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July 29, 2003

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
Room TW-B204
Washington, D.C. 20554

Re: Valor Telecommunications of Texas, L.P. Application for Review of
Order Denying Waiver of 2003 X-Factor Reduction
WC Docket No. 03-166

Dear Ms. Dortch:

Enclosed please find an *erratum* to the AT&T Opposition to Valor's Application for Review, filed on July 28, 2003, under WCB/PPD File No. 03-16. This submission corrects the file number as referenced above.

Respectfully submitted,

Judy Sello

cc: Gregory J. Vogt
William M. Ojile, Jr.

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

In the Matter of)	
)	
Valor Telecommunications of Texas, L.P.)	WC Docket No. 03-166
)	
Petition for Waiver of the 2003)	
X-Factor Reductions Under Section)	
61.45(b)(1)(i) of the Commission's Rules)	
)	

AT&T OPPOSITION TO VALOR'S APPLICATION FOR REVIEW

Pursuant to Section 1.115 of the Commission's Rules, 47 C.F.R. § 1.115, AT&T Corp. ("AT&T") opposes the Application for Review filed by Valor Telecommunications of Texas, L.P ("Valor") of the Wireline Competition Bureau's Order, DA 03-1928, released June 11, 2003 ("*Order*"), denying Valor's petition to permanently waive the 2003 X-factor reduction required for interstate access services under Section 61.45(b)(1)(i) of the Commission's rules so as to allow Valor to achieve higher earnings.¹

Valor's contends that the Bureau "acted contrary to its own precedent and the public interest, and in doing so, jeopardized the financial well-being of a rural carrier." Valor App., p. 1. These contentions are quite plainly, *wrong*. Contrary to Valor's assertions, the Bureau properly found that the low-end adjustments allowed by

¹ See Valor Telecommunications of Texas, L.P. Petition for Waiver of the 2003 X-Factor Reductions Under Section 61.45(b)(1)(i) of the Commission's Rules, April 14, 2003 ("Valor 2003 Petition").

the price caps rules are designed for the very circumstances that Valor faces and provides adequate relief, having allowed Valor to earn more than 10.25% each year that it requested such an adjustment. By contrast, a permanent waiver of the X-factor – or productivity offset to the inflation factor in the price cap formula – as Valor had requested in its 2003 Petition would undermine the price cap rules’ policy objective of eliminating carrier common line (“CCL”) charges, which have been found to be non-cost-causative.

BACKGROUND

In the proceedings below, Valor claimed that its earnings in Texas are severely depressed and that further rate reductions required by the X-factor would “doom its chance of a full recovery and jeopardize vital services provided to rural Texas.”² Valor therefore requested a permanent waiver of the 2003 X-factor reduction and the right to utilize the inflation rate as the X-factor in its annual interstate access tariff filing scheduled to become effective on or about July 1, 2003.

Valor asserted that because of “state-imposed obligations coupled with acquisition-related complications and substantial unanticipated expenditures,” it is caught up in a “vicious cycle of low returns” that threaten its “ability to attract additional capital and ... improve its quality of services.”³ In hopes of ending its alleged cycle of consistently low interstate returns, Valor in April 2002 sought a permanent waiver of the X-factor reductions in all years in which Valor Texas makes a low-end adjustment.

² Valor 2003 Petition, p. 3.

³ Valor 2003 Petition, pp. 1-3.

Acknowledging Valor Texas' circumstances, the Commission granted a partial waiver that delayed – but expressly did not waive – the application of the 2002 X-factor reductions until 2004,⁴ the first X-factor-free year under CALLS.⁵ In its 2003 Petition, Valor contended that the Commission's remedy did not cure its problems in Texas, and that without further relief, its low returns will continue.

In the *Order*, consistent with the *2002 Valor Order*, the Bureau once again properly concluded that there is no valid basis for granting Valor a permanent waiver of its 2003 X-factor adjustment. Valor had failed to demonstrate that the forms of relief already available to it – delayed imposition of the 2002 X-factor reductions and continued utilization of any needed low-end adjustments – are inadequate. In short, the Bureau properly rejected Valor's request that the Commission rescue it from its own bad business decisions and improperly foist costs on access ratepayers.⁶

⁴ *Valor Telecommunications of Texas and Valor Telecommunications of New Mexico Petition for Waiver of the Operation of the X-Factor in the Price Cap Indices Formula Set Forth in 61.45(B)(1)(i)*, DA 02-1325, 17 FCC Rcd. 10,646, ¶ 16 (2002) (“*2002 Valor Order*”).

⁵ 2004 is the first year that rural ILECs that have reached their \$0.0095 target rate do not have to apply X-factor reductions to the CCL charge (if it still exists) per Section 61.45(i)(4) of the Commission's rules. Valor also erroneously claimed in its Application that there are no additional X-factor-free years after the 2004 tariff year. See 47 C.F.R. § 61.45(i)(4) (containing no sunset).

⁶ As AT&T showed below, having apparently overpaid GTE for its telephone plant, Valor's contention that it is now unable to make the additional investments needed to modernize the “dilapidated” plant acquired from GTE, should be rejected. According to a recent report *Reshaping Rural Telephone Markets* (Legg Mason Research, Fall 2001), Valor is estimated to have paid GTE \$942 million for the Texas properties that Valor describes as “dilapidated” (p. 2) and “particularly problematic” (p. 4) and whose depreciated value is only about \$290 million. For the three states combined, Valor paid GTE \$1679 million to acquire plant with a depreciated value of only \$460 million (pp. 96-99). See AT&T Opposition to Valor's Request for Waiver of the X-Factor, WCB/PPD File No. 03-16, filed April 30, 2003, pp. 2-3 and n.4.

I. VALOR’S PLEA FOR SPECIAL X-FACTOR TREATMENT CONTRADICTS THE COMMISSION’S PRICE CAP REGULATION POLICIES.

In its Application for Review, Valor for the first time contends in writing, on the record, that because the Bureau in its *2002 Valor Order* granted Valor a deferral of the 2002 X-Factor reduction that the Bureau was somehow duty-bound to follow this precedent and defer the 2003 X-Factor reduction – relief that Valor did not even request in its 2003 Petition.⁷ (Instead, Valor there asked for a *permanent* waiver, not a deferral, precisely the relief the Bureau had previously rejected).⁸ In its 2003 Petition, Valor reiterated its 2002 argument that strict application of the price cap rules creates “perverse and unwarranted results.” Once again, Valor contended that after raising rates under a low-end adjustment to earn a targeted 10.25% return, it would be counterproductive to immediately reduce those re-targeted rates by an X-factor.⁹

This argument had been soundly rejected by the Bureau in its *2002 Valor Order* – and the Bureau rejected it once again in the 2003 *Order* under review. In the *2002 Valor Order*, the Bureau explained that the “X-factor and low-end adjustment serve

⁷ While Valor contends that it sought a deferral in meetings with the Bureau staff, the June 9, 2003 *ex parte* it cites for this proposition makes no reference to such a request for alternative relief. *Compare* Valor App., pp. 5-6, with Letter of Gregory J. Vogt, Counsel for Valor Telecommunications of Texas, L.P., to Marlene Dortch, Secretary, FCC (filed June 9, 2003).

⁸ *2002 Valor Order*, 17 FCC Rcd. at 10650.

⁹ Valor 2003 Petition, p. 9.

different purposes and coexist without negating each other.” *Id.* ¶ 6. The prior year’s level of interstate earnings, which determines the amount of any low-end adjustment, is only one of several factors that determine the price cap level, and these factors can operate in opposite directions. The Bureau properly recognized that application of the X-factor “does not prevent a carrier from increasing its earnings through other available means, *e.g.*, by increasing its productivity through improved operating efficiencies and innovations” (*Id.* ¶ 8), and noted that consecutive years of low earnings are “an insufficient basis for concluding that a company cannot increase its productivity and operate more efficiently.” *Id.* ¶ 15. Moreover, the Bureau affirmed that “the purpose of the low-end adjustment mechanism is not to guarantee a certain level of minimum profit ... for an upcoming year.” *Id.* ¶ 7. The Bureau also emphasized that X-factor adjustments were needed to achieve its goal of reducing CCL charges (*Id.* ¶ 6) and thus avoided granting any relief that would result in rates permanently higher than they would be had the X-factor been applied. *Id.* ¶ 16.

With respect to the relief Valor actually sought on the record – a permanent waiver of the 2003 X-factor adjustment – the Bureau rejected Valor’s request for the same reasons as in 2002. It was Valor’s renewed plea for a permanent waiver of the 2003 X-factor that directly contravened this well-reasoned and established policy. Moreover, the Bureau noted that Valor “relies largely on the same circumstances for a waiver as it did last year” and that Valor had specifically identified only about \$229,000 in additional depreciation expense that will be incurred this year due to an ice storm that occurred in 2000. *Id.* at ¶ 8. Accordingly, the Bureau concluded that Valor failed to establish that it will incur substantial additional expenditures in 2003 due to

circumstances beyond Valor's control, and thus Valor had not met the unusual circumstances required for a further X-Factor waiver.

II. VALOR HAS FAILED TO DEMONSTRATE GOOD CAUSE FOR A WAIVER OF THE COMMISSION'S X-FACTOR REQUIREMENTS.

The Bureau properly concluded that Valor has not made a showing that would justify an additional waiver from the Commission's price cap policies. Specifically, Valor has not demonstrated that its recent interstate returns present special circumstances that would justify its receiving an exemption from the application of the X-factor.¹⁰ Valor's 2003 Petition did little more than repeat the litany of woes it faces in Texas and noted that its interstate return was only 5.34% in 2002, excluding lower formula adjustment revenues.¹¹ The petition offered no further evidence to demonstrate unique circumstances that would justify Valor's waiver request.

Such evidence does *not* exist. Valor's Form 492, filed April 1, 2003, shows healthy interstate earnings for 2002 and belies its claims of financial distress. With low-end adjustment revenues included, Valor of Texas earned 10.63%, a return above the 10.25% target for low-end adjustments and well above the 8% to 9% cost of capital for the ILECs that AT&T showed existed several years ago when interest rates were higher than today.¹² *See* Exhibit 1. For the three states in which Valor operates –

¹⁰ 47 C.F.R. § 1.3. A petitioner must show that special circumstances exist such that a waiver of a valid Commission rule is appropriate, and that grant of the waiver is in the public interest. *WAIT Radio v. FCC*, 418 F.2d 1153 (D.C. Cir. 1969), *cert. denied*, 409 U.S. 1027 (1972).

¹¹ Valor 2003 Petition, p. 8.

¹² *See* Responsive Submission of AT&T Corp. to Prescription Proceeding Direct Case Submissions and Reply Comments on the Notice of Proposed Rulemaking

Texas, New Mexico, and Oklahoma – the composite interstate rate of return was 11.31% in 2002, a figure that is comparable to and in many cases exceeds the returns of numerous other price cap companies:¹³

Company	Interstate ROR
BellSouth	10.27%
Century Tel. of Northern Alabama	7.50%
Century Tel. of Belle-Herman/Southern Missouri/Southwest Missouri	4.70%
Century Tel. of Central Missouri	11.83%
Citizens Communications (CTC3)	8.94%
Citizens Communications (CTC5)	4.90%
Frontier Telephone of Rochester	11.47%
Verizon Telephone Companies	11.97%
Verizon California (Arizona – COAZ)	6.41%
Verizon North (Wisconsin – GTWI)	9.81%
Verizon Northwest (West Coast Calif. – GNCA)	(5.18%)
Verizon South (Virginia – GTVA)	7.23%

Source: Price Cap Regulation Rate of Return Monitoring Reports (Form FCC 492A), filed March-April, 2003.

Valor has failed to demonstrate why it should be treated any differently from the companies listed above, the majority of whom experienced interstate returns below those of Valor in 2002. Grant of Valor's waiver request would thus have established a harmful precedent, one that would jeopardize the effectiveness of incentive regulation and seriously undermine the Commission's price cap policies.

Indeed, Valor's recent interstate earnings are well within the range that the low-end adjustment mechanism is designed to accommodate. Valor's low-end exogenous adjustment, included as part of its annual filing each year, allows it to increase

in Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Docket No. 98-166, filed March 16, 1999.

¹³ It is worth noting that the returns for Valor's two New Mexico entities, for which Valor requested the X-factor waiver in its 2002 petition, were 16.8% and 15.9% in 2002.

its access rates to ensure that its *prior year* rate-of-return is equal to (re-targeted to) 10.25%. For example, the low-end adjustment Valor plans to make as part of its 2003 annual filing,¹⁴ when added to its calendar year 2002 operating income, will result in its 2002 rate-of-return equaling 10.25%, excluding previously awarded lower formula adjustment revenues. If Valor continues to earn below 10.25% in future years, it will always be able to file a low-end exogenous adjustment to its rates in the current year's annual filing to re-target the previous year's rate-of-return to 10.25%.

Moreover, the low-end adjustment was never intended to guarantee the LECs a 10.25% return, as the Bureau recognized in both 2002 and 2003.¹⁵ Rather, the 10.25% is merely a target, with the new price cap indices based on several factors: base year earnings, the X-factor, and other normal price cap adjustments such as GDP-PI and exogenous costs. All of these factors are still operative when a low-end adjustment is made.

Further, Valor once again provided no evidence that the adverse economic conditions it faces in rural Texas will not improve. Like its 2002 Petition, Valor's 2003 Petition relied on the speculative assumption that the depressed condition of the economy will continue into the indefinite future.¹⁶ In any event, the Commission's low-end adjustment mechanism provides relief for any carrier that experiences low earnings, regardless of their cause.

¹⁴ Valor Petition, p. 5.

¹⁵ 2002 Valor Order ¶ 7 and 2003 Valor Order ¶ 10.

¹⁶ In its 2002 Valor Order, the Bureau found that "there is nothing in the record to suggest that this economic downturn will continue in the future." *Id.* ¶ 13. In the 2003 Valor Order, the Bureau noted that Valor provides "no supporting evidence" for its assumption that adverse economic conditions will not improve. *Id.* ¶ 8.

As to Valor's contention that a waiver is needed to guard against the risk that earnings below 10.25% would impair its ability to raise capital, the Bureau correctly found that the low-end adjustment is intended to address this concern. *2003 Valor Order*

¶ 11. As the Commission has explained:

A LEC with earnings below 10.25 percent is likely to be unable to raise the capital necessary to provide new services that its local customers expect. It may even find it difficult to maintain existing levels of service. Thus, while our lower end adjustment mechanism protects LECs to some extent from errors and misjudgment, it also protects them from events beyond their control that are likely to affect earnings to an extraordinary degree, such as local or regional recessions. *LEC Price Cap Order*, 5 FCC Rcd. 6786, 6804 ¶ 148 (1990).¹⁷

Finally, the Bureau also noted that Valor is free to apply for an above cap filing if it believes its ability to attract capital is affected despite the low-end adjustment.¹⁸ Valor contends that this remedy is unavailable because it requires cost support for the most recent four years under price cap regulation and it has been in existence only three years. *Valor App.*, pp. 6-7. First, the order that Valor cites is *not* the *LEC Price Cap Order* as it claims but an earlier order pertaining to AT&T. Second, the current rule for above cap filings, 47 C.F.R. § 61.49(d), does not contain this requirement. In all events, should Valor not have all the details necessary for an above cap filing, it could request a waiver of that rule. There is simply no basis on this record to grant Valor further X-factor relief, as the Bureau properly concluded.

¹⁷ Cited in *2003 Valor Order* n.50.

¹⁸ *Id.* ¶ 14.

CONCLUSION

For the reasons stated above, Valor's Application for Review should be denied.

Respectfully submitted,

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July 29, 2003

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CERTIFICATE OF SERVICE

I, Judy Sello, do hereby certify that on this 29th day of July, 2003, a copy of the foregoing "AT&T Opposition To Valor's Application for Review" was served by U.S. first class mail, postage prepaid, on the parties named below.

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/s/ Judy Sello
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RETURN DATA FROM VALOR'S 492A REPORT
(\$ in thousands)

2002 Reporting Period (First Report)	Texas	New Mexico #1164	New Mexico #1193	Oklahoma	Valor Total
Total Revenues	\$63,569	\$10,203	\$10,209	\$21,352	\$105,333
Total Expenses and Taxes	\$52,599	\$7,627	\$7,589	\$17,277	\$85,092
Operating Income (Net Return)	\$10,970	\$2,576	\$2,621	\$4,076	\$20,243
Rate Base (Avg. Net Investment)	\$103,180	\$15,312	\$16,506	\$43,928	\$178,926
Rate of Return	10.63%	16.82%	15.88%	9.28%	11.31%
Sharing/Low End Adjustment Amount	\$8,563	\$263	\$0	\$0	\$8,826
Rate of Return excl. Low End Adjustment Revenues	5.34%	15.74%			

Source: Price Cap Regulation Rate of Return Monitoring Report (FCC Form 492A), filed by Valor on April 1, 2003.