Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of **Ameritech Operating Companies** **Tariff FCC No. 2** **Transmittal No. 1312** **Nevada Bell Telephone Companies** **Tariff FCC No. 1** **Transmittal No. 20** **Pacific Bell Telephone Company** **Tariff FCC No. 1** **Transmittal No. 77** **Southern New England Telephone Companies** **Tariff FCC No. 39** **Transmittal No. 772** **Southwestern Bell Telephone Company** **Tariff FCC No. 73** **Transmittal No. 2906**	)	**WC Docket No. 02-319**

AT&T CORP.
OPPOSITION TO DIRECT CASE

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Pursuant to the Investigation Order ("*Investigation Order*") in this matter released on October 10, 2002, by the Chief of the Pricing Policy Division, AT&T Corp. ("AT&T") hereby submits its Opposition to the Direct Case filed by SBC Communications, Inc. ("SBC") on October 31, 2002 ("Direct Case").

I. INTRODUCTION AND SUMMARY

This proceeding is another investigation of a series of anticompetitive proposals by incumbent LECs designed to leverage the recent bankruptcy filings of several competitive local and long distance carriers to gain regulatory approval for radical new tariff provisions that the incumbents would use to disadvantage the remaining carriers that have sound credit and that pose no exceptional bad debt risk. SBC's professed justification – which it never supports and is entirely unfounded – is that the "Telecommunications Act . . . has made the market much more volatile," which has created an "exponential" increase – to which "there appears to be no end in sight" – in SBC's exposure to uncollectible bad debts for interstate access services. SBC's direct case does not come close to establishing a need for any such tariff revisions.

Given the grossly excessive returns that SBC and other large incumbent LECs achieve on access services, SBC's plea for additional security is simply thinly disguised greed – and a stark effort to gain an anticompetitive weapon to use against its new long distance rivals. In 2001, for example, a period in which SBC claims that its bad debt uncollectibles rose significantly, SBC earned about a 22 percent rate of return on interstate access and an astounding (even by BOC standards) *54.6 percent* on special access services. Given the hefty margins on services for which SBC continues to enjoy near-monopolies, there is no need for the Commission to take additional steps to help SBC maximize its access revenues.

In fact, SBC's proposals are an incredibly overbroad response to a largely nonexistent problem, and they should be promptly rejected. No aspect of SBC's provision of access services is particularly risky or volatile, and, as demonstrated below and in the accompanying declaration of Dr. Bradford Cornell, SBC continues to enjoy very low *actual* levels of bad debt expenses that are in no way indicative of any permanent bad debt crisis that is beyond the capabilities of SBC's existing tariff provisions.

In this regard, SBC has grossly exaggerated its claims that the recent downturn in the market has exposed it to substantial liability from unpaid access bills. The ARMIS data reporting on SBC's bad debt expense through 2001 show that SBC has *never* exceeded one-half of one percent. Indeed, the absolute level of uncollectibles for some the SBC companies are comparable to – and in one case lower than – the levels experienced in 1990. Further, any recent fluctuations in SBC's uncollectibles are very modest and entirely consistent with prior variations, and simply result from normal fluctuations in the business cycle or from other short-term market conditions.

In these circumstances, the Commission's price cap system already accounts fully for these potential uncollectibles expenses. Under the price cap system, any year-to-year fluctuations to bad debt expense are considered business risks that the LEC must absorb (just as SBC retains the benefit of lower than average bad debt levels during periods of economic strength). Moreover, the Commission's existing prescribed tariff language already fully protects SBC from customers with a proven history of non-payment, and from customers without established credit. SBC fails to explain why these provisions, which were in place in prior economic downturns, are no longer sufficient.

Any claim that SBC needs these tariff protections because it is seeking to implement credit provisions that are similar to those of companies in competitive industries also completely lacks merit. SBC is *not* a company operating in a competitive industry – it is a near-monopolist that, as the *Investigation Order* recognizes, provides the sole source of access services for most of the traffic handled by its customers. In that case, SBC has no incentive to make commercially reasonable decisions when it applies even facially neutral credit provisions to its customers – instead, it will seek to eliminate any risk of uncollectibles by demanding enormous security deposits or advance payments, secure in the knowledge that its customers cannot choose an alternate supplier for access. Companies in competitive industries, by contrast, are subject to rigorous, market-based checks in how they apply even vague credit provisions, because any unreasonable demands for large security deposits (like those at issue here) generally will cause customers to flee to more reasonable suppliers.

Furthermore, even if SBC had demonstrated some limited increase in its exposure that is not already appropriately covered by the Commission's price cap rules or by its longstanding tariff prescriptions relating to non-payment risks, SBC's proposed tariff revisions are by no means a narrowly circumscribed and measured response to any such problem. SBC seeks wide discretion to demand security deposits from its access customers based upon long-term bond ratings issued by three bond rating agencies. However, SBC has set the bar so low that virtually *all* non-BOC affiliated carriers in the industry are subject to security deposits, even though the bond agencies themselves report that, on average, the actual rate of default for companies with the ratings selected by SBC is a miniscule *4 percent* – proof that SBC's triggers are far too broad. Thus, SBC will be able to eliminate *any* risk of uncollectibles by providing itself with the authority to demand massive deposits from virtually all carriers, even those with a minimal rate of default. For large IXCs, the amounts demanded as "security" deposits or "advance payments" could be hundreds of millions of dollars – easily enough to disrupt the business plans of even large carriers that are otherwise able to pay their bills.

As the *Investigation Order* (¶ 20) explicitly questioned, the anticompetitive effects of such a system are alarming. SBC has designed its criteria so that its own long-distance affiliates are (predictably) creditworthy and need not provide a security deposit – even though, if SBC were to treat those affiliates at arms' length as the Act's terms require, those affiliates would be precisely the types of companies with no established credit for which security deposits are appropriate. It is quite clear therefore that SBC seeks to wield the proposed security deposit provisions as an anticompetitive and discriminatory weapon to disadvantage and raise the costs of the rivals to its new long distance business. The Commission has repeatedly rejected similar proposals to grant SBC and other incumbents wide discretion over payment and security deposit terms for that very reason, and these proposed tariff provisions, like previous attempts, should be rejected.

II. SBC PROVIDES NO EVIDENCE OF ANY CHANGED CONDITIONS THAT WARRANT REVISION OF ITS EXISTING TARIFFS.

As the *Investigation Order* recognizes, SBC's proposed tariff revisions "significantly alter" the balance of risk of nonpayment of access charges between SBC and its captive access customers. *Investigation Order* ¶ 14. Accordingly, even before addressing the propriety of the specific tariff revisions proposed by SBC, the preliminary question to which SBC must respond in its direct case is "whether circumstances have changed" in a way that could justify any revision at all in the Commission's longstanding tariff prescription on security deposits. *Id.* SBC's direct case on this fundamental issue is virtually non-existent, and its proposed tariff revisions should be rejected on this ground alone.

A. SBC's Bad Debt Risk Has Not Risen Significantly And Certainly Poses No Serious Threat Of Revenue Shortfalls.

SBC claims that across-the-board tariff revisions are necessary because the "Telecommunications Act . . . made the market much more volatile than it was in 1990," causing an "unprecedented," "exponential," and "permanent" increase in the risk of uncollectibles that is so "devastating" to SBC that "SBC soon could find itself before the bankruptcy court." Direct Case at 2, 7. These hyperbolic claims are demonstrably false. SBC provides *no* evidence that its access service business has become more risky, because the reality is quite different.[1] In fact, the excessive and increasing rates of return SBC has earned over the last few years confirm that SBC retains near-monopoly control over access markets and thus faces little risk of eroding revenues. SBC is correct that access reform is needed, but the focus should be on *reducing* the Bell Operating Companies' market power abuses, not increasing their discretion and ability to fleece captive customers. In any event, SBC has not remotely demonstrated that its uncollectibles expense – particularly as a ratio of its rapidly increasing access revenues –

[1] SBC's claim (at 7) that the market was less volatile prior to enactment of the Telecommunications Act is equally misleading, as its own prior statements to the Commission prove. For example, in 1989 and 1990, the level of the LECs' projected uncollectibles was expressly contested before the Commission, and several LECs contended that those projections were appropriate, relying for support on many of the very same arguments that SBC makes today. Thus, SWBT claimed that its increases in its 1989 uncollectible ratios were appropriate because of the "floundering Texas economy," which, in SWBT's view, "has damaged the financial stability of many I[X]C's," and which, SWBT asserted, means that uncollectibles "can be expected to trend upward." *In the Matter of Annual 1989 Access Tariff Filings*, 4 FCC Rcd. 3638, ¶ 558 (1989). Likewise, Pacific justified its 1990 increase in uncollectibles by claiming that "it forecasts a slowing economy in California and the United States," and by "argu[ing] that this is expected to exert downward pressure on its ability to collect accounts receivable and will increase uncollectibles." *In the Matter of Annual 1990 Access Tariff Filings*, 5 FCC Rcd. 4177, ¶ 387 (1990). In neither instance did these LECs' predictions come true, because the data indicates that the level of LEC uncollectibles remained extremely low in the early 1990s.

has risen "exponentially" or to "unprecedented" levels. To the contrary, SBC's uncollectibles expense as a percentage of revenues remains remarkably low. SBC certainly has not shown that the very modest recent fluctuations in its uncollectibles expenses are especially volatile or the result of some long-term trend, rather than reflective of general economic business cycles that are endogenous to the price cap regulation of access rates. And SBC's claims of crisis arising from the bankruptcy filings of certain carriers is equally exaggerated: although SBC does not provide precise figures, it seems likely that, excluding its claims relating to Global Crossing and WorldCom bankruptcies – which are unique and non-recurring events precipitated by allegations of massive accounting fraud designed to fool investors and creditors – SBC's bankruptcy claims for 2002 are no more significant than in past years.

1. SBC Continues To Reap Exorbitant Returns On Its Access Services.

SBC's ludicrous claims (at 7) that the financial impact of interstate access uncollectibles is "devastating" to SBC and may cause SBC to file for bankruptcy simply ignore the significant benefits SBC has obtained from its position as the dominant provider of interstate access services.[2] SBC and other incumbent LECs were for years – and remain today – protected from any significant competition in the provision of access services, which has allowed them to earn exorbitant and increasing returns on those services. Even if SBC were now suffering some significant losses due to uncollectibles from access customers – and, as discussed below, it is not – SBC has for years collected

[2] As the *Investigation Order* recognizes (¶ 14), the access market is and for years has "two distinct characteristics:" "SBC must provide access services to IXCs and competitive LECs requesting such services, and those carriers must use SBC's access services to originate or terminate many of their interstate calls." It is now SBC which seeks to "significantly alter" the risks surrounding these two characteristics.

more and more access revenues from these same customers – who were compelled to purchase largely from SBC. Thus, from 1996 to 2001, strong demand caused SBC's interstate revenues to increase – despite rate reductions for switched access services – from about $6.9 billion in 1996 to nearly $9.6 billion in 2001. In past years, SBC was all too willing to sell access services to these customers – indeed, it has steadfastly opposed efforts to open its access markets to true competition, preventing these customers from choosing alternate suppliers – but it now claims that it needs relief from this Commission to avoid what it claims is severe financial loss. Those claims are simply not supported by the facts. If SBC does need to file for bankruptcy, that result would have nothing whatsoever to do with interstate access revenues.

In 2001, a period of time in which SBC claims its uncollectibles rose to dangerous levels that it can no longer control with existing tariff provisions allowing it to require security deposits from customers with no or bad track records of payment, SBC's own Form 492A demonstrates that it earned a 21.96 percent rate of return on its interstate access services.[3] SBC's rates of return on interstate access services were equally bloated in the previous two years: SBC reaped a 21.18 percent rate of return in 2000 and a 18.80 percent rate of return in 1999, again despite increases in the absolute amounts of

[3] SBC FCC Form 492A, Rate of Return Report (filed 2002). The overall rate of return for SBC has been calculated as the sum of the net operating income for the local exchange carriers affiliated with SBC divided by the total net investment of these same carriers. In the attached declaration of Bradford Cornell, Professor Cornell reports a similar rate of return (22.36 percent) using SBC's ARMIS reports. Cornell Dec. ¶ 18 & Exh. 3 (citing 2001 ARMIS 43-01, Table I, Cost and Revenue Table, Interstate, Column (h), Average Net Investment, Row 1910; 2001 ARMIS 43-01, Table I, Cost and Revenue Table, Interstate, Column (h), Net Return, Row 1915). The slight differences in the reported rates of return are due to the fact that ARMIS reports are filed earlier than the final Form 492 reports. Regardless of the source of the data, it is clear that SBC's rates of return on access are excessive.

uncollectibles expenses in those years.[4] And, as AT&T recently demonstrated in a petition seeking reform of the regulation of incumbent LECs' special access rates, SBC's earnings on special access services are even more excessive.[5] In 2001, for example, SBC's own ARMIS reports demonstrate that SBC earned a whopping *55 percent* rate of return on special access.[6] SBC's special access rates of return (like those of every other BOC), moreover, have grown *every year* since 1996 – squarely refuting any claim that these services have become significantly more risky. If the market for access services had in fact become more competitive and risky, then elementary economics dictates that revenues would be driven toward costs.[7]

SBC's pleas that the Commission must immediately intervene to provide SBC with additional protections designed to collect even more access revenues simply cannot be reconciled with the marketplace reality that SBC's access revenues are already wildly excessive. SBC seeks to capitalize on what it calls the "state of crisis" in the "volatil[e]" and "highly competitive telecommunications market"[8] in its ploy to gain authority to demand hundreds of millions of dollars in "security" from its interLATA competitors, but

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[4] SBC FCC Form 492A, Rate of Return Report (filed 2002 & 2001) (the 2000 and 1999 returns are calculated for the same LECs that were affiliated with SBC in 2001); *cf.* Cornell Dec. ¶ 18 & Exh. 3 (under ARMIS report, rate of return for 2000 was 20.98 percent and for 1999 was 18.88 percent).

[5] AT&T Corp., Petition for Rulemaking, RM No. 10593 (filed October 15, 2002).

[6] *Id.* at 8 (SBC earned 54.60% in 2001 on special access, about *five times* the rate of return the Commission found just and reasonable in 1990 – which is itself far too high under current market conditions).

[7] *Id.* at 8-9. Moreover, these rates of return on SBC's access services are in fact significantly *understated*, because the costs that SBC reports on its ARMIS reports are its embedded costs. *Id.* at 10. SBC's true costs of providing access services are the much lower, forward-looking economic costs. *Id.*

[8] Direct Case at 7.

the evidence is clear that the industry downturn has not had any affect on SBC's ability to earn monopoly profits in the provision of access services (and, particularly, special access services).

SBC's real world access returns likewise refute any notion that changes in the Commission's longstanding tariff prescription on security deposits are necessary to ensure that SBC's deposit requirements are similar to provisions that companies in competitive industries (including long distance carriers) have.[9] SBC's exorbitant returns demonstrate that SBC is *not* operating in a competitive environment. As described in Professor Cornell's declaration, in competitive markets, if the customer is not satisfied with the security deposit or other terms that a particular supplier demands, the customer can seek to obtain service from another provider. Cornell Dec. ¶¶ 8, 31-32. The customer of a dominant LEC like SBC, by contrast, generally has no such choice (*id.* ¶ 32; *see also Investigation Order* ¶ 14) – which is why the Commission has always recognized the need for prescription in this context that minimizes dominant LEC abuse of security deposit, advance payment and termination requirements. Because SBC clearly retains substantial market power in the provision of access services, it retains the incentive and ability to impose unfair and discriminatory terms and conditions, like the security deposit revisions it proposes here – both to increase its own revenues, and, as it increasingly gains section 271 authority, to raise its long distance rivals' costs. Cornell Decl. ¶¶ 8-9, 21, 23, 27, 30-32.

[9] As described below, SBC's particular tariff revisions on security deposits are *not* in fact like those of companies in competitive industries – companies in competitive industries cannot generally seek to impose more onerous credit terms on customers during an economic downturn. And companies in competitive industries do not demand security deposits from large customers solely based upon the customer's long-term bond rating, as SBC proposes.

2. SBC's Uncollectibles Are Small Relative To Revenues, And Have Not Varied Substantially Over Time.

SBC's proposed tariff revisions are also plainly unsupported because SBC has not even shown that it is experiencing any significant or sustained increase in its uncollectibles expenses. SBC's claims (at 6-7) that it has incurred significantly higher costs due to an "exponential rise in uncollectibles" is simply misleading. In fact, SBC's bad debt levels, like those of other large LECs, remain very small in comparison to revenues. Moreover, the levels of uncollectibles fluctuate from year-to-year, depending on a number of factors including general economic conditions and the particular LEC's efficiency in collecting bad debts. The recent and very modest increases in bad debt levels experienced by SBC reflect business cycle fluctuations and other temporary events, and not any permanent trend that substantially increases the *future* risks of nonpayment.

The principal data that SBC provides in response to the *Investigation Order*'s requests (¶ 15) for SBC's uncollectibles levels is a chart that lists the absolute amount of interstate uncollectibles expense for each of the SBC companies from 1990 to 2002. Direct Case at 6. Based on this single chart, SBC asserts that "SBC's uncollectibles have experienced a dramatic and unprecedented increase in the past two years" and that this is a "significant and permanent" change. *Id.* at 7. However, SBC's data, and especially its claims about that data, are highly misleading, for a number of reasons.

Most significantly, SBC provides only the absolute amount of interstate uncollectibles, but inexplicably fails to compare those figures to its interstate access revenues, which have increased substantially. The relevant measure of uncollectibles expense is, of course, the *percentage* of revenues that is uncollectible. As shown in the following table, SBC's uncollectibles ratios (uncollectibles expense divided by interstate access revenues) are quite small, and have *never* exceeded 0.50 percent of revenues.

SBC Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001[10] Table 1			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	23,024	5,991,659	**0.38%**
1991	21,987	5,878,025	**0.37%**
1992	21,123	5,980,680	**0.35%**
1993	22,338	6,295,145	**0.35%**
1994	25,905	6,519,373	**0.40%**
1995	16,554	6,717,367	**0.25%**
1996	26,896	6,978,562	**0.39%**
1997	23,029	7,042,184	**0.33%**
1998	21,761	7,687,547	**0.28%**
1999	21,373	8,254,495	**0.26%**
2000	30,987	8,932,712	**0.35%**
2001	48,032	9,622,673	**0.50%**

As these figures confirm, SBC is not suffering from any bad debt "crisis." Its level of uncollectibles is low by virtually any measure, and even the modest increases in the years 2000 and 2001 still have not placed any substantial percentage of SBC access revenues in jeopardy.[11] Indeed, for Ameritech, the uncollectibles ratio *declined* in 2000 and was flat in 2001 at a microscopic 0.11 percent – by far the *lowest point* since 1990. *See* Exh. 1,

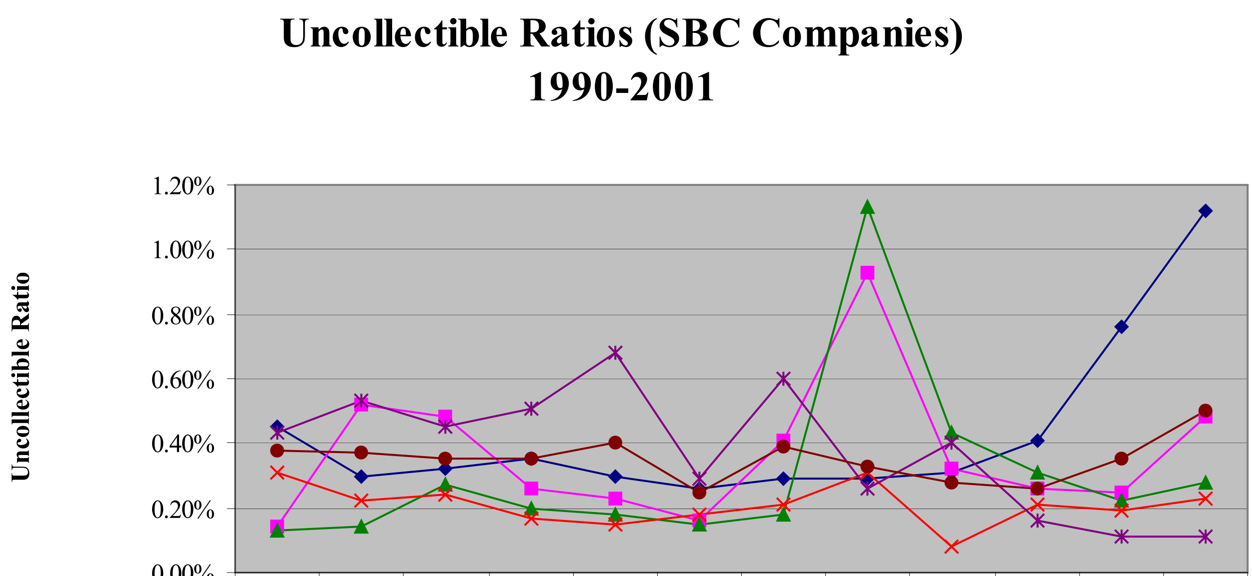
[10] 1990-2001 ARMIS, 43-01, Table 1, Cost and Revenue Table, Interstate, Row 1060, Uncollectibles; 1990-2001; ARMIS, 43-01, Table 1, Cost and Revenue Table, Interstate, Row 1090, Total Operating Revenues. This data shows total figures for all SBC Companies. Separate tables for each company are attached as Exh. 1 (Tables 2-6).

[11] SBC also provides partial figures for its uncollectibles for 2002. Direct Case at 6. The basis for these figures is unclear, but in all events those numbers are distorted because of the WorldCom and Global Crossing bankruptcies which, as explained below, are not likely to recur and were not redressible with security deposit provisions.

Table 2.[12] In fact, the absolute amount of uncollectibles for SBC is *less* than the amount of access charges that carriers have claimed SBC has over-billed (*see* Direct Case at 12) – evidence that SBC's over-billing is far more prevalent than its customers' non-payment. And in all events, as described above, the overall recent and slight increases in bad debt have still had no cognizable negative impact on SBC's ability to earn just and reasonable returns – indeed, SBC continues to reap exorbitant rates of return on its access services.

Nor can the mere fact that there have been fluctuations in the year-to-year levels of uncollectibles expense justify any tariff revisions. SBC's uncollectibles expenses have always fluctuated over time. As Professor Cornell explains (¶¶ 7, 11, 15-17), this is entirely normal and the result of a variety of factors, such as general economic conditions and SBC's efficiency at collecting its debts, and, as explained below, it was anticipated by and accounted for in establishing price caps. Thus, as shown in Table 1 and in the attached chart, in 1994 and 1996, SBC experienced increases in its uncollectibles ratios, jumping to 0.40 percent in 1994, and from 0.25 percent in 1995 to 0.39 percent in 1996. However, in many other years, including 1995, 1997, 1998, and again in 1999, SBC's uncollectibles ratio declined to as low as 0.25 percent in 1995. *See also* Cornell Decl. ¶¶ 11-12.

[12] Likewise, Pacific Bell's uncollectibles are essentially the same in 2001 as in 1999. *See* Exh. 1, Table 3.



	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
SWBT	0.45%	0.30%	0.32%	0.35%	0.30%	0.26%	0.29%	0.29%	0.31%	0.41%	0.76%	1.12%
SNET	0.14%	0.52%	0.48%	0.26%	0.23%	0.16%	0.41%	0.93%	0.32%	0.26%	0.25%	0.48%
Nevada	0.13%	0.14%	0.27%	0.20%	0.18%	0.15%	0.18%	1.13%	0.43%	0.31%	0.22%	0.28%
Pacific	0.31%	0.22%	0.24%	0.17%	0.15%	0.18%	0.21%	0.31%	0.08%	0.21%	0.19%	0.23%
Ameritech	0.43%	0.53%	0.45%	0.51%	0.68%	0.29%	0.60%	0.26%	0.40%	0.16%	0.11%	0.11%
SBC Total	0.38%	0.37%	0.35%	0.35%	0.40%	0.25%	0.39%	0.33%	0.28%	0.26%	0.35%	0.50%

As these figures demonstrate, there is no valid basis for SBC's claims that it has experienced "significant and permanent" growth in its uncollectibles. And as Professor Cornell explains, the 2000 and 2001 fluctuations are not significantly different than prior fluctuations and could not support any reasoned conclusion that there is a long-term (let alone "unprecedented") trend of increased uncollectibles expense. Cornell Decl. ¶¶ 11-17.

Beyond these errors, even the absolute figures on interstate uncollectibles that SBC presents are misleadingly high.[13] Those figures include bad debt for access services

[13] SBC also makes vague and unsupported claims that its "total" uncollectibles exceeded $139 million in 2001 and $260 million for seven months of 2002. Direct Case at 9. Again, SBC fails to provide the relevant information on its revenue that is necessary to

attributable to end users, which is plainly not relevant to the security deposits SBC is seeking to impose on carrier customers. From SBC's ARMIS reports, it is not possible to determine precisely the amount of end user uncollectibles compared to uncollectibles caused by wholesale customers. However, if end user customers default at approximately the same rate as carrier customers (and, excluding aberrations like MCI WorldCom, end user customer default rates may well be higher),[14] it is clear that SBC's absolute figures on interstate uncollectibles overstate the amount of wholesale customers' uncollectibles. In the year 2001, for example, SBC claims that Pacific Bell's interstate access uncollectibles were about $6.1 million. But if end user customer default rates are approximately the same as carrier default rates, about $2.5 million of the Pacific total – i.e., about 40 percent – is attributable to end users, and only the remaining $3.6 million is attributable to wholesale customers.[15]

SBC also points to the amounts of the claims that it has asserted in bankruptcy proceedings since 2000 as evidence that its risks of nonpayments have greatly increased

judge properly any trend in bad debt expense. Moreover, and in all events, SBC admits (*id.*) that those total uncollectibles include all types of bad debts that bear no relation whatsoever to the issues in this proceeding about the propriety of demanding millions of dollars of security deposits from access customers. For example, uncollectibles relating to interconnection agreements would likely involve payments for unbundled network elements, issues which go well beyond the interstate access services at issue here.

[14] SBC claims (at 9) that end user access uncollectibles are small and increased more slowly than carrier uncollectibles, but it does not disclose how it conducted the analysis and it also does not provide the relevant revenue figures that are necessary to fully evaluate these issues.

[15] Based on the same analysis, about 36 percent of Ameritech's uncollectibles would be attributable to end users, 35 percent for Southwestern Bell, 33 percent for SNET, and 36% for Nevada Bell.

in recent years.[16] Those figures are both seriously flawed and ultimately not indicative of the risks of nonpayment at which security deposit provisions are targeted. First, as SBC concedes (Direct Case at 7), many of these bankruptcy proceedings remain open, and SBC cannot determine the amounts that it will recover from the bankrupt entities. Thus, the amounts of the claims presented by SBC significantly overstate actual uncollectibles.[17] Second, the amounts of the claims presumably include the value of *all* of the services that SBC provided to these carriers, and not merely access services – which again results in a significant overstatement of the relevant uncollectibles expense. Third, unlike BellSouth, SBC fails to show the amounts for each bankrupt estate. However, if BellSouth's figures are any guide, the amounts claimed in bankruptcy are generally quite small, apart from the amounts relating to the bankruptcies filed by MCI WorldCom and Global Crossing.[18] And those bankruptcies have been linked to massive and unprecedented instances of accounting improprieties. It would obviously be

[16] Direct Case at 1, 5, 15.

[17] And in fact, by virtue of its status as a dominant supplier of access, SBC has a superior position that makes it more likely to obtain recovery of its claims in bankruptcy. A bankrupt entity's executory contracts can be assumed and assigned pursuant to 11 U.S.C. §§ 365(b)(1) and (f)(1) if the debt associated with such contracts is cured, or paid. Because the LECs' access services are typically the only option available, a company emerging from bankruptcy or a company acquiring all or part of a bankrupt entity will often seek to assume the existing LEC access services. In that instance, as a condition for the assumption and assignment of the access services, the bankruptcy code provides for payment of both the pre-petition and post-petition claims. Thus, there is no basis to presume that SBC will not ultimately obtain payment for significant amounts of access it has claimed in bankruptcy proceedings. Although SBC claims that it has to date collected about 8 percent, that figure is not limited to access services (and is lower than that reported by other carriers). The ability to recover access services may be higher.

[18] *See* Direct Case at 1 (admitting that "most of" the $420 million that SBC has claimed since 2000 in bankruptcy proceedings relate to a few of its "largest customers," which likely includes Global Crossing and WorldCom).

improper to base future policy that will affect all customers on such aberrations that are both unlikely to be repeated (given the serious tightening of accounting and related regulation by the Securities and Exchange Commission and other regulators) and not redressible through security deposit provisions (which SBC concedes must rely upon what is reported and cannot account for what is hidden or misrepresented).[19] With those two claims removed, SBC's bankruptcy claims would likely be drastically reduced.

The *Investigation Order* seeks to determine whether SBC can demand security deposits from remaining *viable* carriers. If anything, the downfall of MCI WorldCom and others should strengthen the remaining viable carriers who will inherit additional customers. Moreover, as described in Professor Cornell's declaration, the bankruptcy data presented by SBC tends to show that bad debt expense for the listed companies will generally *not* be occurring in the future. Cornell Dec. ¶¶ 16-17. SBC nonetheless repeatedly contends that its uncollectibles will continue to increase, but it offers not a shred of evidence to support that prediction (one that LECs have been crying wolf on for years (*see supra* note 1)).[20] In short, SBC has not come close to meeting its burden of demonstrating that an overhaul of longstanding security deposit provisions is necessary to

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[19] Where a company engages in serious accounting fraud that is designed to mask its true financial state, the reported information relied upon by credit managers would likely show that no unusual credit terms or security deposits are needed. In this regard, it is significant to note that SBC and the other large incumbent LECs are among the many suppliers (including AT&T) that have large claims against the MCI WorldCom estate. The tariff revisions that SBC and other incumbent LECs seek would likely not provide additional security in cases where companies engage in fraud or other improper practices.

[20] In particular, SBC claims that unnamed "financial experts" have "predicted" that an "industry downturn" will continue (at 2-3), but SBC fails to back up or even specify the basis of this claim – and in all events never shows that such a downturn, if it continues, will in fact cause any significant risk to SBC's uncollectibles or access returns.

protect it from extraordinary and nontransitory increases in the risk of nonpayment by carrier customers for access services.

B. SBC's Existing Price Cap Rates Adequately Compensate It For The Risk of Uncollectibles.

Any expansion of SBC's security deposit tariff provisions is both unnecessary and improper because the Commission's price cap regime already accounts for uncollectibles expense – and fluctuations in the levels of uncollectibles expenses – in the rates that SBC may charge access customers. As the *Investigation Order* recognizes (¶¶ 3, 15), SBC is a price cap carrier, and any year-to-year fluctuation in uncollectibles will either reduce or increase SBC's profits, but, under the design of the price cap system, such fluctuations cannot entitle SBC to assess higher rates. And by the same token, SBC cannot circumvent this feature of price caps by adopting what is in effect a massive rate increase through new security deposit and advance payment tariff provisions that would radically alter the balance of risk as between SBC and its captive access customers.

The *Investigation Order* specifically directed that "[a]s part of its direct case, SBC shall explain why it believes its rates under price caps do not adequately compensate it for the risk of uncollectibles." *Investigation Order* ¶ 15. As the *Investigation Order* explained, "SBC's rates include a revenue requirement component for uncollectible debts that is based on the amount of uncollectibles permitted as an interstate revenue requirement at the time SBC became subject to price cap regulation." *Id.* The *Investigation Order* directed SBC to submit data as to the "level of uncollectibles that was included in its initial price cap rates," and then to "address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks expected to be endogenous to price caps, or whether it reflects some long term trend that warrants expanded security deposits." *Id.* In addition, the *Investigation Order* required SBC to "address what modifications should be made to its price cap indexes and service band indexes to account for the changes to the capital and risk parameters of price caps" that would occur if the Commission were to permit changes to SBC's access tariff to include expanded security deposit discretion. *Id.*

SBC's Direct Case provides no serious response to the *Investigation Order's* inquiries. In fact, the evidence that SBC does provide shows that the price cap regime put in place in 1990 fully accounted for and anticipated the types of modest fluctuations experienced by SBC.

Any fluctuations in the year-to-year level of uncollectibles are simply business risks that are endogenous to the price cap regime. *See id.* Actual levels of uncollectibles expenses – like actual levels of *all* expenses – will vary over time, depending upon factors such as general economic conditions and the LECs' own efficiency in collecting bad debts. In years where economic conditions are poor, and where uncollectibles in fact rise, a LECs' profits, all other things being equal, will be reduced. On the other hand, when economic conditions improve and where uncollectibles fall, a LECs' profits can be expected to be greater.[21] The very purpose of the price cap regime is to hold rates and other terms constant in the face of expense fluctuations to increase the LEC's incentives to act efficiently.[22]

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[21] In a number of years since price caps were instituted in 1990, SBC and a number of LECs experienced very low uncollectible rates because of economic and other conditions. Their profits in those years were likely larger because they had very little bad debt. However, SBC and the other incumbent LECs have never come forward at those times to relax credit terms to make them more favorable to customers.

[22] SBC claims that the price cap regime "reflects only changes in the costs of production that carriers face in light of price changes that occur in all sectors of the economy."

In fact, the evidence SBC submits regarding the level of uncollectibles in 1990 that were included in the price cap regime demonstrated beyond all doubt that SBC has not suffered any unusual or unanticipated bad debt expense. *See* Direct Case at 6. For Ameritech, the absolute level of uncollectibles in 2000 and 2001 (and, indeed, in most years) was *far less* than the amount included in its price caps in 1990. Ameritech included $9.2 million in expense in 1990, yet in 2000 and 2001, its absolute level of uncollectibles was just $3.4 and $3.6 million, respectively. And for many of the other SBC companies, the 1990 level of uncollectibles is not significantly different from uncollectible levels in recent years.[23] Pacific's 1990 price cap filing apparently included $3.6 million for uncollectibles, which is comparable to its 2001 level of $6.1 million, considering the corresponding increases in revenue. Given that SBC's evidence shows that its 1990 price cap filings included a level of bad debt expense that is largely consistent with its current levels, as adjusted for revenue increases, there can be no doubt that SBC's price caps necessarily account for the risk of uncollectibles.

Direct Case at 4-5. In SBC's view, the telecommunications industry has had "disproportionately negative" results for which price caps do not account. *Id.* Even assuming the telecommunications sector has in fact been disproportionately harmed by the recent downturn, SBC has not shown that it has affected its access services and uncollectibles. To the contrary, the data described in the previous sections show that SBC still maintains excessive returns and low uncollectible ratios. Moreover, SBC's arguments regarding the price cap regime would mean that SBC and other LECs should reduce their rates when the telecommunications sector outperforms the economy as a whole – but as AT&T has explained, SBC has *raised* its special access rates.

[23] SBC claims that Southwestern Bell and Pacific Bell included uncollectible amounts in its price caps in 1990 that were much less than its actual bad debt expense in 1990, but it provides no explanation for these discrepancies. And it entirely fails to address how its current efforts to effectively increase that revenue requirement should be permitted because the amounts included in its price caps in 1990 did not equate to the actual bad debt levels.

Further, as the *Investigation Order* recognizes, under the price cap regime, a LEC experiencing a rise in uncollectibles must demonstrate either that the increase is due to a change in exogenous costs, *i.e.*, some "administrative, legislative or judicial action beyond the control of the carriers,"[24] or that their earnings are low enough to justify an above-cap filing.[25] Despite a stray comment (Direct Case at 10), SBC has not sought an exogenous cost change, and it also has not even attempted to demonstrate that recent fluctuations in uncollectibles expense have been so extreme that existing rates and tariff provisions will prevent it from earning a just and reasonable return – a showing that it could not make given its exorbitant returns.[26]

Given the price cap regime, the *Investigation Order* required SBC to demonstrate, at a minimum, that any changes in its uncollectibles constitute a long-term trend, rather than a simple change in the business cycle or a reduction in its own efficiency in collecting bad debts. *Investigation Order* ¶¶ 3, 15, 19. SBC has not made that showing. Indeed, it admits that a major factor in the modest increases in uncollectibles for some of its companies is the "downturn in the economy." Direct Case at 18. As described above, SBC's uncollectibles expense has fluctuated over time – variability that is entirely consistent with business cycles and other short-lived events. Moreover, the very

[24] *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶ 166 (1990).

[25] *Investigation Order* ¶ 3.

[26] In fact, granting SBC relief here would provide a graphic illustration of why price caps do not eliminate the incumbent LECs' incentives to reduce costs. The incumbents would be secure in the knowledge that, despite the price cap system, they can request regulatory relief to obtain higher rates (or their equivalent – such as the increased security deposits at issue here) in circumstances where the strict application of price caps would reduce their earnings.

difficulties in the telecommunications industry over the past few years that SBC claims require relief will help reduce the risk of bad debt expense going forward. As Professor Cornell describes, given the capital market conditions, few new firms (and even fewer financially unstable firms) will be entering telecommunications markets. Cornell Dec. ¶ 17. And the firms that have declared bankruptcy will either cease to exist or will emerge from bankruptcy with little or no debt and thus will not present extraordinary future risk of non-payment. Cornell Dec. ¶¶ 16-17. Thus, as in the past, SBC's level of uncollectibles expense ratio will almost certainly continue to ebb and flow, but cannot be expected, on average, to rise materially.[27]

The only fact that SBC points to as evidence of any long-term trend or change in its uncollectibles is its claim that the 1996 Act induced the "entry of numerous carriers" into the market, which has increased volatility. Direct Case at 2, 7, 18. However, nothing in the Act or the Commission's decisions implementing the Act necessarily makes it more likely that SBC and other incumbent LECs will have higher levels of bad debt. The Act did not change the regulation of access services through the price cap system, which means that today, as in the years prior to the Act, SBC is properly compensated for the risk of uncollectibles. And the Act – which was designed largely to open *local* markets to competition – did not create any change in the risks of nonpayment by access purchasers. The long distance industry has been subject to intense competition for many years, and well before the passage of the Act.

[27] SBC cites a few scattered press articles stating that any recovery in the telecommunications industry may take years, Direct Case at 18, but that generalized statement, even if true, does not at all show that interstate uncollectibles will not continue to fluctuate as they have for at least the past eleven years.

For all these reasons, the price cap regime ensures that SBC and other LECs are already properly compensated for the risk of uncollectibles.

C. SBC Is Adequately Protected By The Commission's Longstanding Prescription Allowing Security Deposits From Customers With Unusual Risks of Non-Payment.

SBC's existing tariffs contain longstanding, Commission-prescribed language that allows SBC and other incumbent LECs to collect security deposits from customers with a poor payment history or with no established credit.[28] Those provisions have protected SBC and other incumbent LECs for over 15 years – in both good and bad economic times – and they remain more than sufficient today. Given that the level of its interstate uncollectibles was only a mere 0.50 percent in 2001 (and, in most years, is less than that), there is no conceivable need to allow SBC the flexibility to secure even more of its revenues with deposits.

Moreover, in response to the *Investigation Order*'s request (¶ 17) to address "the percentage of interstate billings that are billed in advance" and how that percentage affects the risk faced by SBC, SBC has revealed that between 85 and 90 percent of its access services are already billed in advance (Direct Case at 13) – which should significantly mitigate the need for any security deposit by providing for an effective one month security deposit. Because the overwhelming percentage of SBC's access services are billed in advance, the amount at risk due to nonpayment is smaller – a further reason why there is no need to change the existing security deposit prescription.[29]

[28] *See* Memorandum Opinion & Order, *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1168-70 (1984) ("*1984 Access Order*").

[29] SBC claims that advanced billing does not equate to advance payment, but advanced billing certainly allows SBC to begin the process of collecting past due amounts 30 days earlier, which means that any amounts past due before any termination will be reduced.

The unfortunate reality is that SBC's proposed tariff changes are not aimed at deadbeat or bankrupt customers, but rather at healthy customers – which also happen to be SBC's competitors. And therein lies a fatal flaw in SBC's claims – it has not even attempted to show that radical changes to the Commission's prescribed tariff language are required to protect it from the possibility that its credit worthy customers will not pay, or that those customers are not likely to pay their bills in the future.

Further, these tariff revisions are not necessary to allow SBC to implement the same security deposit provisions that companies in other industries have. As Professor Cornell explains, the critical distinction here is that credit practices in other industries (and in other markets in the telecommunications industry) are disciplined by market forces, whereas SBC's dominance in providing access leaves its customers with no realistic alternatives from which to choose. Cornell Dec. ¶¶ 8, 31-32; *see Investigation Order* ¶ 14. Thus, in other industries, if a company demands a substantial security deposit from a large customer, the company risks losing the customer to another supplier who determines to offer better credit conditions. Cornell Dec. ¶¶ 8, 31-32. That marketplace dynamic provides a powerful incentive for companies to evaluate properly a customer's true creditworthiness, and not to request security deposits unless the harm from a default and the risk of default outweigh the potential revenues. *Id.* For SBC, in contrast, there are rarely any market forces that discipline its credit decisions, and thus SBC has every incentive to abuse its authority to demand security deposits. *Id.*

SBC's reaction to its modest recent increases in uncollectibles is also not at all prevalent in other industries. Rather, when the customers of companies in competitive industries uniformly experience hard times, those competitive companies themselves often suffer as well – and they certainly are *not* able to request relief from a regulatory agency to avoid slight increases in bad debt expense. In its request to change its credit practices in response to a downturn in the business cycle, therefore, SBC seeks not equal treatment, but special treatment to which it is not entitled and that would seriously harm competition and consumers.

III. THE SPECIFIC REVISIONS THAT SBC PROPOSES ARE UNLAWFULLY VAGUE AND WOULD PROVIDE SBC WITH UNFETTERED DISCRETION TO DEMAND SECURITY DEPOSITS FROM ITS COMPETITORS.

A. SBC Has Not Demonstrated That Its Proposed Security Deposit Triggers Are Sufficiently Correlated With Non-Payment Risks.

The Act requires that a tariff be "just and reasonable," and not "unreasonab[ly] discriminat[ory]," and the Commission's rules further mandate that tariff provisions "contain clear and explicit" statements in order "to remove all doubt" as to the proper application of the tariff.[30] SBC's initial tariff filing plainly violated all of these criteria. As explained by the *Investigation Order* (¶ 14), SBC's initial tariff filing raised serious "concerns about whether the tariff language clearly and unambiguously sets forth a standard that can be objectively administered in a nondiscriminatory manner." SBC likewise "has not shown that [SBC's new criteria for demanding a security deposit] . . . are valid predictors of the likelihood of a customer paying its access bill, or that they are better predictors of whether a customer will pay its bills in the future that the customer's past payment history." *Investigation Order* ¶ 20. Accordingly, the Commission ordered SBC to "explain how [SBC's proposed criteria] . . . is a valid predictor of whether the carrier will pay its interstate access bill" (*id.*), and "how such varied data can be applied

[30] *See* 47 U.S.C. §§ 201, 202; 47 C.F.R. § 61.2.

in a manner that will not produce arbitrary and/or discriminatory results." *Id.* The Commission emphasized that a satisfactory response to these critical issues "is especially important here because in most cases the entity upon which SBC would impose the security deposit would also be a competitor of SBC itself, or of its long-distance and advanced services affiliate." *Id.*

SBC's Direct Case barely addresses these serious concerns. In fact, it admits that "there are *no* studies directly relating credit impairment to ability to pay interstate access bills." Direct Case at 21 (emphasis added). It nonetheless contends that based on "SBC's experience with uncollectible accounts" – which it does not explain with written testimony and which it admits it does not retain – "there does *appear to be* a relationship between deteriorating credit and payment problems." *Id.* at 21, 28. Based largely on this unsupported claim, SBC attempts to defend its six proposed security deposit/advanced payment triggers. But it utterly fails to show that any of these triggers is necessary or a better predictor than those set forth in its existing tariffs.

As an initial matter, SBC provides no sound basis for its proposal to include a trigger that, SBC contends, "clear[s] up potential ambiguity" regarding its existing tariff language, *i.e.*, the tariff's new provisions allowing SBC to collect a security deposit if a customer's account balance has fallen in arrears in any two months out of any consecutive twelve month period. Direct Case at 4, 25. But as AT&T has already explained,[31] this provision is not at all a clarification of existing provisions allowing SBC to collect deposits from carriers with a proven history of nonpayment, but rather is a new and onerous term that unlawfully "impose[s] significant sanctions" for very "insignificant

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[31] Petition of AT&T Corp., *Ameritech Operating Companies Tariff FCC No. 2, Transmittal No. 1312*, *et al.* at 16-18 (filed August 9, 2002).

violations" of a tariff.[32] This trigger simply does not "prove[]" that a particular carrier has exhibited a "history of late payments," as the existing tariffs require.

The provision could apply, for example, to an IXC that twice in a year had paid less than its full access bills by only *de minimus* amounts. Especially given the complexity of the intercarrier billing process, such minor discrepancies are hardly unexpected, and do not provide any justification for SBC to demand advance payments or deposits that necessarily would be grossly disproportionate to these access bill payment discrepancies. The Commission has refused to permit dominant LECs impose such disproportionate penalties on captive customers for insignificant tariff violations (like those here), which in no way establish a "proven history of late payments." *1984 Access Tariff Order*, 97 F.C.C.2d at 1155.

Further, because SBC has stated (at 33) that it generally includes disputed amounts as past due and thus eligible to trigger a security deposit, SBC's so-called clarifications are even more unreasonable. An IXC faced with an inaccurate of clearly overstated access bill would be confronted with the "Hobson's choice" of either paying the excessive charges or laying itself open that SBC would use the refusal to pay an erroneous access bill as the basis for a substantial security deposit that dwarfs the amount in dispute. Moreover, this term provides SBC with a perverse and anticompetitive incentive to bill less accurately or even engage in intentional over-billing and other efforts that set traps for IXCs to be unable to pay their access bills on a timely basis. And it is undisputed that over-billing is already a problem that is at least as significant as any bad debt expense "crisis" – even when SBC's current incentives are to collect payment as

[32] *1984 Access Tariff Order*, 97 F.C.C.2d at 1155.

rapidly as possible. As SBC concedes, carriers have disputed about $75 million worth of access charges, which is more than the absolute amount of uncollectibles for SBC in a year.

The two other primary security deposit triggers proposed by SBC – which are based on long-term bond ratings issued by certain credit rating agencies – are also overbroad, subjective, and not correlated with an inability to pay for access charges.[33] SBC proposes to demand a security deposit where "any debt securities of a customer or its parent . . . are below investment grade" or "any debt securities of a customer or its parent are rated the lowest investment grade by a nationally recognized credit rating organization and are put on review by the rating organization for a possible downgrade."[34] For "all customers satisfying the impaired creditworthiness criteria" and whose "most recent interstate access bills from the SBC Telephone Companies total (including any outstanding balances) $1 million or more."[35] SBC claims that these measures are "objective," "narrowly tailored" and, based on "substantial statistical support," demonstrate a credit risk. Direct Case at 2, 21. These claims are demonstrably without merit.

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[33] SBC's other two triggers call for deposits where a carrier files for bankruptcy and where it "publicly states" it cannot pay its debts. The latter trigger, in particular, is unreasonable to the extent it allows SBC to collect a security deposit based on ambiguous, off-the-cuff remarks made by low or mid-level managers that SBC could pounce upon as a basis to trigger a substantial security deposit. Such unofficial pronouncements are not significant predictors of an inability to pay access bills.

[34] *E.g.*, Ameritech Operating Cos., FCC Tariff No. 2, Transmittal No, 1312, § 2.8.1(B)(1), (2).

[35] *Id.* § 2.8.1(B).

First, SBC's long-term bond rating triggers are hopelessly overbroad, and encompass virtually all carriers in the industry, regardless of their ability to meet their access payments on a month-to-month basis. SBC claims these provisions are reasonable because studies by Moody's and S&P, two of the three credit rating agencies upon which SBC seeks to rely, has claimed that "the risk of default increases from 4 companies per 1000 to 100 companies per 1,000 as rated companies fall from investment grade to the lowest speculative grade." Direct Case at 21. But even if true, that fact provides no support for SBC's proposal to demand security deposits or advance payments not just from the "lowest speculative grade," but also from all speculative grade companies and even some investment grade companies. SBC's triggers apply to a much broader group of companies, and the risk of default for the companies SBC targets is much lower. As Professor Cornell sets forth, Moody's own data show that, over the last 30 years, about *96 percent* of companies that are below investment grade *do not default* in a given year.[36] And the annual default figure for the investment grade companies SBC targets is even lower.[37] Accordingly, a below-investment grade long-term bond rating is not at all correlated with a customer's inability to pay monthly access bills, and the overwhelming majority of companies with such ratings continue to pay all of their obligations. SBC seeks the authority to demand security deposits or advanced payments from *all* such companies – and even some that are rated above investment grade. With only 4 percent

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[36] *See* Cornell Decl. ¶ 24 (citing Moody's Investor Service, Special Comment "Default & Recovery Rates of Corporate Bond Issuers: A Statistical Review of Moody's Ratings Performance 1970-2001," at 33 (Exh. 27) (February 2002)) (available at http://www.moodys.com/moodys/cust/research/venus/Publication/Special%20Comment/noncategorized_number/74171.pdf) ("Moody's Statistical Review").

[37] Moody's Statistical Review at 33, Exh. 27.

of below-investment grade rated companies likely to default in a given year, it is plain that SBC's proposal to allow it to demand security deposits or advance payments from every one of these companies is overbroad, and not at all consistent with how the market judges these companies' risk of default.

The overbroad and widespread impact of SBC's long-term bond rating triggers can also be seen by examining a list the long-term bond ratings of some of the largest long distance carriers – data that, again, SBC did not provide. AT&T has compiled the long-term bond ratings of the nation's largest IXCs (or a parent company) issued by three credit rating agencies (Moody's, S&P, and Fitch).[38] The results of this compilation are striking: virtually *all* of the long distance carriers that are not affiliated with BOCs are very close to or already fall within SBC's proposed long term bond rating triggers. Of the top ten carriers, only two, AT&T and Verizon's long distance affiliate, have long term bond ratings that do *not* fall within the SBC-defined triggers.[39] For those two carriers, AT&T could fall within the triggers if the rating agencies make relatively

[38] *See* Exhibit 2, attached hereto. For carriers that do not have bond ratings, SBC proposes to use a Dun & Bradstreet composite credit appraisal or a D&B "Paydex" score. SBC provides no detail about these tools, but they are not appropriate for use in these circumstances. Paydex is system that depends on the *voluntary* disclosure by suppliers of a customer's payment habits. Not all of a company's suppliers likely will participate, and any sample of suppliers is not likely to be representative. Thus, one or two suppliers can skew the Paydex data for a customer. Moreover, there is no way to validate the data provided by the suppliers, and it typically includes, for example, even amounts that are subject to legitimate billing disputes. Because of these flaws, any reliance solely on these mechanisms would be arbitrary and would not be a valid predictor of non-payment of access services.

[39] The list of carriers was compiled by examining the Commission's data listing long distance carriers by revenue. Sprint maintains investment grade ratings, but is at the lowest level of investment grade, and is on review for downgrade by two of the three credit rating agencies. WorldCom, Qwest, LCI (a Qwest subsidiary), IDT Corp, and Broadwing Communications Services all have below investment grade ratings.

modest changes to its ratings, and it seems obvious that Verizon's affiliate (like all BOC long distance affiliates) would be eligible for a deposit except for its close connection with Verizon. Moreover, of the top 40 carriers, only *five* additional carriers (apart from BOC-affiliated companies) maintain investment grade ratings.[40] With about three-quarters of the long distance companies failing to meet SBC's investment grade criteria, it is evident that SBC's long-term bond ratings are overbroad, and are simply a pretext that SBC can use to demand hundreds of millions of dollars in security deposits or advance payments, even though the bond rating agencies' own statistics show that the annual default rate for below-investment grade companies is only 4 percent.

Second, even if the long-term bond ratings did not in fact apply so broadly to virtually all of SBC's customers, SBC has not shown that these long-term bond ratings are an accurate measure of a customer's inability to pay access charges on a monthly basis. Indeed, SBC concedes that "there are no studies directly relating credit impairment to ability to pay access bills." Direct Case at 21. Further, as the bond rating agencies fully admit, the very purpose of these long-term bond ratings is *not* to measure a carrier's immediate ability to pay its month-to-month obligations like access charges.[41] Rather, these agencies consider a wide variety of factors about a company's long-term financial condition to assess the chances it will be unable to pay off its bonds and other debt

[40] The five are Cable and Wireless, Touch America, Inc., Electric Lightwave, Equant Operations (a subsidiary of France Telecom), and ALLTEL Communications.

[41] Statement of Robert Konefal, Managing Director, Moody's Investors Service, FCC En Banc Hearing, (Oct. 7, 2002) ("our ratings reflect Moody's *opinion* on the relative creditworthiness of a *fixed income security*") (emphasis added); Standard & Poor's, *Standard & Poor's Corporate Ratings Criteria*, at 5 (1996) (the intent of the bond ratings is to measure creditworthiness of "a particular debt security").

securities over a long term horizon.[42] Thus, a company can have low long-term bond ratings, yet still maintain an unquestioned ability to pay any short-term obligations. The long-term bond rating measures proposed by SBC – unlike the Commission's existing tariff prescription that examines a proven history of nonpayment – are simply not aimed to measure the risk of non-payment of access charges.

Third, SBC's claims that these long-term bond ratings are "objective" and worthy of deference are exaggerated. The three bond rating agencies are simply offering their opinion as to the risk presented by a certain company – and, like all opinions, they are based on subjective judgments that often turn out to be spectacularly wrong. Indeed, the three bond rating agencies relied upon by SBC have recently come under fire for their inadequate processes and methodologies used in issuing their ratings.[43] Moreover, as the bond rating agencies admit, they rely extensively on financial information that is publicly available (or provided by the rated company), and do not engage in any independent effort to verify the accuracy of that information.[44] Because SBC's proposal is largely prompted by the bankruptcies of WorldCom and Global Crossing, it is certainly

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[42] To determine long term debt ratings, bond rating agencies will examine factors like the specific characteristics of a company's debt instruments (*e.g.* standard / plain vanilla bond, coupon, zero-coupon, convertibility provisions), the maturity date of the instruments, the expected corporate cash flow over the life of the debt instruments, the capital structure of the issuer (*e.g.*, debt-to-equity ratios), and the expected business environment over the life of the debt instruments. Many of these items have little to do with an issuer's ability to pay immediate obligations.

[43] *E.g.* Report of the Staff to the Senate Committee on Governmental Affairs, *Financial Oversight of Enron: The SEC and Private Sector Watchdogs*, (Oct. 8, 2002) ("rating agency reform is needed if the actual performance of these organizations is to live up to public expectations").

[44] Konefal Statement at 2 ("we do not audit the financial information provided to us").

significant that SBC's proposed solution would not have addressed either of these bankruptcies.

To be sure, long-term bond ratings are not totally irrelevant to a credit analysis of whether a customer should be required to pay a security deposit, but as AT&T explained in its opposition to BellSouth's Direct Case, neither AT&T nor any other company would rely solely on a single piece of data like a long-term bond rating as the basis for demanding a security deposit from a customer – particularly from its largest customers that have demonstrated their ability to pay and that may respond to any requests for a deposit by taking their business to a supplier with less onerous credit requirements.[45]

Thus, there is no question that SBC's amended tariff proposal suffers from the same problems as its initial tariff filing. SBC's amended tariff proposal does not remotely "remove all doubt" as to the proper application of its tariff – to the contrary, if there is anything certain about its proposal, it is that SBC has defined its security deposit and advanced payment triggers so broadly that it can effectively require a security deposit from most any carrier in the industry.

B. SBC's Proposed Tariff Revisions Would Provide It With Enormous Discretion In Requiring Security Deposits, Which It Could, And Would, Use To Discriminate Against Competitors By Raising Their Costs.

The triggers selected by SBC and its discretion to demand security deposits or advanced payments provide SBC with the discretion to saddle virtually every carrier-customer with massive deposit requirements. As a result, neither the Commission nor interested parties can, based on the record in this proceeding, predict which carriers will be subject to such deposit requirements. SBC's tariff is therefore unlawfully vague, and

[45] *See* AT&T Opp. To BellSouth Direct Case, Blatz Decl.

because SBC could use – and has a substantial incentive to use – that discretion to impose large costs on its competitors, SBC's tariffs also are unlawfully discriminatory.

This is especially troubling, "because in most cases the entity upon which SBC would impose the security deposit would also be a competitor of SBC itself, or of its long-distance and advanced services affiliates."[46] Absent sufficient safeguards, SBC could, for example, rely on tariffs to demand that virtually all unaffiliated IXCs provide substantial security deposits, but then determine, that SBC's long distance affiliates are deemed sufficiently creditworthy to be excused from such a requirement.

Significantly, under the methods that SBC proposes to use, its new long distance affiliates (like those of Verizon and BellSouth, the other BOCs proposing to revise their access tariffs) are sufficiently creditworthy that no deposit would be required.[47] That is because SBC proposes to examine the long-term bond ratings of the customer *or* its parent. For BOC long distance affiliates, therefore, they will be excused from any deposit requirement so long as the BOC is itself creditworthy. *See* AT&T Exh. 2 (SBC, BellSouth, and Verizon all creditworthy). However, under the Act, the long distance affiliate is intended to be separate from the BOC, and in particular is not permitted to obtain credit under any arrangement that allows the affiliate's creditors to have recourse to the BOC's assets. 47 U.S.C. § 272(b)(4). Thus, under the Act, the affiliate must be creditworthy based on its own financial condition, not that of its parent. And given that the SBC long distance affiliates are new companies, they likely should be deemed under SBC's existing tariffs to have "no established credit," and thus to qualify for a security

[46] *Investigation Order* ¶ 20.

[47] *See* Cornell Dec. ¶¶ 8-9, 27-30 & AT&T Exh. 2; SBC Direct Case at 22 ("SBC has not required deposits from its affiliates").

deposit. Yet SBC apparently intends to exclude them, largely based on the long-term bond ratings that have been developed for SBC as a whole.

Because of this feature of SBC's proposals, SBC will be able to exempt its own affiliate from any security deposit or advance payment costs, and yet impose substantial costs on SBC's affiliates' rivals – a classic instance of a LEC acting anticompetitively by raising its rivals' costs.[48] This discriminatory conduct would be all the more troubling because these long distance affiliates, if treated consistent with the requirements of the Act, would be precisely the types of companies for which a security deposit could be appropriate. Cornell Decl. ¶¶ 8-9, 27-30. That result is unlawful under section 272, unreasonably discriminatory, and flatly anticompetitive.

Moreover, even if SBC required its affiliates to post a deposit – in an amount similar to those posted by competing IXCs – there would still be little hardship on SBC, because such deposits would constitute a classic "left-pocket, right-pocket" transfer that inflicts no real costs on the SBC entity as a whole. In both cases, the unfettered right to demand a security deposit from any IXC would, as the Commission recognized in 1984, be a powerful anti-competitive and discriminatory weapon,[49] and one that result directly in increased costs for SBC's long distance rivals. To prevent SBC from obtaining this addition method of harming interLATA competition, it is critical that SBC be precluded from arbitrarily assessing large deposits on its competitors.

[48] *See* Cornell Decl. ¶¶ 8, 21, 27-30; Salop & Krattenmaker, *Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power Over Price*, 96 Yale L.J. 209 (1986).

[49] *See 1984 Access Order*, 97 F.C.C.2d at 1168-70 (LEC proposals to expand security deposit provisions were "unreasonably onerous" in scope and had "anticompetitive effects" where proposals applied so broadly and could be applied selectively to carriers chosen unilaterally by the LEC).

It is also not possible to ignore these fatal flaws in SBC's tariffs because firms in competitive industries sometimes use the same credit agencies to assess credit risk of potential creditors. But, as discussed above, firms generally do not use the long-term bond ratings proposed by SBC as the *sole* means for assessing credit risk. Rather, competitive firms, including AT&T, use long-term bond ratings as one among many factors, and not as a bright-line test.

But even if SBC's proposals were consistent with the practices of firms in competitive industries (which they are not), that would not mean that SBC, a monopoly firm, should be permitted to implement them. As described above and in Professor's Cornell's Declaration, firms in competitive markets have substantial incentives accurately to ascertain credit risk, and to impose deposit requirements only where a substantial credit risks actually exists. Cornell Decl. ¶ 31. A competitive firm that attempts to impose large deposit requirements on a customer that is not likely to default on future payments will lose the business of that customer to competitors that do not impose such unnecessary deposits requirements.

SBC, however, faces none of those competitive pressures – SBC is a near monopoly that does not face any serious risk of losing a substantial number of access customers as a result of imposing unnecessary deposit requirements on those customers. Because SBC does not face any measurable competitive pressures, it has every incentive to minimize *any* risk of non-payment by maximizing deposits – as this proposal makes self-evident. SBC also has incentive to favor its own affiliates that do operate in competitive markets by imposing large deposit requirements on companies that pose the greatest threat to those affiliates. And that is precisely why SBC is seeking regulatory approval to impose deposit requirements based on triggers using long term bond ratings that apply to most of its competitors.

The bottom line is this: SBC's tariff provides SBC with significant discretion to impose hundreds of millions of dollars of deposit requirements on its customers. Such discretion is unlawful because it violates the Commission's rule that a tariff "must contain clear and explicit" statements in order "to remove all doubt" as to the proper application of the tariff and because it is unreasonably discriminatory in violation of the Act.[50] Accordingly, SBC's tariff must be rejected.

IV. SBC'S PROPOSED PROVISIONS TO SHORTEN THE TERMINATION PERIOD ARE UNREASONABLE.

SBC's proposal to reduce the time in which it may terminate access services from 30 days to just 10 is equally unreasonable. SBC claims that the current 30 days is "not necessary to protect [the IXC's] customers," in part because SBC asserts that the 30 days specified in the tariff often occurs "when a firm already has failed to pay its bills." SBC D&Js at 11.[51] Even assuming that is true, however, SBC's tariff revisions would not merely apply in those circumstances, but would apply whenever *any* IXC – even those that present no payment risks – fails to pay an access bill in full (or to meet one of the other conditions specified in the tariff). The Commission has recognized for many years that such accelerated termination provisions are not reasonable when they apply generally

[50] *See* 47 C.F.R. § 61.2; 47 U.S.C. §§ 201, 202.

[51] SBC also claims that the provisions are necessary to prevent SBC from being exposed to "potentially two-months of unpaid debt," and would result in SBC "fac[ing] only one-month of unpaid debt." Direct Case at 29. This disclaimer makes it clear that SBC has *not* in fact, as it claims, "consider[ed] the cash flow concerns of its customers" by seeking a one month deposit, rather than a two month deposit. Rather, it demands only a one month deposit because its accelerated termination provisions would put no more than one month of payments at risk.

to IXCs that pose no risk. *See 1987 Access Tariff Order* at 304. Such provisions give the dominant LECs far too much leverage in negotiating billing or other disputes with IXCs. The ability to so promptly terminate access services – which would disrupt the long distance services of an IXC's customers – is a powerful threat in the hands of dominant LECs, which could and would be used in a discriminatory fashion.

Moreover, reducing the time for IXCs and other carriers to respond to SBC's claims that bills have not been paid increases the likelihood of service disruptions. The existing 30-day period provides time for carriers and SBC to work out honest billing and payment errors. The 30-day period also provides carriers with temporary cash shortfalls to address those problems and pay outstanding bills (with interest where appropriate) without disrupting services to carriers' customers. Reducing the termination intervals by more than half would substantially increase the likelihood that service would be terminated in these situations.

Notably, these service disruptions would not be limited to interstate services. Interstate and intrastate traffic are routinely carried over the same lines and switches.[52] To the extent that SBC "turns off" a carrier's interstate traffic, that carrier's intrastate traffic will be shut down as well. In this regard, the Commission should be mindful that SBC's proposed restrictions could have a substantial impact on intrastate matters within the jurisdiction of the states.

[52] In general, inter- and intrastate traffic is calculated for billing purposes. The inter- and intrastate traffic is not physically separated on different lines and switches.

V. CONCLUSION

For the foregoing reasons, the Commission should find that SBC's Transmittal No. 226 is unjust, unreasonable, and discriminatory. Accordingly, the Commission should reject the proposed tariff revisions.

Respectfully submitted,

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November 14, 2002.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Opposition to SBC Direct Case was served the 14th day of November, 2002, on the following:

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EXHIBIT 1

Ameritech Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001 Table 2			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	9,387	2,171,715	0.43%
1991	11,378	2,155,414	0.53%
1992	9,794	2,199,704	0.45%
1993	11,572	2,284,012	0.51%
1994	16,193	2,371,933	0.68%
1995	7,056	2,410,630	0.29%
1996	15,137	2,506,236	0.60%
1997	6,243	2,435,536	0.26%
1998	10,997	2,727,081	0.40%
1999	4,708	2,938,256	0.16%
2000	3,382	3,115,367	0.11%
2001	3,573	3,151,777	0.11%

Pacific Bell Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001 Table 3			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	4,943	1,588,213	0.31%
1991	3,401	1,557,501	0.22%
1992	3,731	1,568,577	0.24%
1993	2,857	1,642,142	0.17%
1994	2,566	1,687,956	0.15%
1995	3,196	1,734,753	0.18%
1996	3,755	1,817,471	0.21%
1997	5,673	1,848,219	0.31%
1998	1,595	2,040,605	0.08%
1999	4,640	2,224,451	0.21%
2000	4,527	2,424,598	0.19%
2001	6,162	2,691,944	0.23%

Nevada Bell Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001 Table 4			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	76	58,207	0.13%
1991	77	53,716	0.14%
1992	147	53,579	0.27%
1993	111	54,783	0.20%
1994	98	53,454	0.18%
1995	82	53,297	0.15%
1996	103	56,702	0.18%
1997	670	59,461	1.13%
1998	267	62,587	0.43%
1999	195	63,505	0.31%
2000	155	71,829	0.22%
2001	212	76,492	0.28%

SNET Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001 Table 5			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	516	360,627	0.14%
1991	1,755	338,459	0.52%
1992	1,688	350,670	0.48%
1993	933	365,462	0.26%
1994	867	373,812	0.23%
1995	603	382,490	0.16%
1996	1,616	397,132	0.41%
1997	3,632	389,741	0.93%
1998	1,273	403,988	0.32%
1999	1,106	417,610	0.26%
2000	1,185	470,898	0.25%
2001	2,558	535,184	0.48%

Southwestern Bell Interstate Uncollectibles Data As A Percentage of Interstate Revenues 1990-2001 Table 6			
Year	**Interstate Access Uncollectibles (000s)**	**Interstate Revenues (000s)**	**Uncollectible Ratio**
1990	8,102	1,812,897	0.45%
1991	5,376	1,772,935	0.30%
1992	5,763	1,808,150	0.32%
1993	6,865	1,948,746	0.35%
1994	6,181	2,032,218	0.30%
1995	5,617	2,136,197	0.26%
1996	6,285	2,201,021	0.29%
1997	6,811	2,309,227	0.29%
1998	7,629	2,453,286	0.31%
1999	10,724	2,610,673	0.41%
2000	21,738	2,850,020	0.76%
2001	35,527	3,167,276	1.12%

EXHIBIT 2

Table of Long Term Debt Rating For Selected Telecommunications Companies (November 2002) by Nationally Recognized Statistical Rating Organizations (NRSROs)

(Non-BOC Companies Falling Outside SBC Criteria Shown In Bold)

COMPANY	**S&P**			**Moody's**			**Fitch**		
	Rating	**Investment Grade**	**Watch**	**Rating**	**Investment Grade**	**Watch**	**Rating**	**Investment Grade**	**Watch**
RBOCs									
BellSouth	A+	YES	Negative	Aa3	YES	Negative	A+	YES	Negative
Qwest (US West)	B-	NO	Negative	Caa1	NO	Negative	B	NO	Negative
SBC	AA-	YES	Negative	Aa3	YES	Negative	AA-	YES	Negative
SBC	A+	YES	Negative	A1	YES	Negative	AA	YES	Negative
Interexchange Carriers									
AT&T Corp.	**BBB+**	**YES**	**Negative**	**Baa2**	**YES**	**negative**	**BBB+**	**YES**	**Stable**
WorldCom Inc.	D	NO		Ca	NO	negative	D	NO	
Sprint Corp.	BBB-	YES		Baa3	YES	negative	BBB	YES	Stable
Qwest Corp. [ratings shown for parent; Qwest Comm. Int'l]	– B	NO		Caa1	NO		N/A		
Concert Global Networks USA, LLC	N/A			N/A			N/A		
IDT Corp.	N/A			B2	NO		N/A		
Global Crossing Corp.	N/A			N/A			N/A		
VarTec Telecom, Inc.	N/A			N/A			N/A		
LCI Int'l Telecom Corp. (Qwest Corp. Subsidiary)	B-	NO		Caa1	NO		CCC+	NO	Negative
Verizon Long Distance [ratings shown for parent; Verizon]	A+	YES	negative	A1	YES	negative	AA	YES	negative

Table of Long Term Debt Rating For Selected Telecommunications Companies (November 2002) by Nationally Recognized Statistical Rating Organizations (NRSROs)
(Non-BOC Companies Falling Outside SBC Criteria Shown In Bold)

Global Crossing Telecommunications, Inc.	N/A			N/A			N/A		
Broadwing Communications Services, Inc.	BB	NO	Negative	B1	NO	Negative	BB	NO	Negative
Teleport Communications Group Inc. [ratings shown for parent; AT&T Corp.]	**BBB+**	**YES**	**Negative**	**Baa2**	**YES**		**BBB+**	**YES**	**Negative**
Excel Telecommunications [ratings shown for parent; Teleglobe Group]	N/A			C	NO		D	NO	
Cable & Wireless Plc.	**A**	**YES**		**A3**	**YES**	**Negative**	**A-1**	**YES**	**Negative**
Williams Communications, LLC	N/A			N/A			N/A		
Verizon Select Services, Inc. [ratings shown for parent; Verizon]	A+	YES	negative	A1	YES	negative	AA	YES	negative
Touch America, Inc.	**BBB+**	**YES**		**Baa1**	**YES**		**N/A**		
McLeodUSA Telecommunications Services	N/A			N/A			N/A		
Southwestern Bell Communications Services [ratings shown for parent SBC]	AA	YES	Negative	Aa3	Yes	Negative	AA-	YES	Negative
Broadwing Telecommunications Inc. (ratings shown for Parent; Broadwing (Cincinnati Bell))	BB	NO		B1	NO		BB	NO	
Network Plus, Inc.	N/A			N/A			N/A		
BellSouth Long Distance, Inc. [ratings shown for parent; Bellsouth]	A+	YES	Negative	Aa3	YES	Negative	A+	YES	negative

<u>Table of Long Term Debt Rating For Selected Telecommunications Companies (November 2002) by Nationally Recognized Statistical Rating Organizations (NRSROs)</u>
(Non-BOC Companies Falling Outside SBC Criteria Shown In Bold)

Primus Telecommunications, Inc.	CCC+	NO		Caa2	NO		N/A		
Business Telecom, Inc.	N/A			N/A			N/A		
Americatel Corporation	N/A			N/A			N/A		
ITC DeltaCom Communications, Inc.	D	NO		Ca	NO		N/A		
Talk America Inc. (f/k/a) talk.com Holding Corp.	N/A			N/A			N/A		
Evercom Systems, Inc.	D	NO		Ca	NO	Negative	N/A		
General Communication, Inc. (GCI Inc.)	BB	NO	Negative	B2	NO		N/A		
Electric Lightwave, Inc.	**N/A**			**Baa2**	**YES**		**BBB**	**YES**	
Teleglobe Group	N/A			C	NO		D	NO	
PT-1 Long Distance, Inc. (or Star Telecommunications)	N/A			N/A			N/A		
Equant Operations Inc. [ratings shown for parent; France Telecom]	**BBB**	**YES**		**Baa3**	**Yes**		**BBB**	**YES**	
SNET America, Inc. N/A [ratings shown for parent SNET Corp.]	AA-	YES	stable	Aa3	YES	Negative	AA-	YES	
ALLTEL Communications, Inc.	**A**	**YES**	**Negative**	**A2**	**YES**	**Stable**	**A**	**YES**	**Stable**
Level 3 Communications, LLC	CCC	NO		Caa3	NO		N/A		
Norlight Telecommunications, Inc.	N/A			N/A			N/A		
Lightyear Communications	N/A			N/A			N/A		
Working Assets Funding Services, Inc.	N/A			N/A			N/A		