

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)
)
AT&T Corp.) CC Docket No. 96-45
)
Petition for Preemption, Pursuant to Section)
253 of the Communications Act And Common)
Law Principles, of South Carolina Statutes that)
Discriminate Against New Entrants)
)
)
)

REPLY COMMENTS OF AT&T CORP.

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TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION AND SUMMARY	1
ARGUMENT	4
I. THE COMMISSION MUST PREEMPT THE SOUTH CAROLINA STATUTES AND ADMINISTRATIVE PROCEDURES ESTABLISHING THE INTERIM LEC FUND PURSUANT TO SECTION 253 OF THE COMMUNICATIONS ACT.....	4
A. The South Carolina Statutes And Administrative Procedures Establishing The Interim LEC Fund Violate Section 253(a) Because They Discriminate Against New Entrants And Have The Effect Of Prohibiting Their Ability To Provide Telecommunications Services.	4
B. The South Carolina Statutes And Administrative Procedures Are Not Permissible Under Section 253(b).	9
II. THE COMMISSION MUST PREEMPT THE SOUTH CAROLINA STATUTES AND ADMINISTRATIVE PROCEDURES ESTABLISHING THE INTERIM LEC FUND BECAUSE THEY CONFLICT WITH SECTION 254 OF THE COMMUNICATIONS ACT.	11
III. AT&T’S PREEMPTION CLAIM IS NOT PROCEDURALLY BARRED.	13
CONCLUSION.....	16

the ILEC support. This scheme fosters a competitive playing field that is radically tilted in favor of incumbents and against new entrants in clear violation of section 253 of the Communications Act.² Indeed, the Interim LEC Fund is so clearly inconsistent with the requirements of federal law that it would be preempted under traditional preemption principles even in the absence of the express preemption standard of section 253.

The opposing commenters' principal argument in response is that the ILECs' competitors should not be heard to complain, because the South Carolina regulatory environment could be even *more* hostile to local competition. Competitive carriers are better off now, the argument goes, because subsidies that were once implicit (in access charges) have become explicit. These arguments miss the mark entirely. Section 253 contains no exemption for explicit subsidies. Although states should obviously be encouraged to eliminate the enormous implicit subsidies that exist in access charges today, they must also comply with the express section 253 requirement that *all* subsidy mechanisms, however labeled or structured, be competitively neutral and nondiscriminatory. The only relevant inquiry under section 253 is whether South Carolina's current scheme – and, more particularly, the Interim LEC Fund – is competitively neutral and nondiscriminatory in both funding and distribution. It quite plainly is not.

Indeed, the opposing commenters make no serious attempt even to argue that the Interim LEC Fund is competitively neutral and nondiscriminatory. No such argument could be made. The Interim LEC Fund is funded principally by those that have no opportunity to participate in distributions. The Commission has previously recognized that a functionally identical Kansas scheme for providing state support to ILECs in the context of intrastate access charge reform

² 47 U.S.C. § 253.

would run afoul of section 253. The opposing commenters provide virtually no analysis of this Commission decision, and utterly fail to distinguish it.

Although section 253(b) can save from preemption state requirements that are necessary to advance universal service (but only competitively neutral ones), most of the opposing commenters, including the South Carolina Public Service Commission, claim that the Interim LEC Fund has nothing to do with universal service. A few of the opposing commenters do view the Interim LEC Fund as a universal service fund, but they fail to provide any lucid explanation how the fund could be deemed competitively neutral. Accordingly, the Interim LEC Fund cannot escape preemption under section 253(b).

Apart from section 253, the South Carolina statutes and administrative procedures must be preempted under the traditional principle that preemption is required when there exists a conflict between federal and state law. The South Carolina statutes and administrative procedures conflict with section 254 of the Act, which requires that *all* telecommunications carriers contribute to federal universal service support. Moreover, subsection (f) of section 254 expressly requires *state* universal service programs to be funded by *all* telecommunications carriers who provide intrastate service. South Carolina's discriminatory funding mechanism, which requires contributions only from certain carriers, directly conflicts with these federal requirements.

No commenter does, or could, contend that the Interim LEC Fund satisfies the requirements of section 254. That is why several commenters make the untenable claim that the Interim LEC Fund is not a universal service fund that is governed by section 254. As other commenters recognize, the Interim LEC Fund is designed to eliminate an implicit subsidy for

universal service (inflated access charges that subsidize local rates in high-cost areas) and replace it with an explicit subsidy for providing universal local service. And if the subsidy cannot be justified as necessary to support universal service, it is a naked transfer payment to incumbent LECs and cannot be justified at all. Moreover, the South Carolina General Assembly expressly provided that the Interim LEC Fund “must transition into the [South Carolina] USF” when the state USF is established and fully funded,³ which confirms that the “Interim” LEC Fund is an interim universal service fund until the permanent universal service fund is fully established.

ARGUMENT

I. THE COMMISSION MUST PREEMPT THE SOUTH CAROLINA STATUTES AND ADMINISTRATIVE PROCEDURES ESTABLISHING THE INTERIM LEC FUND PURSUANT TO SECTION 253 OF THE COMMUNICATIONS ACT.

A. The South Carolina Statutes And Administrative Procedures Establishing The Interim LEC Fund Violate Section 253(a) Because They Discriminate Against New Entrants And Have The Effect Of Prohibiting Their Ability To Provide Telecommunications Services.

South Carolina’s Interim LEC Fund is precisely the sort of scheme that section 253(a) prohibits because it discriminates against new entrants, and thereby materially limits their ability to compete, in two significant respects. Petition 10-19. First, eligibility for receiving disbursements from the fund is limited to incumbent LECs, which means that incumbent LECs receive a substantial state subsidy that their competitors do not. *Id.* 11-15. Second, AT&T and other traditional long distance carriers bear the principal burden of funding these subsidies.⁴ As

³ S.C. Code Ann. § 58-9-280(M).

⁴ Contrary to the assertion of several commenters, *see, e.g.*, PSCSC 4-5, SCTC 7-8, USTA 5-6, AT&T does not dispute that carriers other than long distance providers contribute to the Interim LEC Fund. As AT&T noted in its Petition, the statute provides that the Interim LEC Fund is

a result, long distance carriers, especially those who are trying to introduce local service competition, bear an additional cost that their direct competitors do not, thereby effectively subsidizing their entrenched competitors. Petition 15-19. Significantly, the Commission has already recognized, in reviewing a functionally identical Kansas scheme for providing state support to ILECs in the context of intrastate access charge reform, that such state laws are prohibited by section 253. *Id.* 12-17 (discussing Memorandum Opinion and Order, *In the Matter of Western Wireless Corporation Petition For Preemption Of Statutes And Rules Regarding The Kansas State Universal Service Fund Pursuant To Section 253 Of The Communications Act of 1934*, 15 FCC Rcd. 16227 (2000) (“*Western Wireless*”).

Although most commenters oppose AT&T’s Petition, none refutes AT&T’s showing that the Interim LEC Fund is not competitively neutral, discriminates against new entrants, and has the effect of deterring competitive entry. Moreover, the opposing comments wholly fail to distinguish the South Carolina scheme from the substance of the Kansas scheme addressed in *Western Wireless*.

Rather, the principal response of the opposing commenters is that AT&T and other carriers that pay into the Interim LEC Fund are better off than they were before the Fund was implemented, because they receive intrastate access charge reductions that are equal to or greater

“funded by those entities receiving an access or interconnection rate reduction from LEC’s,” which by its terms can encompass other carriers, including ILECs that provide long distance service. Petition at 15-16 (quoting S.C. Code Ann. § 58-9-280(M)). AT&T demonstrated in its Petition, however, that South Carolina’s funding mechanism does not require contributions from *all* carriers and that traditional long distance providers such as AT&T “bear the principal burden of funding the subsidies for incumbent LECs” since they pay the vast majority of access charges, *id.* at 3, 15. No commenter disputes these points. Indeed, as Verizon concedes, “[a]s long as AT&T remains the largest provider of intrastate long distance, it will contribute more in total terms than other competitors and pay higher total access charges.” Verizon 4 n.5.

than their contributions to the fund. Second, they claim that the rate rebalancing has made it easier for new entrants to enter local markets, particularly in rural areas, because intrastate access charges have decreased and incumbent LECs' local service rates have increased.

Neither of these points is responsive to AT&T's section 253 claim. Rather, both are attempts to read limits that simply do not exist into the section 253 prohibition. Section 253 prohibits state laws and regulations that are not competitively neutral, *i.e.*, that discriminate against new entrants and have the effect of prohibiting their ability to provide telecommunications services. Therefore, the relevant inquiry under section 253 is whether South Carolina's *current* scheme is competitively neutral and nondiscriminatory, not merely whether it is an improvement over even worse conditions that may have prevailed in the past.

And the opposing commenters make no real attempt to argue that the Interim LEC Fund – which pays subsidies to incumbent LECs for reducing their inflated intrastate access charges and places the principal burden of funding these subsidies on long distance carriers – is competitively neutral and nondiscriminatory. Instead, they focus on whether the rate rebalancing legislation *as a whole* was an incremental improvement over the prior regime. This is not surprising because the prior regime was blatantly discriminatory and characterized by substantial barriers to entry – as several commenters readily admit. CenturyTel acknowledges, for example, that “[p]rior to the enactment of these statutes, both ILECs and CLECs in South Carolina recovered their intrastate costs through a combination of end-user charges and intrastate access charges,” such that a portion of the access charges “represented implicit support for local rates.”⁵

⁵ CenturyTel 3; *see also* Verizon 2 (“In South Carolina, as in many states, below-cost residential local telephone service has been supported, in substantial part, by revenues from business customers and intrastate access.”).

The subsidized local rates of the prior regime, Verizon acknowledges, were a “substantial economic barrier to entry into the mass market.”⁶ Accordingly, the rate rebalancing was designed to “increase retail residential local service rates to *more* cost-based levels” and “reduce ILEC intrastate access charges to *more* cost-based levels.”⁷

The new scheme, however, removed only *some* of the discrimination and anticompetitive effects inherent in South Carolina’s prior system and created entirely new barriers to entry that are themselves prohibited by section 253. In this regard, the Interim LEC Fund is nothing more than a vehicle for providing *explicit* subsidies to ILECs that replaced in part the *implicit* local rate subsidies embedded in the prior rate regime. Indeed, Verizon concedes that South Carolina’s intrastate access charge reform efforts are more properly characterized as a “*partial* rebalancing” of rates, and CenturyTel acknowledges that the Interim LEC Fund is a mechanism for identifying “implicit universal service support” and “render[ing] it explicit by segregating it into a separate recovery mechanism.”⁸ Accordingly, while rate rebalancing should certainly be encouraged where rates are not at all aligned with costs, it simply cannot be said that post-rebalancing, the South Carolina laws challenged here are competitively neutral and nondiscriminatory. To the contrary, the challenged state law – and, in particular, the Interim LEC Fund – are potent barriers to entry of precisely the sort that section 253 prohibits.

⁶ Verizon 5; *see also id.* 2 (“this support flow adversely affects both local and long distance competition”).

⁷ CenturyTel 2 (emphasis added).

⁸ Verizon 2 (emphasis added); CenturyTel 2; *see also* CenturyTel 1 (noting that the South Carolina statutes and regulations at issue “rebalance local rates *and* create explicit state universal service support”) (emphasis added).

The Commission's *Western Wireless* decision is directly on point. As AT&T noted in its Petition,⁹ the Kansas program at issue in *Western Wireless* and the Interim LEC Fund are functionally identical. Both provide explicit state subsidies to incumbent LECs to offset their revenue loss from reducing intrastate access charges to levels that more closely reflect their costs (as opposed to the grossly inflated, above-cost rates that they charged previously under monopoly conditions). The Commission opined that the explicit subsidies provided through the Kansas program violate section 253 because they are not competitively neutral. Specifically, by providing funding "only to ILECs," the Kansas fund created "a substantial barrier to entry" because such state support was not available to new entrants.¹⁰ As the Commission noted, such state support imposed a structural pricing disadvantage on new entrants.¹¹ As AT&T has demonstrated,¹² South Carolina's Interim LEC Fund suffers from the same fundamental flaws because it provides funding only to ILECs. Accordingly, it creates the same structural pricing disadvantage, and the same substantial barrier to entry, and it is therefore unlawful under section 253.

The commenters fail to distinguish *Western Wireless*. Indeed, they barely address it, other than to note that the disapproved Kansas subsidies were provided through the state universal service fund while the South Carolina subsidies are provided through a fund with a different label.¹³ Nothing in the Commission's analysis in *Western Wireless*, however, turned on the fact that the source of the Kansas subsidies was labeled a universal service fund, as opposed

⁹ Petition 14-15.

¹⁰ *Western Wireless* ¶ 8.

¹¹ *Id.*

¹² Petition 14-15.

to any other type of fund. The Commission opined that the subsidies violated principles of competitive neutrality because they were provided only to ILECs, as is equally true of the subsidies provided by the Interim LEC Fund. Accordingly, the Commission's analysis in *Western Wireless* is controlling here.

In addition, the Commission in *Western Wireless* implicitly rejected the argument commenters make here – that the subsidies provided by the Interim LEC Fund do not violate section 253 because the accompanying rate rebalancing is procompetitive. In *Western Wireless*, the Commission focused only on the Kansas subsidy program itself, and did not excuse the competitive advantage it conferred on ILECs on the ground that the accompanying rate rebalancing made local market entry easier than under the previously distorted access charge regime.

Finally, AT&T demonstrated – and no commenter refuted or even addressed – that South Carolina's Interim LEC Fund imposes a far more powerful barrier to entry than the Kansas scheme, because it is discriminatory with respect to *both* its distributions and its funding mechanism.¹⁴ Long distance providers are disadvantaged at both ends of the South Carolina subsidy program: they bear the burden of funding it, but are ineligible to receive distributions. In effect, they are forced to support their chief competitors, the incumbent LECs. For this reason as well, the Interim LEC Fund creates a barrier to entry in violation of section 253(a).

B. The South Carolina Statutes And Administrative Procedures Are Not Permissible Under Section 253(b).

¹³ PSCSC 8; SCTC 9 n.26.

¹⁴ Petition 17.

AT&T also demonstrated that the Interim LEC Fund is not permissible under any of the “safe harbors” in section 253(b).¹⁵ Specifically, the Interim LEC Fund cannot escape preemption under section 253(b) as a universal service program because it fails the “safe harbor” criteria for universal service programs specified in that statute: it is not “competitively neutral” and is not “consistent with section 254” (the provision of the federal Act that governs universal service programs). *See Western Wireless* ¶ 10 (it is “doubtful” that the Kansas subsidy program “would be found competitively neutral, and thus within the authority reserved to the states in section 253(b)”).

Most of the opposing commenters, including the architect of the Interim LEC Fund, forego any claim that the section 253(b) safe harbor for universal service programs is applicable by taking the position that the Interim LEC Fund is not designed to support universal service.¹⁶

Verizon and CenturyTel are of the view that the Interim LEC Fund *is* a universal service fund.¹⁷ But they offer no analysis under section 253(b), instead merely cross-referencing their same non-responsive arguments that the new South Carolina regime is an improvement over the

¹⁵ Petition 19-22.

¹⁶ NTCA 3 (the Interim LEC Fund “is not a universal service fund”); OPASTCO 3 (the Interim LEC Fund “is not a state universal service fund”); PSCSC 2 (“AT&T’s analysis under Section 253(b) of the Act is not relevant because the ILF does not provide universal service support”); SCTC 3 (the Interim LEC Fund “is not a universal service fund”); USTA 2 (“AT&T’s analysis of the South Carolina ILF under Section 253(b) of the Act is not relevant because the ILF does not provide universal service support”).

¹⁷ CenturyTel 1 (the Interim LEC Fund “create[s] explicit state universal service support”); Verizon 6-7 (“the South Carolina Interim LEC Fund falls squarely within the grant of authority in 254(f) [which authorizes states to adopt universal service programs]: it seeks to preserve and advance universal service”).

old one.¹⁸ As explained above, those arguments do not aid the opposing commenters at all in making the required showing: that the current regime is competitively neutral and nondiscriminatory. Accordingly, the Interim LEC Fund cannot escape preemption under section 253(b).

II. THE COMMISSION MUST PREEMPT THE SOUTH CAROLINA STATUTES AND ADMINISTRATIVE PROCEDURES ESTABLISHING THE INTERIM LEC FUND BECAUSE THEY CONFLICT WITH SECTION 254 OF THE COMMUNICATIONS ACT.

Even apart from section 253, traditional preemption doctrine provides an independent basis for preempting the statutes and administrative procedures establishing the Interim LEC Fund because they conflict with section 254.¹⁹ Specifically, section 254 requires the federal universal service fund to be funded by *all* telecommunications carriers,²⁰ and subsection (f) of section 254 expressly requires *state* universal service programs to be funded by *all* telecommunications carriers who provide intrastate service. Because it is undisputed that the Interim LEC Fund is funded only by a specific subset of carriers in South Carolina – not *all* telecommunications carriers – it is flatly inconsistent with section 254(f) and other provisions of section 254. In *Western Wireless*, the Commission made an independent finding that the Kansas scheme “could well be found invalid under traditional preemption doctrine” because its

¹⁸ CenturyTel 5 (“For the same reasons that the Interim LEC Fund does not create any barrier to entry under Section 253(a), it is competitively neutral under Section 253(b)”); Verizon 7 (“[E]ven under a Section 253(b) analysis, the South Carolina statute must be considered competitively neutral for the reasons explained in the preceding paragraphs”).

¹⁹ Petition 23-26.

²⁰ 47 U.S.C. §§ 254(b)(4), (d).

restriction of funding to ILECs is not competitively neutral and therefore conflicts with section 254²¹ – a flaw also present in the South Carolina scheme.

Most opposing commenters argue that there is no conflict with section 254 because, as noted above, they claim that the Interim LEC Fund is not a universal service fund that is governed by section 254.²² This argument cannot pass the “straight-face” test; indeed, two ILECs (Verizon and CenturyTel) concede that the Interim LEC Fund *is* a universal service support mechanism. Moreover, the South Carolina General Assembly expressly provided that the Interim LEC Fund “must transition into the [South Carolina] USF” when the state USF is established and fully funded.²³ This provision demonstrates that the “Interim” LEC Fund was created by the South Carolina legislature to serve as an interim universal service fund until the permanent universal service fund could be established. Simply put, if the Interim LEC Fund is *not* a universal service fund, as these commenters contend, then why did the South Carolina General Assembly provide that it will merge into the state universal service fund?

The answer, of course, is that the Interim LEC Fund *is* a universal service fund (if it is anything other than a naked, purposeless subsidy to incumbent LECs from their competitors). In this regard, the Interim LEC Fund, like other universal service funds, is premised on the notion that implicit subsidies (in access charges) should (to the extent they are needed for universal service) be replaced with explicit subsidies.²⁴ Thus, the Interim LEC Fund is designed to eliminate an implicit subsidy for universal service (inflated access charges that subsidize local

²¹ *Western Wireless* ¶ 11.

²² NTCA 2; OPASTCO 3; PSCSC 7; SCTC 9-10; USTA 6-8.

²³ S.C. Code Ann. § 58-9-280(M).

²⁴ Petition 17.

rates in high-cost areas) and replace it with an explicit subsidy for providing universal local service. As noted above, pp. 6-7, Verizon and CenturyTel recognize that the Interim LEC Fund has precisely this purpose and function. Accordingly, the Interim LEC Fund must comply with the funding requirements of section 254.

No commenter even attempts to argue that the Interim LEC Fund satisfies the requirements of section 254.²⁵ No such argument is possible. The Interim LEC Fund utilizes a funding mechanism that Congress and the Commission expressly rejected as detrimental to competition. Congress required that the federal universal service fund and all state universal service funds be funded by *all* telecommunications carriers. As the Commission concluded, it is “competitively neutral to require all carriers and ‘other providers of interstate telecommunications’ to contribute to the support mechanisms because it reduces the possibility that carriers with universal service obligations will compete directly with carriers without such obligations.”²⁶ Because the Interim LEC Fund is funded only by a subset of carriers (primarily long distance carriers), the statutes and administrative procedures establishing the Interim LEC Fund conflict with federal law. They therefore must be preempted under traditional preemption principles.

III. AT&T’S PREEMPTION CLAIM IS NOT PROCEDURALLY BARRED.

²⁵ Verizon asserts in conclusory fashion that the Interim LEC Fund “falls squarely within the grant of authority in 254(f)” because it “requires contributions on an equitable and nondiscriminatory basis,” Verizon 6-7, but Verizon wholly fails to address AT&T’s analysis demonstrating that the Interim LEC Fund’s contribution scheme is contrary to federal law.

²⁶ Report and Order, *Federal-State Joint Board on Universal Service*, 12 FCC Rcd. 8776, ¶ 783 (1997).

There is no merit to the contention of some commenters²⁷ that AT&T is precluded from bringing this action because it did not raise its preemption claim in the administrative proceedings that established the Interim LEC Fund and did not appeal the administrative orders.

Even apart from the fact that section 253 contains no “exhaustion” requirement, the commenters’ suggestion that it is somehow improper or unfair for AT&T to be raising this claim now ignores the history of the Interim LEC Fund. Specifically, as noted above, the Interim LEC Fund was intended to be a temporary measure. When the South Carolina legislature undertook to reform South Carolina’s intrastate access charge system in 1996, there was no state universal service fund. The implementing legislation for the state universal service fund was enacted at the same time as the statutes at issue here. Accordingly, the “Interim” LEC Fund was created as a transition device – as its title and its implementing statute make quite clear – until the state universal service fund was up and running. Indeed, as noted, the South Carolina legislature provided that the Interim LEC Fund “*must* transition into the USF . . . when funding for the USF is finalized and adequate to support the obligations of the Interim LEC Fund.”²⁸

When the South Carolina commission held proceedings to implement the legislation that reformed its highly discriminatory intrastate access charge system – legislation that AT&T supported overall as a step in the right direction – AT&T did not challenge the Interim LEC Fund because the statute provided that it was merely a temporary measure and because proceedings to establish the permanent universal service fund – which presumably would be consistent with the Act’s nondiscrimination and competitive neutrality requirements – were underway. Thus, AT&T chose not to raise its preemption claim in either the state administrative

²⁷ PSCSC 8-9; SCTC 10-14.

proceeding or with this Commission, because it reasonably believed that such a claim likely would be moot in a very short amount of time, when the Interim LEC Fund was transitioned into the more equitably funded state universal service fund. AT&T could then challenge the permanent universal service fund if it was not designed and implemented in compliance with federal requirements.

Remarkably, the South Carolina commission has not yet undertaken the transition, despite the mandatory language of the statute and despite AT&T's repeated requests that it do so in the protracted state universal service fund proceeding.²⁹ Moreover, as several commenters point out,³⁰ no date has yet been set for the transition. Because the South Carolina commission shows no signs of eliminating the "Interim" LEC Fund, and the Commission opined in its *Western Wireless* decision that such a fund likely violates section 253, AT&T brings this Petition.³¹

²⁸ S.C. Code Ann. § 58-9-280(M) (emphasis added).

²⁹ See, e.g., Brief of AT&T Communications of the Southern States, Inc., *Proceeding to Establish Guidelines For an Intrastate Universal Service Fund*, PSCSC Docket No. 97-239-C, at 24-25 (Oct. 9, 2000); AT&T Petition for Reconsideration of Commission Order No. 2001-419, *Proceeding to Establish Guidelines for an Intrastate Universal Service Fund*, PSCSC Docket No. 97-239-C, at 3 (June 18, 2001). See also Order on Reconsideration, *Proceeding to Establish Guidelines for an Intrastate Universal Service Fund*, PSCSC Docket No. 97-239-C, at 13 (Aug. 31, 2001) ("a transition of the Interim LEC Fund into the State USF is neither practical nor reasonable at this time").

³⁰ MCI 2; OPASTCO 5; PSCSC 7; USTA 7.

³¹ In any event, it arguably would have been futile for AT&T to raise its federal preemption claim in the state administrative proceeding. AT&T is seeking preemption here of the South Carolina *statute* that established the Interim LEC Fund, as well as the accompanying administrative procedures. It is not clear that the South Carolina commission has authority to find an act of the South Carolina legislature preempted by federal law. Cf. Order, *Illinois Bell Telephone Company Filing to implement tariff provisions related to Section 13-801 of the Public Utilities Act*, Illinois Commerce Commission Docket No. 01-0614, 2002 Ill. PUC LEXIS 564, ¶

CONCLUSION

For the foregoing reasons, and for those stated in the Petition, AT&T respectfully requests that the Commission, pursuant to section 253 of the Communications Act and traditional preemption doctrine, preempt S.C. Code Ann. §§ 58-9-280(L) & (M), which established the Interim LEC Fund, as well as the accompanying administrative procedures that govern the operation of the Fund.

Respectfully submitted,

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42 (June 11, 2002) (“The Illinois Commerce Commission has no authority to declare an Act of the Illinois General Assembly preempted or otherwise unconstitutional”). Similarly, an appeal of the administrative decisions to state court would not have given AT&T the relief it seeks here because the state court could at most have invalidated the administrative decisions, whereas AT&T is also seeking a ruling that the statute itself is preempted.

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of December, 2003, I caused true and correct copies of the forgoing Reply Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: December 15, 2003
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