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January 17, 2001

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW – Room TWB-204
Washington, DC 20554

Re: Ex Parte, CC Docket No. 00-217, Application of SBC Communications, Inc., Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region InterLATA Services in Kansas and Oklahoma

Dear Ms. Salas:

Yesterday, James W. Cicconi, AT&T General Counsel and Executive Vice President, and I met with Commissioner Michael Powell, Kyle Dixon, Legal Advisor to Commissioner Powell, and Laura Newman, an intern with Commissioner Powell's office, concerning AT&T's views in the captioned proceeding. Mr. Cicconi and I reiterated, in particular, AT&T's concerns with SBC's recurring and non-recurring UNE rates in Oklahoma, and the fact that those rates do not comply with the requirements of the Act. We noted specifically that SBC's arbitrarily-determined recurring rates in Oklahoma are supported by no cost evidence, and are substantially higher than the corresponding recurring rates in Kansas, notwithstanding SBC's own recognition that its costs in the two states are about the same.

The process through which UNE rates were established in Oklahoma was unusual and very troubling. Although the Administrative Law Judge ("ALJ") appointed by the Oklahoma Corporation Commission ("OCC") held hearings on the parties' cost studies and submissions, the ALJ did not establish rates on the basis of any application of forward-looking costing principles to that evidence. Rather, the ALJ recommended (and the OCC adopted) settlement rates agreed to by SBC and Cox, a cable-based provider that obviously has no need for many important UNEs (and that could well benefit from high UNE prices that raise the costs of its UNE-based competitors). The settlement rates were supported by no cost study or cost evidence of any kind and were strongly opposed by every other

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potential new entrant. The sole basis for the ALJ's finding that the settlement rates are cost-based was his observation that the settlement rates fell somewhere between the proposals of SBC and AT&T. *See* ALJ Decision at 159 ("The Commission, similar to the responsibility of a jury in a civil case, has the discretion to adopt a position in the 'middle' of what has been proposed by the parties").

At Commissioner Powell's request, we provide the following additional information about the decision of the Oklahoma ALJ. The ALJ decision is comprised of 11 pages of "Findings of Fact and Conclusions of Law" and 156 pages that merely purport to summarize the parties' testimony (primarily about the cost studies that were not used to set rates).¹ As noted, the ALJ based his approval of the unsupported settlement rates on the fact that most of the settlement rates were lower than SBC's proposals and higher than AT&T's proposals. Although the ALJ noted that every party that submitted cost testimony asserted that its proposals satisfied the long run forward-looking cost standard, ALJ Decision at 158, the ALJ made *no* findings that either AT&T's or SBC's proposals were TELRIC-compliant (or otherwise consistent with the Act's requirement of cost-based rates). Rather, the findings of fact and conclusions of law contain only brief criticisms of a handful of each parties' cost study assumptions with no attempt to assess the impact of the supposed errors or to link them with the rates to which Cox and SBC stipulated. Plainly, mere recognition that neither party's cost study was perfect cannot mean that *any* number between the parties' proposals is cost-based. *See* DOJ Evaluation at 18 ("The fact that a price is set in some mid-point range between prices proposed by an ILEC and a CLEC does not indicate that the price is appropriately cost based, absent a separate determination that both the higher and lower proposed prices are appropriately cost based. We are not aware of any such determination in Oklahoma").

Furthermore, the ALJ's brief discussion of the parties' cost studies confirms beyond doubt that he was laboring under a seriously flawed view of the basic forward-looking costing principles mandated by the Commission's TELRIC rules. Thus, for example, on the issue of loop "fill" factors, which the ALJ recognized as "the single most influential input to loop investment," SBC's cost study used SBC's extremely low embedded fill factor without regard to whether an efficient provider, subject to competition, would maintain less idle capacity. *See* ALJ Decision at 161. The ALJ summarily and incorrectly dismissed AT&T's criticism of this embedded cost approach, noting that "the Act requires SWBT to unbundle its existing network, not some superior quality network." *Id.*² *See also id.* at 167 ("SWBT witness Cooper filed embedded studies

¹ As is apparently the practice in Oklahoma, SBC, as the prevailing party, drafted the ALJ Decision, which was subsequently amended in a few minor respects at the request of various parties.

² *Compare Local Competition Order*, ¶ 685 ("the forward-looking pricing methodology for interconnection and unbundled network elements should be based upon the costs that assume that wire centers will be placed at the incumbent LEC's current wire center locations, but that the reconstructed local network will employ the most efficient technology for reasonably foreseeable capacity requirements").

for the principal elements of loop, local switching and transport. . . . SWBT argued that these embedded rates represent the more likely actual cost it will incur in providing service and UNEs in Oklahoma. . . . In reviewing the [Cox/SBC] stipulation rates with the embedded costs, together with the requirement in Section 252 of the Act that cost-based rates may include a reasonable profit, the ALJ concludes that the stipulated rates meet these obligations”).

The result of this flawed process was, not surprisingly, rates that far exceed the rates in adjoining SBC states in which state commissions did seriously attempt to apply forward-looking costing principles. Notably, the Oklahoma ALJ flatly refused to admit into evidence the rate findings of other state commissions in SBC’s territory.³ AT&T appealed that decision to the OCC (and attached some of the excluded rate comparisons to its appeal papers), but the appeal was denied.⁴ As AT&T, DOJ and others have explained, SBC’s inability to justify much higher rates in Oklahoma than in states that applied TELRIC principles provides powerful confirmation that the Oklahoma rates are not remotely cost-based. In particular, SBC has offered no explanation how its recurring Oklahoma rates could legitimately be so much higher than the corresponding Kansas rates when SBC’s own cost studies estimated that costs in the two states are about the same (with the exception of rural loops, which SBC contended are much more costly in *Kansas*). In short, there can be no serious dispute that SBC has failed to demonstrate that its Oklahoma UNE rates are cost-based. See OCC Final Order, Cause No. PUD970000213/442 (Commissioner Anthony dissenting in part) (“Instead of rates based on cost, today’s order has adopted ‘settlement process’ rates”).

For this reason, the Commission should reject SBC’s application, and make clear that the Commission’s pricing rules have content and will be enforced. A Commission decision enforcing the very basic forward-looking costing principles embodied in the TELRIC rules will, moreover, encourage BOCs to fix pricing problems *before* they seek 271 approval, and avoid unnecessary involvement by the Commission in pricing decisions in the future. Indeed, no one is suggesting that the Commission should engage in rate-setting or ignore state commission rate proceedings and determinations. To the contrary, the pricing challenges in section 271 proceedings have always been very targeted and discrete claims of clear error, even following the Commission’s *Ameritech-Michigan* statement that it would take a hard look at pricing issues.⁵

³ AT&T sought to introduce Texas and Missouri rates and related findings and testimony. The Kansas permanent UNE rate order was entered after the Oklahoma order.

⁴ See *AT&T Communications of Southwest, Inc.’s Appeal of Arbitrator’s Recommendation* (filed with the OCC on June 25, 1998); OCC Final Order, Cause No. PUD970000213/442, page 4.

⁵ It is likewise clear that there are a number of straightforward indicia to guide the Commission’s determinations in future 271 proceedings whether a more searching, less deferential approach to pricing is even needed, including whether: (1) the state employed a

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To be sure, there may be close (and difficult) questions on some pricing issues in some future proceedings, but that is equally true of the many other checklist requirements that Congress directed the Commission to enforce. The alternative is to deny the Commission's pricing rules of substance, and encourage the BOCs to file Section 271 applications regardless of how far state-approved rates deviate from the Act's requirements. That approach would turn the Act on its head and deny competitors the cost-based rates that the law requires and upon which competition depends.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206 of the Commission's rules.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "K. Dixon", written over the typed name "Kyle Dixon".

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cc: Commissioner Michael Powell
Kyle Dixon
Laura Newman

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process rationally designed to apply forward-looking costing principles, (2) the approved rates have fostered significant UNE-based residential services, and (3) the approved UNE rates are consistent with rates that have been established in similar states and with the Commission's Synthesis Model cost estimates.