting the Staff's counsel to seek to take the extraordinary step of moving to exclude the pre-filed testimony of the Staff's own witness. *See ALJ Report* at 157.

In short, the stipulated rates are nothing more than what one party (with its own unique agenda and entry strategy) was willing to accept, and there is absolutely no basis to conclude that they meet the requirements of the Act and the Commission's pricing rules. Although Cox was certainly free to agree to network element rates that exceed forward-looking costs, *see* 47 U.S.C. § 252(a)(1) ("an incumbent local exchange carrier may negotiate and enter into a binding agreement with the requesting telecommunications carrier or carriers without regard to the standards set forth" in the Act), the OCC imposed Cox's compromise on *all* new entrants, including those with very different entry strategies that require all elements to be appropriately cost-based. And it did so without any rationale that can plausibly be defended as consistent with TELRIC.

In defending the decision to impose the rates that Cox agreed to upon all CLECs, the ALJ – lacking any cost-study – relied instead on the fact that these negotiated rates appeared to split the difference between the rates that SBC and AT&T had each proposed as consistent with TELRIC. In so holding, the ALJ analogized his function to that of a jury assessing damages in a civil case:

The Commission, similar to the responsibility of a jury in a civil case, has the discretion to adopt a position in the "middle" of that which is proposed by the parties. When a jury elects to award damages "in the middle" of what has been proposed by either side, the jury's decision will not be thrown out by the court simply

because of this. *See, e.g., Allen v. City of Tulsa*, 345 P.2d 443, 447 (Okla. 1959).

*ALJ Report* at 159. The ALJ returned to this theme throughout the balance of his report. For example, in explaining why a number of AT&T's objections to the rates for unbundled loops should be rejected, the ALJ explained:

The ALJ has read the testimony, sifted through the contentions and reviewed the various cost proposals in the record. Future [sic] delineation of each individual disagreement would burden the record unnecessarily (except as discussed with some cost characteristics below). Suffice it to say, it is the ALJ's opinion that all of the cost proposals are within the range of the rate stipulation and therefore the rates are reasonable.

*Id.* at 162. The ALJ echoed the point in rejecting AT&T's proposals with respect to local switching rates, labor rates, and depreciation lives. *See id.* at 163, 166, 167.

Such an approach cannot be reconciled with the Commission's TELRIC rules. While it is no doubt true that juries in Oklahoma have considerable latitude in awarding civil damages, splitting the difference between SBC's and AT&T's rates is not and cannot be a permissible rationale for adopting factually unsupported, negotiated rates. That is true for several independent reasons.

*First*, the ALJ's approach presupposes that the upper boundary of the rates, which were the rates SBC proposed, were themselves TELRIC rates. But as noted above, the assumption is entirely unfounded. SBC's rates were not, in fact, TELRIC-compliant. As a result, they could not properly serve as an upper bound on the setting of TELRIC rates.

*Second*, inherent in the very nature of a "split-the-difference" methodology is a refusal to grapple with the principles that underlie the parties' respective positions. The point is simple. If one party's proposal for a given rate element conformed to TELRIC principles, then TELRIC requires the adoption of that proposal. Conversely, if that proposal is not adopted, then reasoned

decision making requires an explanation of why the proposal was not, in fact, consistent with TELRIC. Either way, there is no room in reasoned decision making for simply avoiding the substance of the issues by simple compromise. For that reason, courts have repeatedly held that agency decision making based on a split-the-difference rationale is arbitrary and capricious. As Judge Posner explained in *Schurz Communications, Inc. v. FCC*, a decision is arbitrary and capricious when:

[k]ey concepts are left unexplained, key evidence is overlooked, . . . contradictions within and among Commission decisions are passed over in silence [and] [t]he possibility of resolving a conflict in favor of the party with the stronger case, as *distinct from throwing up one's hand and splitting the difference*, was overlooked.

982 F.2d 1043, 1050 (7th Cir. 1992) (emphasis added). Similarly, in *Public Utilities Comm'n of California v. FERC*, 894 F.2d 1372, 1383 (D.C. Cir. 1990), the court made clear that an agency cannot satisfy its obligation to engage in reasoned decision making by simply engaging in “baby-splitting.” See also *United States Tel. Ass'n v. FCC*, 188 F.3d 521, 536 (D.C. Cir. 1999) (reversing and remanding FCC’s choice of a 6% “X-factor” because FCC failed to state a reasonable basis for selecting that particular number).

*Third*, and perhaps most notably for this application, the ALJ’s endorsement of the SBC-proposed rates as TELRIC is irreconcilable with the holding of the Kansas Commission that rejected the SBC-proposed rates as inconsistent with TELRIC. The Kansas Commission did not find or even imply that SBC’s rates set a permissible “upper boundary” for TELRIC. To the contrary, on element after element, the Kansas Commission rejected SBC’s proposed rates and assumptions as inconsistent with TELRIC, and instead endorsed the assumptions and adopted the rates proposed by CLECs. Baranowski/Flappan ¶¶ 36-63. If the Kansas Commission applied TELRIC, then the Oklahoma Commission did not.

For example, with respect to loop costs, the Kansas Commission agreed with AT&T that, in an efficient, forward-looking network, no more than half the carrier's available loop capacity would be idle. The Kansas Commission rejected SBC's proposed use of historic fill factors, finding that "future utilization of the facilities should be considered" and that a "fill factor reflecting increased utilization over time is reasonable." *KCC Inputs Order* at A-27. The Kansas Commission therefore set a distribution "fill" factor of 53%. *Id.*; and see *Baranowski/Flappan* at ¶ 42. The setting of this factor is enormously important to loop costs, because, as even the Oklahoma ALJ recognized, "the single most influential input to loop investment" is the "fill" percentage. *ALJ Report* at 161.

Nevertheless, the Oklahoma ALJ rejected AT&T's proposed distribution fill factor, even though AT&T's proposal (50% fill) was virtually the same as that adopted in Kansas. Instead, the ALJ endorsed SBC's proposed 30% fill factor – which was based on the very historic data that the Kansas Commission rejected, and that effectively assumes that more than 2/3 of the loop capacity is idle – and did so precisely because a 30% fill factor reflected SBC's "actual, current" usage of loop capacity. The ALJ then further explained his preference for SBC's use of its historic, monopoly-market fill level by observing that "[a] reflection of fill well beyond what is currently available and used by SWBT to provide retail services essentially asks SWBT to provide superior quality facilities to AT&T," and noting that the Act does not require SBC to provide "some superior quality network." *ALJ Report* at 161.

The ALJ's explanation constitutes a blatant methodological error of the type described by this Commission in the *Ameritech Michigan Order* and the *BA-New York Order* as requiring independent scrutiny and reversal. The superior quality rules, of course, are entirely irrelevant to the forward-looking rate requirement, which demands that SBC *price* its existing network at

efficient rates. Indeed, the Commission’s TELRIC rules preclude the very methodology the ALJ endorsed here, which is the setting of UNE rates based on incumbents’ “embedded costs,” which are typically reflected in the costs associated with its “existing network design and technology.” *Local Competition Order* ¶¶ 620, 684. Rather, because TELRIC is a long-run, forward-looking cost methodology, which attempts to derive the rates that a competitive (rather than monopoly) market would produce, TELRIC rates must be based “on the use of the most efficient telecommunications technology currently available and the lowest cost network configuration” – regardless of whether the incumbent’s network currently features such technology or such a configuration. 47 C.F.R. § 51.505(b)<sup>1</sup>. In short, by criticizing AT&T for proposing a fill factor based on the use of more efficient technology and a superior network design to that which SBC then had, the ALJ effectively rejected AT&T’s proposed fill factor *because* it comported with TELRIC. Such an error alone precludes a finding that the Oklahoma UNE rates comply with TELRIC.

Similarly, with respect to the fill factor for dedicated transport, the KCC again rejected use of a factor based on past usage, finding that a factor reflecting a level of usage that engineers designed the network to achieve “better reflects forward-looking conditions . . .” *KCC Inputs Order* at A-88 – 89. Conversely, the Oklahoma ALJ again endorsed SBC’s reliance on a factor based on past usage. *ALJ Report* at 165.

A third example is the assessment of depreciation rates. SBC proposed, and the Oklahoma ALJ effectively endorsed, the setting of depreciation rates based upon the equipment lives that SBC uses for financial accounting purposes. *ALJ Report* at 167 (“depreciation lives is

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<sup>1</sup> The Commission has made clear that networks under TELRIC are to be sized to meet “current demand” which includes only the amount of excess capacity needed to meet short term growth.

of relevance and material but given the ranges, is amply addressed within the stipulation results which reduce recurring costs (where the cap cost is applied) considerably”). But as the Kansas Commission, like most state commissions, found, these accounting equipment lives are irrelevant to the setting of forward-looking depreciation rates. Thus, the Kansas Commission rejected SBC’s use of the equipment lives used for financial reporting, instead adopting “the FCC-authorized (and state-approved) SWBT depreciation rates for Kansas . . . [which] reflect forward-looking considerations . . . “ *KCC Inputs Order* at A-43 – 44.

Fourth, the KCC also reached strikingly different conclusions from the Oklahoma ALJ concerning the use of manual processes in connection with the calculation of non-recurring charges. According to the Kansas Commission: “NRCs should not be based on inefficient manual processing systems” which are “not consistent with TELRIC principles requiring forward looking least cost methods.” *KCC Recon. Order* at 28. The Kansas Commission thus ordered SBC to set UNE non-recurring charges based on the assumption that in the long run, an efficient, forward looking network would handle orders with electronic processing. That, of course, is precisely what SBC’s Application contends it is doing through its Operations Support Systems.<sup>2</sup>

By contrast, the Oklahoma ALJ rejected AT&T’s proposals for setting non-recurring UNE rates based on the assumption that, in the long run, UNE ordering and provisioning would be accomplished electronically. According to the ALJ, “the electronic handling assumption, along with the associated estimates of time, flow thru, etc., . . . are at this point speculative. SWBT identified that manual activity would be needed for all UNE service orders submitted *at*

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Tenth Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No.96-45, 14 FCC Rcd. 20156 (1999) ¶¶ 189-90; ¶¶ 200-203

<sup>2</sup> SBC has not yet complied with this Order. See Part I.B, *infra*.

*the present time.*” *ALJ Report* at 165 (emphasis added). Thus, once again, the ALJ built in the costs of the inefficient technology that SBC currently uses, rather than the costs of the more efficient technology that would be used by an efficient firm in a competitive market, to set UNE rates. Once again, the ALJ rejected the AT&T proposal *because* it relied on long-run, forward-looking costs, rather than on the current costs that the inefficient incumbent monopolist now faces.

In short, on all of these issues, and on numerous others, the Kansas Commission attempted to follow the Commission’s pricing rules. The Oklahoma Commission did not. The methodological divergence between the two Commissions therefore could not be more stark. For this reason as well, this Commission cannot reasonably hold that both of these Commissions adopted TELRIC. Such a holding would be tantamount to holding that any approach to setting rates is TELRIC, at least so long as the state commission so labels it. Unless the Commission is prepared formally to rescind not only its commitment to enforce its TELRIC pricing rules in section 271 proceedings, but the TELRIC rules themselves, it cannot approve this joint application.

Finally, the accompanying declaration of Michael Lieberman provides still further confirmation that the Oklahoma recurring rates exceed any level of rates that could be found to comply with TELRIC. As Mr. Lieberman demonstrates, the conditions necessary to support local residential entry using the UNE-platform do not exist in Oklahoma, because SBC’s Oklahoma recurring UNE rates are far too high to support mass-market UNE offerings. Lieberman ¶ 19 (concluding that state-wide UNE-P offering is likely to have a negative profit margin). Even taking full account for all the revenues and benefits from being a local service provider, Mr. Lieberman’s analysis confirms that AT&T (or any other entrant) would lose

money if it were to make a state-wide offer of local residential service based on use of the UNE-platform. *Id.*

**B. The Kansas Non-Recurring UNE Rates Do Not Comply With TELRIC.**

Although the Kansas Commission rigorously attempted to set recurring charges in accordance with TELRIC principles, it did not complete its task with respect to non-recurring charges. This failure is significant. As the Commission has long recognized, regardless of how closely an incumbent LEC's recurring charges are held to efficient forward-looking costs, an incumbent LEC can and will evade competition if it is allowed to increase potential competitors' costs significantly through non-cost-based non-recurring charges. *See, e.g., AT&T Communications*, 103 FCC 2d 77, ¶37 (1985) ("It is evident that nonrecurring charges can be used as an anticompetitive weapon to . . . discourage competitors"); *Expanded Interconnection with Local Telephone Company Facilities*, 8 FCC Rcd. 7341, 7360 (1993) ("absent even-handed treatment, nonrecurring reconfiguration charges could constitute a serious barrier to competitive entry"). *See also* 47 CFR § 51.507(e) ("[n]onrecurring charges . . . shall not permit an incumbent LEC to recover more than the total forward-looking economic cost of providing the applicable element").

The KCC generally applied forward-looking TELRIC principles in establishing the recurring charges for SBC's network elements. With few exceptions, the KCC identified the many TELRIC violations in SBC's recurring rate proposals, insisted that SBC adjust its rates to correct for those violations, and refused to approve the rates until SBC had done so. *See Baranowski/Flappan* ¶ 19.

Unfortunately, the KCC's resolve faltered with respect to the equally important non-recurring charges for those same elements. The KCC again fully recognized that SBC's

proposals – which, among other things, assumed manual processing 100 percent of the time, thereby inflating costs by twenty times or more – flatly violated basic forward-looking principles, and it ordered SBC to modify its studies in a number of very specific ways to correct for the most obvious errors. The KCC ordered SBC to “rerun NRC studies” and to “use a fall out rate of 5%,” to “assume electronic processing,” and to “assume a 100% Dedicated Inside Plant (DIP) and an 80% Dedicated Outside Plant (DOP) factor.” *KCC Recon. Order* at 27. *See also id.* (noting that “both SWBT and AT&T seem to acknowledge” that a “1-2% fall out rate” is achievable in the long run); *id.* at 28 (“Staff and AT&T have persuasively argued that charges for NRCs should not be based on inefficient manual processing systems”); *id.* at 26-28 (“electronic processing is a reasonable assumption for calculation of non-recurring costs, which is consistent and arguably required under the TELRIC costing principles which this Commission and the FCC have adopted”). Indeed, SBC’s Joint Application claims that its OSS achieve these levels of electronic processing.

Nonetheless, SBC proceeded to ignore the KCC’s order, and refiled its NRC studies with most of the very same errors, including, for many NRCs, the same erroneous 100 percent manual processing assumption. The KCC was understandably troubled by this insubordination. *See KCC NRC Order* at 13 (“Staff notes that in spite of direct language in Commission orders, SWBT submitted a cost study based on fully manual processes”); *id.* at 27 (“The Commission specifically directed SWBT to use a fall out rate of 5 percent”). Incredibly, given the finding in the KCC’s Reconsideration Order finding that the resubmission of cost studies was necessary because SBC’s original proposals were “overstated,” the prices set forth “in SWBT’s re-submitted cost study are significantly *higher* than the prices submitted in SWBT’s original cost studies.” *Id.* at 41 (emphasis added). *See also id.* at 41-42 (“No explanation has been provided

explaining why a re-submitted cost study could have caused a doubling, tripling or even quadrupling of the UNE prices”).

The KCC acknowledged that SBC’s refusal to comply with the KCC’s orders (and TELRIC principles) with regard to non-recurring charges has important implications for its section 271 application: “the [KCC] agreed to support SWBT’s [section 271] application premised, in part, on the expectation that final permanent prices for UNEs, including the non-recurring charge component, would be in place and available to CLECs.” *KCC NRC Order* at 24. Rather than adopt what it admitted was a “practical choice[.]” in the circumstances – “to continue the proceeding until all unbundled network elements needed by CLECs are available with prices supported by accurate and Commission-approved cost data,” *id.*, however, the KCC put the 271 cart before the local competition horse. Frankly acknowledging that it was doing so because it had “agreed to support SWBT’s application before the FCC for InterLATA authority under Section 271,” *id.* at 4, the KCC approved some of SBC’s original “overstated” NRC proposals “as is” and used the original SBC proposals to calculate rates for most of the remaining NRCs, through an entirely arbitrary one third/two thirds weighting of the SBC and AT&T proposals.

The resulting non-recurring charges far exceed forward-looking costs. Because of SBC’s clearly erroneous manual processing, fallout and DIP/DOP assumptions, SBC’s rate proposals were many times higher than AT&T’s TELRIC-based proposals, and thus even weighting SBC’s study at 1/3 had the effect of more than doubling the resulting rates above cost-based levels. *See Baranowski/Flappan ¶¶ 79-81.*

This is obvious when the Kansas NRCs are compared to SBC’s NRCs in Texas where the Commission largely rejected SBC’s unlawful NRC proposals. As the KCC recognized, “NRCs

should not be expected to vary significantly across SWBT's jurisdictions because the activities associated with the NRCs are expected to be very similar across these jurisdictions." *KCC Recon. Order* at 26. *See also KCC Final Order* at 32 ("variances between Kansas [NRC] prices and other states should be limited").

The differences in the NRC rates between the two SBC states are enormous. For example, if a Kansas customer ordering local service for the first time at a new address chooses a new entrant's local service, the new entrant must pay 50% more in non-recurring charges alone in Kansas than in Texas,<sup>3</sup> notwithstanding the KCC's recognition that "[p]rices should be similar for similarly defined elements, especially for those cost elements that use common resources with the five SWBT states: Texas, Missouri, Arkansas, Oklahoma and Kansas." *KCC NRC Order* at 2. In Texas, the loop NRC is uniformly \$15; in Kansas, the same NRC is over \$30. The NRC for a basic analog loop to port cross-connect is \$4.72 in Texas, but over \$26 in Kansas. Again and again, the Kansas NRCs are two, three or four or more times higher than the NRCs for the same elements in Texas. *See Baranowski/Flappan* ¶¶ 79-81.

**C. The Evidence Of Insufficient Margins Is Evidence Of Violations Of the Checklist And the Public Interest Alike.**

In this regard, evidence that profitable UNE-based entry is impossible – even after considering all possible revenue sources – is highly relevant to decision on a § 271 application. It is both evidence that the UNE rates in a state do not satisfy the checklist and a critical factor in the Commission's separate determination whether grant of the application is consistent with the public interest.

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<sup>3</sup> *Baranowski/Flappan* ¶¶ 22.

First, computed forward-looking costs are, by definition, the costs that SBC incurs in providing the elements of its network to its own retail arm (which then incurs additional retailing and related costs in using the elements to offer exchange, exchange access, and other services). *Local Competition*, ¶ 679. SBC recovers its network and retailing costs from a variety of sources, including retail local service charges, vertical features charges, intrastate and interstate access charges and subsidies. And there can be no doubt that, when all costs and revenues are considered, SBC's local services business is quite profitable. Thus, where, as here, the costs that a SBC competitor incurs using the same network exceed the expected revenues, that is powerful evidence that those UNE prices are not cost-based.

And this goes to the very heart of § 271. Its objective was to bar BOC long distance entry until CLECs had the same ability to offer exchange and exchange access over leased BOC facilities as BOCs have to provide long distance service over resold interexchange carrier lines. Indeed, even if checklist item two could be deemed satisfied by UNE rates that foreclose competition, the Commission has repeatedly recognized that “the public interest analysis is an independent element of the statutory checklist.”<sup>4</sup> It requires the Commission “to review the circumstances presented by the application to ensure that no other relevant factors exist that would frustrate the congressional intent that markets be open.”<sup>5</sup> As the Justice Department has repeatedly stated, entry cannot be in the public interest unless local markets are “irreversibly open.” SBC's pricing of UNEs at levels which preclude competitive UNE-based entry plainly means that residential markets in Oklahoma and Kansas are not “irreversibly open.”

The Commission has recognized these points. It has held that UNEs must be priced at levels that “allow efficient entry” and that “drive retail prices to cost-based levels.” *Ameritech*

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<sup>4</sup> *Texas 271 Order*, ¶ 417; *BA-New York*, ¶ 423.

*Michigan*, ¶ 289. By contrast, if UNE rates do not permit the profitable provision of service at existing retail and other rates, it is powerful evidence that the UNE rates are not cost-based.

Nonetheless, one BOC (Verizon) has claimed, through counsel it shares with SBC, that the Commission rejected this position in its *BA-New York Order*. Verizon’s Massachusetts Reply Comments, p. 19, *citing BA-New York Order*, ¶ 382. That is nonsense. This paragraph of the *BA-New York Order* was discussing not checklist item two and UNE pricing, but the BOC’s compliance with “checklist item 14[‘s] requirement” that the “avoided cost discount” that governs the pricing of wholesale services be computed in accord with the requirements of § 252(d)(4) of the Act. *Id.* Even in this context, the Commission did not there hold that the existence of margins are irrelevant. Rather, it held that it was permissible for a BOC to have a “unitary discount” governing all its services and that Bell Atlantic’s margins were therefore sufficient. *Id.* ¶¶ 382-83.

Second, evidence that competition is impossible at prevailing rates is relevant not only to checklist item two but also to the Commission’s separate public interest determination.<sup>6</sup> Indeed, it is difficult to understand how the Commission could make a finding that it would be in the public interest to grant a BOC long distance relief – and thereby remove the only meaningful incentive that BOC would have to promote residential competition – at a time when the BOC’s UNEs are priced at a level that forecloses broad-based residential competition. It cannot be in the public interest to condone a result that defeats the fundamental purpose of section 271 –

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<sup>5</sup> *BA-New York Order*, ¶ 423.

<sup>6</sup> In its *BA-New York Order*, the Commission noted that – although competition was limited in some areas in New York – commenters had failed to “link these market facts to any sin of omission or commission by Bell Atlantic.” *Id.* ¶ 427. In Massachusetts, the fact that there has been virtually no use of UNEs to provide residential service is directly attributable to Verizon’s excessive UNE-P rates. *See VZ-MA DOJ Eval.* at 19.

using the carrot of 271 relief to achieve competition in both business *and* residential local exchange and exchange access markets.

**II. SBC's INTERCONNECTION POLICIES EFFECTIVELY DENY CLECS NONDISCRIMINATORY INTERCONNECTION AT ANY TECHNICALLY FEASIBLE POINT AND JUST AND REASONABLE RECIPROCAL COMPENSATION.**

SBC claims that it provides CLECs with interconnection at any technically feasible point, and in particular that CLECs may choose a single, technically feasible point of interconnection within each LATA. SBC Br. at 76. That assertion is incorrect. In reality, SBC imposes terms and conditions on interconnection that violate not only its obligations to provide interconnection on just and reasonable terms in accordance with sections 251(c)(2) and 252(d)(1), but also its duty to provide reciprocal compensation in accordance with section 252(d)(2). *See* 47 U.S.C. § 271(c)(2)(B)(i), (xiii).

The interconnection provisions of the 1996 Act permit a carrier to “choose the most efficient points at which to exchange traffic with incumbent LECs.” *Local Competition Order* ¶ 172. The purpose of the requirement, as the Commission has repeatedly explained, is to relieve competing carriers of the need “to transport traffic to less convenient or efficient interconnection points” *Id.* ¶ 209. For example, the Commission intervened in pending litigation as *amicus curiae* to emphasize to the district court that a requirement that new entrants be forced to interconnect “at multiple locations within a single LATA . . . could be so costly to new entrants that it would thwart the Act’s fundamental goal of opening local markets to competition.”<sup>7</sup> Most recently, in the *Texas 271 Order*, the Commission expressly reaffirmed the importance of

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<sup>7</sup> Memorandum of the FCC as Amicus Curiae at 20-21, in *U S West Communications v. AT&T Communications of the Pacific Northwest, Inc., et al.*, No. CV 97-1575-JE) (D. Or. 1998). *See* also Fettig Decl. ¶ 13 n.13 (citing cases rejecting U S West efforts to require interconnection at each local exchange).