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October 3, 2002

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Marlene H. Dortch, Secretary
Federal Communications Commission
The Portals
445 12th Street, S.W., TW-A325
Washington, DC 20554

Re: Response to APCC's *Ex Parte* Letter of September 23, 2002; Implementation of the Pay Telephone and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No.96-128

Dear Ms. Dortch:

AT&T Corp. ("AT&T)") respectfully submits this *ex parte* response to arguments raised by the American Public Communications Council ("APCC") in its September 23, 2002 *ex parte* submission in this docket.[1]

APCC's most-recent submission recycles the same arguments that have been presented to the Commission in this proceeding since 1997. These arguments were before the Commission when it properly mandated true-ups for the Intermediate Period (October 7, 1997 – April 21, 1999) and when the Commission mandated true-ups for the Interim Period (November 7, 1996 – October 6, 1997).[2] As it has done in numerous recent *ex parte* submissions, APCC once again puts forth a litany of speculative and false assumptions in an attempt to circumvent AT&T's legal right to

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[1] *See* Letter from Albert H. Kramer, Robert F. Aldrich, and Robert N. Felgar to Marlene H. Dortch dated Sept. 23, 2002, "Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, IXC Over Recovery of Compensation Payments" ("APCC Sept. 23 Ex Parte").

[2] *See Implementation of the Pay Telephone Reclassification & Compensation Provisions of the Telecommunications Act of 1996*, 14 FCC Rcd. 2545, ¶ 196 (1999) ("*Third Report & Order*"), *aff'd*, *American Public Communications Council* v. *FCC*, 215 F.3d 51 (D.C. Cir. 2000); *Implementation of the Pay Telephone Reclassification & Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Fourth Order on Reconsideration & Order on Remand, ¶ 34 (rel. Jan. 31, 2002) ("*Fourth Report & Order*").

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true-ups for overpayments that it made in the Interim and Intermediate Periods.[3] None of APCC's arguments undermine the conclusion that AT&T paid PSPs more than the amount that the Commission has determined to be fair in both the Interim and Intermediate Periods. Nor do APCC's arguments affect AT&T's showing that, for the Intermediate Period alone, AT&T would remain undercompensated by almost $150 million even after a true up. As a result, APCC's Sept. 23 Ex Parte provides no basis for reconsideration.

First, APCC claims that the revenues generated by AT&T's payphone-specific surcharges provide sufficient payphone cost recovery. APCC Sept. 23 Ex Parte at 7-8. That is false. Although AT&T generated payphone-specific revenues, AT&T's payphone-specific costs substantially exceeded those revenues. In its October 1, 2002 *ex parte*, AT&T specifically sets forth, on a quarterly basis, its estimated payphone revenues and costs for the Intermediate Period.[4] As those data demonstrate, even taking the true-up amounts in account, a best-case estimate is that AT&T will remain undercompensated by at least $149 million for the Intermediate Period alone.

Second, APCC further argues that reductions in access charges made during the Interim Period should be used in calculating AT&T's payphone cost recovery for the Interim and Intermediate Periods. APCC September 23 Ex Parte 3, 6-7. APCC assumes, wrongly, that these savings are relevant here and that AT&T did not pass along those savings to consumers. Even if these reductions were relevant – and they are not – the Commission has rejected the argument that IXCs would not pass along reductions in access charges to their customers. As the Commission has stated: "We see nothing to indicate that market forces will not compel IXCs to flow through access charge reductions"[5] In this regard, the Commission has recognized, AT&T's long-stated policy to pass through access charge reductions to its end users. *See id.* In fact, for the period July 1, 1997 to June 30, 1998, the AT&T's total ARPMin (average revenue per minute) for interstate services dropped by almost $2.5 billion, almost 1 billion more than the $1.5 billion in interstate access reductions received by AT&T.[6] Finally, it remains AT&T's policy to pass on its access cost reductions to its end users.

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[3] *See generally* Letter from Teresa Marrero et al. to Marlene H. Dortch dated Oct. 1, 2002, "Re: Response to APCC's *Ex Parte* Letters Of September 5, 2002 and September 11, 2002, Re: Implementation of the Pay Telephone and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128 ("IXC Oct. 1 Ex Parte"); Letter from Teresa Marrero to Marlene H. Dortch dated July 2, 2002, "Re: Implementation of the Pay Telephone and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128; Colorado Payphone Association Petition for reconsideration Re: Retroactive Adjustment of Second Report and Order Period Compensation; Retroactive Adjustment of Interim Compensation ("IXC July 2, 2002 Ex Parte").

[4] IXC Oct. 1 Ex Parte, Attachment 1 (Confidential).

[5] *Price Cap Performance Review for Local Exchange Carriers; Access Charge Reform*, 12 FCC Rcd. 16642, 16717, ¶ 185 (1997).

[6] *See* Attachment 1, Letter from Mark C. Rosenblum, AT&T to William Kennard, Mar. 6, 1998. *See also*, Attachment 2, AT&T News Release "Audit Confirms that Prices for AT&T Long Distance Service Declined by More Than Reductions in Access Fees", Aug. 13, 1998.

Last, APCC claims that AT&T's general rate increases, made during the Interim Period, generated substantial revenues that would more than make up for any under recovery for the Interim and Intermediate Periods. *See* APCC Sept. 23 Ex Parte at 1. This claim is wholly speculative and factually inaccurate. In essence, APCC argues that IXCs have already recovered payphone compensation payments by focusing on increases for specific rate elements, while ignoring larger rate reductions that have been occurring across the totality of IXC product lines. As WorldCom properly explains, APCC's approach ignores the nature of the competitive markets in which IXCs compete and therefore does not provide a basis for concluding that IXCs such as AT&T were not undercompensated for the Interim and Intermediate Periods.[7] Indeed, APCC ignores that, for example, from 1997 through 1999, the weighted average of AT&T's domestic service per-minute revenues dropped by over 26%. Last, some of the rate increases upon which APCC relies applied only to a subset of AT&T services, thereby further undermining the validity of the estimates and approach advocated by APCC.[8]

In short, APCC's spurious claims of AT&T's purported "over recovery" are baseless and should be rejected by the Commission.

Sincerely,

-For-

Teresa Marrero

Attachments

cc: M. Brill
J. Carlisle
J. Goldstein
D. Gonzalez
L. Kinney
J. Marcus
J. Rogovin

[7] *See* Letter from Larry Fenster to Marlene H. Dortch dated Sept. 23, 2002, Re: Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128, at 2-3 ("WorldCom's Oct. 2 Ex Parte").

[8] Thus, the Frost and Sullivan survey cited by APCC as "proof" of AT&T's over-recovery completely ignores that these rate increases applied to Interstate service only (and not to Intrastate services) and the limited reach of these increases caused by the prevalence of customer-specific contracted rates not affected by general rate increases. For example, AT&T's February 27, 1997 increase did not apply to all toll-free services, as APCC asserts, APCC Sept. 23 Ex Parte at 2, but only to interstate toll-free services. Similarly, AT&T's May 1, 1997 rate increase did not, as APCC suggests, *id.*, apply to all interstate toll-free services, but only outbound interstate toll-free services.

Attachment 1

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

AT&T

Mark C. Rosenblum
Vice President - Law & Federal
Government Affairs

Suite 1000
1120 20th St. NW
Washington, DC 20036
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March 5, 1998

The Honorable William E. Kennard, Chairman
Federal Communications Commission
1919 M Street, NW, Room 814
Washington, DC 20554

Re: CCB/CPD 98-13

Dear Chairman Kennard:

AT&T's Chairman and CEO C. Michael Armstrong has asked that I respond to your February 26, 1998 letter, and to set the record straight on the allegations made by the United States Telephone Association ("USTA") about interexchange carrier ("IXC") pricing and access flowthrough. AT&T's response again confirms, as we have consistently stated, that AT&T customers are in fact paying lower actual prices for long distance service -- and that our long distance prices are dropping faster than the access charges that we must pay to local exchange carriers ("LECs").

The good news here is that long distance competition remains a singular success for the customer, in terms of choice, innovation and price. Even though access prices and the new universal service fund ("USF") charges are too high, AT&T's customers continue to pay lower prices that more than reflect the modest reductions in interstate access charges that have occurred. Indeed, for the period July 1, 1997 to June 30, 1998, AT&T's average revenue per minute ("ARPMin") for interstate services has dropped by almost $2.5 billion, almost $1 billion more than the $1.5 billion in interstate access reductions received by AT&T. Moreover, these interstate reductions are dwarfed by the massive and unjustified profits monopoly LECs continue to earn from access rates inflated above true economic costs by almost $10 billion.

In these circumstances, AT&T submits that the real challenge in the telecommunications industry today is genuine access reform and opening local telephone markets

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to meaningful competition. If the Commission would make cost-based access pricing a reality, and implement the new USF at more appropriate and competitively-neutral levels, the prospects for local competition would be brighter, and long distance prices could fall even faster.

First, it is clear that AT&T's customers are paying prices for long distance service, as measured by ARPMin, that are falling faster than the level of interstate access charges AT&T must pay. Unlike customers of monopoly LECs who have no choice of service and price plans, long distance customers enjoy a broad and expanding array of price and service offers, from hundreds of competing providers. As a result of this competition, customers can and do obtain lower and lower prices (that more than reflect access reductions) through reduced rates in filed tariffs, promotional offers, custom contract offerings for business customers (or renegotiation of existing services provided under such contracts), and movement by customers to more attractively priced services (for example, optional calling plans like AT&T's One Rate plan). The best measure of price is the amount customers actually pay for long distance in a given period. The industry standard for measuring price is ARPMin: long distance revenues divided by long distance usage. When ARPMin is falling faster than per-minute access charges (as it is), then AT&T's customers are getting the full benefit of access cost reductions.

AT&T has estimated that, for the period July 1, 1997 to June 30, 1998, AT&T's ARPMin for interstate services has dropped by nearly $2.5 billion. Customer savings in excess of access reductions realized by AT&T for that period are projected to be $977 million. AT&T thus passes far more than 100% of its savings in access costs through to its subscribers in the form of lower prices paid by those subscribers for AT&T's services.

Against this massive decline in the amounts customers actually pay for AT&T service, the total access cost savings to AT&T attributable to reductions in interstate access charges pales by comparison. AT&T's total access savings are estimated to be $1.4743 billion for the period July 1, 1997 to June 30, 1998. This total was computed by subtracting the per minute access charges AT&T expects to pay for that period from what it would have paid for the prior twelve-month period under the LEC access charge tariffs in effect during that period. Specifically, AT&T multiplied its demand by representative access charges in effect from July 1, 1996 to June 30, 1997, multiplied its demand by access charges revised to reflect revisions to access charges effective July 1, 1997 and January 1, 1998, and subtracted the products of those two calculations, which equals $1.7028 billion. From this, AT&T subtracted the new costs it has incurred for the payment of PICCs to local exchange carriers. For the period July 1, 1997 to June 30, 1998, AT&T will pay $543.0 million more than it would have under the access charges in effect on June 30, 1997, which included no PICCs. Finally, AT&T added back in, for the period July 1, 1997 to June 30, 1998, the $314.5 million amount reflecting reductions in access charges due to the elimination of the old high cost fund.[1] These calculations result in a total reduction in AT&T's interstate access costs for this period of $1.4743 billion.

As the table below illustrates, the "net" of AT&T's total ARPMin reductions and its total access savings amounts to $977 million.

Customer Savings in Excess of Access Reductions
July 1, 1997 to June 30, 1998
($ in millions)

	TOTAL
Access Cost Reductions	(1,474)
ARPMin Decline	(2,451)
Customer Savings in Excess of Access Reductions	977

Although, as the above table shows, AT&T customers, in fact, are enjoying lower long distance prices that more than reflect access savings AT&T has realized, the data are conservative because these figures do not include the additional cost burden imposed on AT&T by the Commission's new USF rules. AT&T's contributions to support universal service programs for the period from January 1, 1998 to June 30, 1998 were calculated using USAC 1998 first quarter contribution factors, AT&T's estimate of the second quarter 1998 factors, and AT&T's revenues from its filed Form 457 USF Worksheet. The second quarter contribution factors were developed based on funding caps established by the Commission in CC Docket No. 96-45 and the revenue bases reported in FCC Public Notice DA 97-2623.

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1 Although AT&T's analysis reflects a reduction in its access costs due to the elimination of the old High Cost Fund ("HCF"), AT&T has not included in the above table the new separate costs it bears as a result of its required contributions to the new USF.

Universal Service Contributions
January 1, 1998 to June 30, 1998
($ in millions)

High Cost Support	395
Low-Income Support	114
Schools, Libraries and Rural Health Care	155
Total AT&T Universal Service Contributions	664

Limited recent actions by AT&T to recover *some* of the new costs (namely, USF assessments and PICCs) added to the system do not change this. They include mechanisms that seek to recover no more than AT&T's actual cost of contributing to the new programs in respect of the customer; in fact, AT&T underrecovers by a wide margin. AT&T is not generating profits on USF recovery because it is already flowing through more in price reductions than it has received in access reductions. Moreover, because of systems and implementation requirements, as well as price-guaranteed contracts, AT&T currently is only recovering a portion of the new USF assessment associated with business services, and it is not recovering as a line-item on the consumer bill any of the assessment associated with residential services. For example, although for business services AT&T's USF payments are $302 million, it is recovering only two-thirds or $198 million through a line-item on the bill. Similarly, while AT&T's liability for PICCs for business customers is approximately $245.5 million, it is only recovering approximately $49 million through line-item charges on the bill. As you also know, AT&T is considering actions to begin recovering some additional portions of the USF and PICC costs.[2]

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[2] Even if any such actions are taken (for example, a PICC recovery mechanism for non-basic schedule residential customers of no more than $0.95 per month), residential and business customers will each still enjoy a significant net decrease in actual price paid.

Indeed, because the additional expenses associated with USF payments, commencing January 1, 1998, more than offset USF recovery and PICC recovery (including planned PICC recovery for residential customers), the figures show an even greater consumer saving as compared to AT&T's costs. Because of competition, this proves that AT&T customers are able to take advantage of better and better price plans, in larger and larger numbers, thus reducing their overall long distance bill.

Net Customer Savings in Excess of Access Reductions and PICC/USF Recovery
July 1, 1997 to June 30, 1998
($ in millions)

	TOTAL
Customer Savings in Excess of Access Reductions	977
PICC Recovery	(83)
Planned Blended PICC Recovery (4/1/98-6/30/98)	(91)
USF Payments (1/1/98-6/30/98)	664
USF Recovery	(198)
Net Customer Savings in Excess of Access Reductions and PICC/USF Recovery[3]	1,269

Finally, AT&T is especially surprised at questions raised in your letter with respect to how we label PICC and USF charges on the customer bill. AT&T has been particularly active and forthcoming with you and your staff, and with others in Washington, about its plans. AT&T decided in December, 1997 *not* to put a separate USF charge on residential bills until at least July 1, 1998. Where AT&T has separately charged such items (to business and wireless customers), we have been scrupulous to observe the Commission's request that such descriptions be accurate: we always make clear that AT&T must pay these charges and AT&T has *chosen* to recover them through a separate assessment on the bill. Moreover, we have worked hard with the Commission and others to share our descriptive language and meet any concerns.

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[3] The net customer savings in excess of access reductions and PICC/USF recovery is computed by subtracting from Customer Savings in Excess of Access Reductions the additional revenues AT&T expects to recover through PICCs, Blended PICCs, USF Recovery, and adding back USF Payments.

I trust this fully addresses the issues raised in your letter and that the Commission will continue its focus on local markets, so that the promise of the 1996 Telecommunications Act can become a reality. In short, AT&T has already flowed through to customers more than the access cost reductions it has received, and strikingly more than that when the new USF program costs are taken into account. Far more impressive long distance price cuts are possible, but the Commission holds the key. Interstate access reductions in July 1997 and January 1998, welcome as they were, amount to a small fraction of the total access revenue stream enjoyed by the LECs. AT&T estimates that these revenues exceed by a massive $8-$9 billion the LECs' true cost of providing access. If the FCC were to act to ensure that access prices reflect these costs, far larger reductions in long distance pricing would be assured.

Respectfully yours,

cc: Commissioner Susan Ness
Commissioner Michael K. Powell
Commissioner Harold W. Furchtgott-Roth
Commissioner Gloria Tristani

Attachment 2

News Release

For further information:
Jim McGann
202-457-3942

AUDIT CONFIRMS THAT PRICES FOR AT&T LONG DISTANCE SERVICE DECLINED BY MORE THAN REDUCTIONS IN ACCESS FEES

FOR RELEASE THURSDAY, AUGUST 13, 1998

WASHINGTON -- AT&T today released the results of a report from its outside auditor confirming the company's assertion that between July 1, 1997 and June 30, 1998, AT&T lowered long distance prices far in excess of the reductions in the access fees it paid to local telephone companies.

The PricewaterhouseCoopers audit confirms that prices paid by customers for AT&T's long distance service declined by some $460 million *more* than reductions ordered by regulators in what AT&T pays to the local telephone companies for access.

"This audit confirms what we've been saying for a long time: AT&T passes along much more in the form of lower long distance prices than we receive in access cost reductions," said Rick Bailey, AT&T vice president -- federal government affairs. "And contrary to what Consumers Union and the Consumer Federation are saying today, this is true for both business and residence customers.

"It's especially ironic that access flow through questions are being raised today in light of today's other news," he said.

A *Washington Post* story today says that an FCC audit of Bell company equipment indicates some $5 billion of equipment the Bells have included in rate-setting calculations cannot be located.

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"It's been obvious for years that the real issue facing the industry is inflated access fees and now it looks like those fees may be even more inflated than we thought," said Bailey.

"So the real question isn't, Where's the access flow through? The questions are, Can the monopoly Bell companies justify what they've been charging for access? Why aren't access reductions much bigger than they've been?" he said.

# # #