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November 21, 2001

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Before the  
FEDERAL COMMUNICATIONS COMMISSION  
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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )  
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2000 Biennial Regulatory Review )  
Separate Affiliate Requirements of Section )  
64.1903 of the Commission's Rules )

CC Docket No. 00-175 /

**REPLY COMMENTS OF AT&T CORP.**

Pursuant to Rule 1.415 (47 C.F.R. § 1.415) and the Commission's Notice of Proposed Rulemaking, released September 14, 2001 ("*Notice*"), AT&T Corp. ("AT&T") submits these reply comments on the separate affiliate rules governing the independent incumbent local exchange carriers' ("LECs") provision of in-region, interexchange services.

No commenter has offered any new argument or changed circumstances that would call into question the Commission's longstanding policy, reaffirmed only two years ago, that the existing separate affiliate rule (47 C.F.R. § 64.1903) remains necessary to guard against anticompetitive behavior that would cause substantial public harm. The Commission has repeatedly found that independent incumbent LECs have monopoly control over bottleneck local exchange facilities. As a result, such LECs unquestionably have both the incentive and the ability to favor their long distance operations anticompetitively through cost misallocation, discriminatory interconnection, and price squeezes. *See, e.g., Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, et al.*, CC Docket Nos. 96-149 *et al.*, Second Report and Order, 12 FCC Rcd. 15756, ¶¶ 158-59 (1997) ("*LEC Classification Order*").

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“[O]nly the emergence of competition in the local exchange and exchange access markets will eliminate independent LECs’ ability and incentive to engage in anticompetitive activity.” *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC’s Local Exchange Area, et al.*, CC Docket Nos. 96-149 *et al.*, Second Order on Reconsideration, 14 FCC Rcd. 10771, ¶ 14 (1999) (emphasis added) (“*Second Reconsideration Order*”); *see also LEC Classification Order* ¶ 196. And the LEC commenters make no serious attempt to show that they have lost their control over bottleneck facilities. Nor could they. There has been virtually no competitive entry in the independents’ territories. *See, e.g., Communications Daily*, p. 11 (November 14, 2001) (new Yankee Group study shows that rural LECs face little competition)<sup>1</sup>; *see also* ASCENT at 4 (citing *2000 Biennial Regulatory Review*, Updated Staff Report, CC Docket No. 00-175, FCC 00-456, Appendix IV, p. 150 (released January 17, 2001)). As WorldCom notes (at 1-2), the level of local competition in these markets has not changed appreciably since the *Second Reconsideration Order*, and indeed, “[i]f anything, the competitive picture has grown bleaker over the past two years as numerous CLECs have been forced to curtail capital spending or exit the business altogether.”<sup>2</sup> Moreover, as the Commission has repeatedly held, the independent LECs have overwhelming market power within their service areas notwithstanding the fact that their service areas are smaller. *See, e.g., LEC Classification*

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<sup>1</sup> The study shows that “lack of competition allows rural ILECs to control the ‘customer relationship for most telecom products and services,’” and that when “the local phone monopoly segment of overall business was broken out, operating margins were 33% -- very high for telecom service provider[s].” *Communications Daily*, p. 11 (November 14, 2001). The “[m]argins for all services and products sold by rural ILECs were 16%.” *Id.* Moreover, the independent LECs’ service areas are expanding, as they acquire lines from the Bell Operating Companies, and the report indicates that the trend will continue “as rural LECs gain ‘considerable market share’ in [the] next few years.” *Id.*

<sup>2</sup> *See also* “Telecom Debt Bombs Exploding,” *Forbes* (June 18, 2001) (quoting recent Moody’s report as saying “[t]he CLEC sector is facing a severe liquidity crisis unparalleled in the history

*Order* ¶¶ 159-61. Because competitive conditions have not changed since 1999, there is no basis for changing the rules governing the independent LECs' provision of in-region interexchange services. *WorldCom* at 1-3; *ASCENT* at 4-5.

In the absence of competition, the independent LECs simply reiterate arguments that have been raised and rejected many times before. The LECs' principal theme is that separate affiliate requirements are unnecessary to guard against anticompetitive practices, because the Commission can rely on after-the-fact enforcement through Section 208 complaints and the antitrust laws. *See, e.g., USTA* at 4; *ALLTEL* at 4-5; *Sprint* at 4-6; *ITTA* at 18-19. The Commission has consistently found, however, that in the absence of a separate affiliate requirement, anticompetitive practices would be dramatically easier to execute and much more difficult to detect. But the separate affiliate rules are not only essential to help prevent anticompetitive practices. They are also necessary if the enforcement mechanisms the LECs tout are to be effective. As the Commission explained in the *LEC Classification Order* (¶ 111), discriminatory interconnection would be "difficult to police" in the absence of separate ownership of facilities, because "the level of [LEC] 'cooperation' with unaffiliated interLATA carriers [would be] difficult to quantify." Similarly, as the Commission found, "separate books of account are necessary to trace and document improper allocations of costs or assets between a LEC and its long-distance affiliate as well as discriminatory conduct." *Id.* ¶ 163. Elimination of the separate affiliate requirements would not only remove prophylactic constraints on the LECs' behavior – and thus greatly increase the risk of harm to the public interest – it would also fatally

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of telecom financing," and predicts that the capital markets "will remain virtually closed to this sector at least through 2002").

undermine the Commission's ability to detect violations and to enforce its rules prohibiting such practices.<sup>3</sup>

Finally, the LECs provide no reason for the Commission to reconsider its previous findings that the separate affiliate rule does not impose undue costs on independent LECs. The Commission has previously found that the regulatory burdens imposed by the separate affiliate rules "are not unreasonable in light of the benefits these requirements yield in terms of protection against improper cost allocation, unlawful discrimination, and price squeezes." *LEC Classification Order* ¶ 167. Other than making bare, unsupported assertions, the commenting LECs offer no evidence that such costs have changed. *See, e.g.,* *Valor* at 9 (increased long distance competition "has increased the desire of many independent ILECs" to convert their long distance operations from resale to facilities-based service in order to "increase profit margins"); *USTA* at 3 (bare assertion that rule "threatens inefficient facilities deployment, especially in a SoftSwitch environment"); *ALLTEL* at 7 (unexplained assertions that rule prohibits "bundled" offerings). Both the benefits and the costs of the rule are unchanged, and therefore the Commission has no basis for changing the rule.

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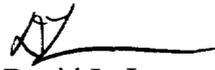
<sup>3</sup> In addition, as WorldCom notes (at 5-6), the mere fact that there have been few complaints concerning such anticompetitive practices does not mean that the Commission's prophylactic restrictions are unnecessary. Rather, it is likely that there are few complaints because the existing rules are designed to deter such conduct – as the Commission itself has previously found. *See, e.g., Second Reconsideration Order* ¶ 14; *see also GTE Midwest, Inc. v. FCC*, 233 F.3d 341, 345 (6<sup>th</sup> Cir. 2000) (upholding separate subsidiary requirements for CMRS services because of LECs' control of bottleneck facilities, even though "the Commission noted no specific instances of anti-competitive behavior").

## CONCLUSION

The Commission should retain the existing separate affiliate rules governing independent incumbent LECs' provision of in-region interexchange services, and if anything, it should strengthen those rules to require more complete disclosure of the affiliate's separate financial results.

Respectfully submitted,

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November 23, 2001

**CERTIFICATE OF SERVICE**

I hereby certify that on this 21<sup>st</sup> day of November, 2001, I caused true and correct copies of the forgoing Reply Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: November 21, 2001  
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