

December 19, 2001

EX PARTE – Via Electronic Filing

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W.
Washington, DC 20554

Re: CC Docket Nos. 94-1, 96-45, 99-249, and 96-262

Dear Ms. Salas:

On December 18, 2001, Whit Jordan (of BellSouth), Joel Lubin (of AT&T), Bob McDonnell (of Verizon), Pete Sywenki (of Sprint), Jamie Tan (of SBC), and I met with Carol Matthey, Katherine Schroeder, Jack Zinman, Bill Scher, Ted Burmeister, Jay Atkinson, and Jennifer McKee to discuss the impact of the decision of the United States Court of Appeals for the Fifth Circuit in *Texas Office of Public Utility Counsel v. FCC*,¹ (“*TOPUC II*”), on both the Commission’s *CALLS Order*² (“*Order*”) and on pending petitions for reconsideration.

With respect to the pending petitions for reconsideration, while these petitions lack merit, we believe that *TOPUC II* has no significant effect on the One Call and Operator Communications petitions. With respect to the procedural challenges raised by Pathfinder that the *Order* was adopted in violation of the Administrative Procedures Act because of alleged (and unsubstantiated) ex parte violations and Commission prejudice,³ the Fifth Circuit rejected these same challenges in *TOPUC II*.⁴ To the extent Pathfinder simply reframes this APA argument as a violation of the Regulatory Flexibility Act,⁵ the Fifth Circuit also rejected that argument.⁶ The Fifth Circuit likewise rejected claims that the Commission violated the Negotiated Rulemaking Act.⁷ Because these petitions for reconsiderations presented no new facts beyond those presented to the Fifth Circuit, these procedural challenges can be dismissed. Pathfinder’s other claims lack merit, as *CALLS* has previously explained in its opposition to the petitions for reconsideration.

¹ 265 F.3d 313 (5th Cir. 2001).

² 15 FCC Rcd. 12962 (2000), *aff’d in part and rev’d in part, sub nom. TOPUC II*.

³ Pathfinder Petition for Reconsideration, filed July 20, 2000 (“Pathfinder Pet.”) at ¶¶32, 34-35.

⁴ *TOPUC II*, 265 F.3d at 325-327.

⁵ Pathfinder Pet. at ¶47.

⁶ *TOPUC II* at 325-327.

⁷ *Id.* at 327.

With respect to the petition for reconsideration filed by ALTS and Focal, the question of whether targeting x-factor reductions to local switching was unlawful was presented to the Fifth Circuit,⁸ which rejected the argument *sub silentio*. Similarly, the Fifth Circuit was presented with and rejected *sub silentio* arguments that targeting x-factor reductions to local switching and transport would be anti-competitive.⁹ ALTS' and Focal's remaining claims also lack merit for the reasons stated in CALLS' previously filed opposition to the petitions for reconsideration.

The Fifth Circuit remanded only two issues for further explanation, although it did not vacate the Commission's rules. First, the Court found that the FCC had not adequately explained its decision to size the interstate access universal service at \$650 million.¹⁰ Second, in response to petitions for review regarding switched access, the Court found that the FCC had not adequately explained the use of the 6.5% x-factor until average traffic sensitive charges reached the applicable target rate.¹¹

We believe both of the Fifth Circuit's concerns can be addressed on the existing record, without need for further comment.

Size of the Universal Service Fund – The Fifth Circuit criticized the Commission for not fully explaining why it picked a number consistent with AT&T's estimate of interstate access support using the Commission's synthesis model with common inputs as of June 2, 1999, and not a number based on other studies cited by the Commission.¹² It is important to remember that projections of universal service support remain interim, as the Commission will benefit from the actual field experience in implementing this support. With this background, the Commission's sizing of universal service at a number supported by the AT&T study, and not other studies that yielded substantially higher estimates of support, is justified by the interim nature of the proposal.¹³ Part of the difficulty in projecting a "sufficient" level of universal service support stems from the reality that such an exercise is imprecise, and that withdrawing universal service support in the future will likely be more difficult than supplementing such support.¹⁴ By sizing universal service at the lower end of the range indicated by studies in the record (excluding the flawed TOPUC study and wholly baseless ALTS/Time Warner proposal), the Commission left itself greater latitude in later adjusting that level of support, if necessary, based upon the empirical experience gained during the five years that the size of universal service is to be fixed. A further indicator of the reasonableness of sizing universal service at the lower range of the significant studies in the record – but not the sole reason for selecting such a fund size – is that it was supported by companies representing both net payors and net recipients of universal service support.¹⁵ It was reasonable, under these circumstances, for the Commission to exercise its expert judgment and, on an interim basis, to size universal service at a level supported by a credible study at the lower end of the range in the record, pending further real world experience.

X-factor for Switched Access – Although the Court remanded the question of whether an x-factor of 6.5% was appropriate for reductions in switched access rates to the applicable target rates, it

⁸ Brief of National Ass'n of State Utility Consumer Advocates, *Texas Office of Public Utility Counsel v. FCC*, No. 00-60434 (5th Cir., filed Sept. 20, 2000), at 56 ("NASUCA brief").

⁹ NASUCA brief at 56.

¹⁰ *TOPUC II*, 265 F.3d at 327-328.

¹¹ *Id.* at 328-329.

¹² *TOPUC II*, 265 F.3d at 328. The Court, however, rejected Texas Office of Public Utility Counsel's (TOPUC's) argument that the Commission was required to address TOPUC's "study." *Id.* at 328 n.7.

¹³ CALLS Further Reply Comments (filed April 17, 2001) at 25.

¹⁴ Order at ¶201.

¹⁵ Order ¶¶199, 202.

is important to note what the Court did not do. The Court did not reverse the target average traffic sensitive rates established under the Order. The Court also upheld the targeting of x-factor reduction to local switching and transport. In addition, the question of whether (GDPPI-6.5%) was an appropriate annual price reduction for special access was not before the Fifth Circuit. Thus, the Fifth Circuit's mandate only reaches the question of whether (GDPPI-x) with x equal to 6.5% was a reasonable price reduction formula for switched access services.

The Commission's Order did not address what we believe to have been the most powerful reason for using 6.5% as the "x" or "price reduction factor" to reduce ATS rates – this reduction percentage had already been incorporated into the industry's existing financial projections and business plans.¹⁶ Once price cap reductions were severed from the theory of productivity offset, and once the target rates were set, the "x" price reduction factor simply governed how rapidly a carrier made the transition from its then-existing rates to its applicable target rate. In determining an appropriate "glidepath," the least disruptive starting point was the level of price reductions already incorporated into industry financial projections and plans. Any other glidepath would have altered expectations in financial markets with only an incremental, transitory effect, slightly accelerating or slightly slowing price reductions to the target rates. Under the portions of the Order affirmed by the Fifth Circuit, the ultimate target average traffic sensitive rate never changed, regardless of the level of the x-factor selected. Thus, use of (GDPPI-6.5%) to determine the price reduction "glidepath" was reasonable.

In accordance with FCC rules, a copy of this letter has been filed electronically in each of the above-captioned dockets.

Sincerely,



John T. Nakahata

Counsel to the Coalition for Affordable Local and Long Distance Services

c: Ms. Carol Matthey
Ms. Katherine Schroeder
Mr. Jack Zinman
Mr. Bill Scher
Mr. Ted Burmeister
Mr. Jay Atkinson
Ms. Jennifer McKee

¹⁶ CALLS Further Reply Comments at 42.