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

In the Matter of	)	
Section 272(b)(1)'s "Operate Independently" Requirement for Section 272 Affiliates	)	**WC Docket No. 03-228**

REPLY COMMENTS OF AT&T CORP.

DAVID L. LAWSON
MICHAEL J. HUNSEDER
SIDLEY AUSTIN BROWN & WOOD, LLP
1501 K Street, NW
Washington, D.C. 20005
(202) 736-8000

LEONARD J. CALI
LAWRENCE J. LAFARO
ARYEH S. FRIEDMAN
AT&T CORP.
One AT&T Way
Bedminster, NJ 07921
(908) 532-1831

Counsel for AT&T Corp.

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Pursuant to the Commission's Public Notice, DA-03-3742, released November 21, 2003, AT&T Corp. ("AT&T") hereby submits the following reply comments to the comments submitted in response to the Commission's *Notice Of Proposed Rulemaking*, WC Docket No. 03-228, FCC 03-272, released November 4, 2003 ("*Notice*").

INTRODUCTION AND SUMMARY

The comments confirm that the Commission cannot eliminate its rules implementing § 272(b)(1)'s requirement that the Bell Operating Companies ("BOCs") offer long distance services only through a separate affiliate that must "operate independently" of the BOC. Those rules prohibit the BOCs from providing operating, installation, and maintenance ("OI&M") services for the § 272 affiliate's facilities (and vice versa) and bar joint BOC-affiliate ownership of switching, transmission facilities and associated land and buildings. Most basically, the text of the Act forecloses a finding that a BOC's § 272 affiliate would "operate independently" of the BOC if the BOC "operates," installs, and maintains a long distance network that the BOC and the § 272 affiliate jointly own. That would be dependent, not independent, operation and would violate § 272(b)(1).

The BOCs' view that, because Congress did not itself adopt a specific ban against BOC provision of OI&M services or against joint BOC-affiliate ownership of networks, the Commission is free to adopt – or not adopt – a variety of possible policies does not support elimination of these rules. The Commission surely has authority to adopt more stringent separation and independent operation requirements, as it had in the past and as many commenters, including the Department of Justice, urged the Commission to do again in 1996. But the Commission is not at liberty to adopt *no* requirements and thereby to permit the BOCs to operate and own, with a nominally separate affiliate, a long distance network that is integrated with its local network.

Even if Congress did not direct the Commission to establish particular separation and independence requirements, Congress *did* adopt the exceptionally broad "operate independently" requirement, which necessarily requires *some* separation and *some* independent operation that exceeds the minimum requirements Congress elsewhere specified in other sections of § 272. The Commission's previous judgments that it is "not at liberty" to depart from the separate affiliate requirement and that the "*sine qua non*" of that requirement is to prevent integration of BOC local and long distance network operations are plainly correct, and foreclose the action proposed by the BOCs. Regardless of the degree of deference the Commission were to receive, it could not hope to defend, as an "interpretation" of Congress's requirement that § 272 affiliates operate independently, a ruling that sanctions the BOCs' operation and joint ownership of integrated local and long distance networks.

In the proceeding rejecting Verizon's petition for forbearance from the OI&M rules, at least some Commissioners indicated their concern that the OI&M rules impose significant costs on the BOCs. However, the record in this proceeding demonstrates, even more

than did the previous records, that the BOCs' claims are without merit. While Verizon claims that the OI&M rules will cost it hundreds of millions of dollars during the period in which § 272 applies to its operations, other BOCs admit that the costs are nowhere near that high. BellSouth, in particular, has submitted evidence showing that the absolute cost of OI&M services for its long distance operations, which already provide services to about 3 million subscribers, is $3.3 million a year – or about *9 cents* per month for each of BellSouth's customers. This tiny amount explains fully why the BOCs have been able to compete in long distance markets without the slightest competitive handicap imposed by the OI&M rules.

Thus, even if they could be credited, Verizon's absurd claim that it incurs hundreds of millions of dollars in costs are not at all caused by the OI&M rules. Rather, those costs, to the extent they have any basis in reality at all, are the result of either gigantic errors in its accounting for such costs (the methodology for which it has never adequately disclosed) or its own choices as to the structure of its long distance operations – decisions which, if its figures are correct, would demonstrate gross inefficiency relative even to other BOCs. At a bare minimum, these vast discrepancies show that the amount of a BOC's OI&M costs have almost nothing to do with whether the services are provided on an integrated basis (*i.e.*, whether joint OI&M is permitted) and instead are far more dependent upon a carrier's individual business plans. In all events, Verizon's "cost study" in fact consists of merely unsupported assertions, and it would be patently arbitrary for the Commission to repeal an entire regulatory structure on the basis of those assertions.

Given this evidence, and all the other evidence compiled here and in previous proceedings, there is no basis for the Commission to determine – even if Congress had provided it with the discretion to do so – that a cost-benefit analysis justifies eliminating the

Commission's OI&M rules. Further, the same analysis (if permitted by Congress) would also require the Commission to retain its rules banning joint ownership of switching, transmission facilities, and associated land and buildings, for the BOCs have not even claimed that those rules impose significant costs – and one BOC flatly concedes that elimination of the rules would not lead to any "immediate cost savings of any great magnitude."

Further, the OI&M and joint ownership rules are not overbroad. The Commission would in fact be required to engage in *more* detailed oversight of the BOCs' operations if it eliminated the rules. The Commission would ignore decades of precedent and experience if it concluded that it could more easily prevent cost misallocation and discrimination through detailed review of BOC-affiliate transaction rather than through structural safeguards like the OI&M and joint ownership rules.

Accordingly, the Commission should retain its current rules barring joint provision of OI&M services and prohibiting joint ownership of network facilities.

I. THE COMMENTS CONFIRM THAT THE COMMISSION COULD NOT LAWFULLY ELIMINATE THE BAN ON JOINT OWNERSHIP OF SWITCHING, TRANSMISSION FACILITIES, AND ASSOCIATED BUILDINGS.

Although some of the BOCs nominally support the Commission's proposal to eliminate its ban on joint ownership of switching and transmission facilities and associated land and buildings, their comments actually confirm that § 272(b)(1)'s "operate independently" requirement and the purposes of § 272 compel retention of the rule.[1] SBC, for example, affirmatively trumpets that ownership of a facility like a switch provides a "measure of control over how it is configured and used." SBC at 6. Further, with advanced technologies and data

[1] Verizon does not even address the joint ownership rules, and Qwest claims to favor their elimination, but it presents no separate analysis from its unfounded complaints against the OI&M rules, which AT&T addresses below. Only SBC and BellSouth separately discuss the rule against joint ownership, and they do so only as an afterthought. SBC at 6; BellSouth at 14-16.

services that are "more complex and customized," SBC asserts, joint ownership that allows "control over configuration and use" will become "ever more significant." *Id.* But SBC's comments demonstrate precisely why a flat prohibition against joint BOC-affiliate ownership has been and will remain critical to preventing cost misallocation and discrimination, the central goals of section 272. Section 272 was enacted because the control over "configuration and use" of a facility that joint ownership provides enables the BOC and its affiliate to configure and use facilities in ways that advantage the BOC affiliate and that discriminate against unaffiliated providers.[2] The ban on joint ownership reduces the threat of this misconduct by eliminating integration of a BOC's local and long distance facilities, as § 272(b)(1) was "principally designed" to do, and by ensuring that the § 272 affiliates must enter into written terms with the BOC for access to BOC facilities, thereby facilitating a "comparison of the terms of transactions between a BOC and a section 272 affiliate with the terms of transactions between a BOC and a competitor."[3]

Further, as carriers deploy newer technologies, the prospects for discrimination become greater because ownership of the facilities needed to deploy new technology will allow, as SBC admits, more "customized" control (SBC at 6) – and thus will heighten the already serious threat that such technology will be deployed in a manner that discriminates in favor of

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[2] *See Non-Accounting Safeguards Order* ¶ 160; Second Order on Reconsideration, *Implementation of the Non-Accounting Safeguards,* 12 FCC Rcd. 8653, ¶¶ 47, 49 (1997) (Congress "ended the debate" on the wisdom of separate operation of long distance facilities and agreed with claims that a "BOC, if permitted to provide [long distance] services on an integrated basis, would have the ability and incentive to arrange more efficiently designed, higher quality connection between its local network and its interLATA facilities than between its local network and rivals' interLATA facilities") ("*Second Non-Accounting Safeguards Reconsideration Order*"), *aff'd Bell Atlantic Tel. Cos.* v. *FCC*, 131 F.3d 1044, 1046 (D.C. Cir. 1997); *Computer II*, 77 F.C.C.2d 384, ¶ 240 (1980).

[3] *Non-Accounting Safeguards Order* ¶ 160; *Second Non-Accounting Safeguards Reconsideration Order* ¶ 37.

the BOC § 272 affiliates. Accordingly, as advanced services become more prevalent, the need for the joint ownership ban and other rules enforcing § 272(b)(1)'s operate independently requirement will become *more* necessary – and not less, as the BOCs contend (*e.g.,* BellSouth at 14). *See Applications Of Ameritech Corp. And SBC Communications Inc., For Consent To Transfer Control*, 14 FCC Rcd. 14712, ¶ 206 (1999) ("*SBC-Ameritech Merger Order*") (for advanced services, rules against discrimination and other "existing regulatory safeguards" are not by themselves sufficient because "it is impossible for the Commission to foresee every possible type of discrimination, especially with evolving technologies).[4]

The BOCs also offer no serious explanation of how it is possible for them to satisfy § 272(b)(1)'s requirement that they "operate independently" from their § 272 affiliates if BOCs and § 272 affiliates jointly own and integrate core network facilities like switches, central offices, and transmission facilities. As AT&T and other commenters demonstrated, such joint ownership would violate the text of section 272's independent operation and non-discrimination requirements, would create unexplainable inconsistencies with prior Commission policies flatly prohibiting such joint ownership, and would arbitrarily create substantial advantages for the BOC affiliates that § 272 was expressly designed to remove. *See, e.g.*, AT&T at 10-20; Sprint at 2-4; Americatel at 9-12. All that the BOCs offer to try to reconcile elimination of this core requirement with the text of § 272 is BellSouth's claim that "requiring BOCs to break their

[4] BellSouth's claim that the threat of discrimination arising from joint ownership "is no longer valid" because "[e]xperience has shown" that unaffiliated carriers can obtain access to switching and transmission facilities "from CLECs and other carriers" (at 15) is entirely unsupported and simply ignores reality. The BOCs still control an overwhelming percentage of the local market and thus retain bottleneck local facilities that IXCs must as a practical matter be able to access. It is obvious, for example, that no BOC § 272 affiliate could offer long distance service if it were denied equal access to BOC facilities and had to rely on alternative facilities. CLECs and other carriers often do not provide alternatives services at all, and where they do, those services are extremely limited in scope.

network ownership into different companies defies logic." BellSouth at 15. But in light of the Commission's prior determinations that Congress would not have chosen "to require a separate affiliate at all" if the Commission were then authorized to permit the BOCs "to provide interLATA services on an integrated basis," *Second Non-Accounting Safeguards Reconsideration Order* ¶ 51, BellSouth's claim reduces to an impermissible attack against Congress's "logic" and judgment in enacting § 272 in the first place. As the Commission itself recognized, it is "not at liberty to depart from [Congress's] decision" (*id.* ¶ 49), and thus eliminating the rule against joint ownership "defies" Congress's clear intent.[5]

Although the Commission has no discretion to re-weigh the costs and benefits and permit joint ownership of switching and transmission facilities despite Congress' clear commands in § 272, the BOCs do not provide any record evidence showing that any costs of this rule outweigh its significant benefits. Indeed, Qwest's comments concede that elimination of the joint ownership rule will not lead to any "immediate cost savings of any great magnitude." Qwest at 13 n.36. None of the other BOCs even attempt to quantify any costs associated with the joint ownership prohibition – a telling silence, given that the BOCs have attempted (but ultimately failed) to do so for the OI&M rules, even when, as in BellSouth's case, those costs were only about $3 million. The record's silence with respect to the costs associated with the joint ownership thus means that those costs are insubstantial. Accordingly, even if the Commission had been provided authority by Congress to eliminate the joint ownership rule, nothing in the record would support that result.

[5] Though Congress's logic needs no defense, operational independence and separation of network ownership is plainly logical and amply justified for all the reasons previously explained by the Commission (*see Non-Accounting Safeguards Order* ¶¶ 158-61; *Second Non-Accounting Safeguards Reconsideration Order* ¶¶ 37, 47-51) and discussed in AT&T's comments (at 17-21).

II. THE COMMENTS CONFIRM THAT ELIMINATING THE OI&M SAFEGUARDS WOULD BE UNLAWFUL AND ARBITRARY.

The BOCs devote most of their comments to their claims that the Commission's rules barring the BOCs from providing OI&M services to the § 272 affiliate should be eliminated. But virtually none of what the BOCs claim is any different than what they previously submitted in their petitions for forbearance, and the little new evidence they do submit demonstrates that the OI&M rules must be retained.

A. The Commission Cannot Interpret The "Operate Independently" Requirement To Permit A BOC To Operate Its § 272 Affiliate's Network.

Most fundamentally, none of the BOCs offer any sensible interpretation of the Act that explains how a BOC can be lawfully be permitted to "operate" – as well as install and maintain – the network of its § 272 affiliate even though Congress imposed the broad requirement in § 272(b)(1) that § 272 affiliates shall "operate independently" from the BOC. A § 272 affiliate whose long distance network is operated (and installed and maintained) by the BOC is *dependent* on the BOC, not independent, as Congress required.

None of the BOCs' comments address the text of the Act. Rather, they rely entirely on claims that Congress itself did not impose the specific rule barring joint provision of OI&M services, claiming that the rule is therefore a mere Commission "policy" judgment that can be tossed aside if the Commission's preferences have changed. *E.g.*, Verizon at 5-7; BellSouth at 2-4. But as the comments show and as courts have previously reminded the Commission, statutory interpretation does not permit that result. *See* AT&T at 13, 22 n.11 (citing cases); MCI at 2; Sprint at 2. Congress did not need to enact a specific prohibition against joint provision of OI&M services among the BOC and its affiliate, because it did enact the exceptionally broad requirement that § 272 affiliates shall operate independently of the BOC. That phrase could easily justify a host of other safeguards and rules designed to effectuate

Congress's intent,[6] but, at a minimum, Congress's enactment of the "operate independently" requirement necessarily forecloses the BOC's view that they may "operate" the long distance networks of their § 272 affiliates.

Indeed, the Act's terms apply to the conduct of the BOC and its § 272 affiliate regardless of the Commission's decision to adopt implementing rules. So long as § 272 is effective, the BOCs are obligated by the command of § 272(b)(1) to operate § 272 affiliates that are truly independent of the BOC. In the absence of Commission implementing rules, the BOC would have to decide for itself how to structure its operations so as to comply with the law. A BOC that chose to allow BOC personnel to install, operate and maintain the § 272 affiliate's long distance network would violate the plain terms of § 272(b)(1) – and so, too, would the Commission, if it sanctioned the BOC's decision.

This is a matter of simple statutory construction, but the point is all the more clear because the Commission is *not* acting a clean slate. To the contrary, the Commission has, in fact, prohibited joint BOC-affiliate provision of OI&M since 1983 and re-affirmed that ban in 1996, finding that eliminating the rule would create "substantial" opportunities for cost misallocation and would "inevitably" lead to discrimination. *See Non-Accounting Safeguards Order* ¶ 163. Further, the Commission's 1996 determination was made even though all of the current regulatory safeguards which the BOCs claim adequately protect competition were in place. *See infra* Part II.C. There are, accordingly, no changed circumstances that would justify

[6] Indeed, competitors and the Department of Justice advocated in 1996 that a complete ban on sharing of services between the BOC and the affiliates was the most reasonable interpretation of the operate independently requirement. *See* AT&T at 9 (citing DOJ comments); Sprint at 3.

eliminating the rules, and as AT&T explained, if the Commission attempted to reverse course, it could not rationally explain the inconsistencies with its prior decisions.[7]

For all of these same reasons, there is simply no basis for the Commission to preempt states from prohibiting joint OI&M, as SBC requests. SBC at 5-6. Even if the Commission decided to withdraw its OI&M rules (and that elimination was not held by a court of appeals to be unlawful), that result could not possibly mean that the Act prohibits such a rule. In the absence of a federal requirement, the states are free to supplement minimum federal requirements. *See, e.g.*, *Illinois Bell* v. *WorldCom*, 179 F.3d 566, 573 (7th Cir. 1999); *Southwestern Bell* v. *Waller Comm.*, 221 F.3d 812, 820-21 (5th Cir. 2000); *MCI Telecom. Corp.* v. *US West Comm.,* 204 F.3d 1262, 1265 (9th Cir. 2000)..

B. Even If Congress Had Provided The Commission With Discretion To Allow BOCs To Operate The Long Distance Networks Of Their § 272 Affiliates, The Record Does Not Support Elimination Of The OI&M Rules.

Even if the Commission were free to ignore the terms of § 272(b)(1) and could simply conduct a cost-benefit analysis of the OI&M rules, the record the BOCs have submitted only confirms that the OI&M rules should be retained. Most of the BOCs' submissions repeat their previously unsupported claims, and, because AT&T has already responded to those claims

[7] For similar reasons, the Commission cannot lawfully grant SBC's alternative request to "clarify" that the Act and OI&M rules do not prohibit other BOC affiliates from performing OI&M services. SBC at 4-5. As SBC recognizes, the Commission has *twice* rejected this very result, finding that it would "create a loophole around the separate affiliate requirement" and thus was compelled by the Act. *See id.*; *Non-Accounting Safeguards Order* ¶ 163; *Third Order On Reconsideration*, ¶ 20. SBC's claims that its affiliates are somehow different because they are not "sham" affiliates is beside the point: the Commission was not concerned about sham affiliates, but rather that the creation of a legitimate affiliate would allow the BOCs to perform indirectly the OI&M services that the Act forbids them from providing directly. If the § 272 affiliate's network is operated not by a BOC directly but by a BOC affiliate, the fact remains that the § 272 affiliate is not operating independently of a BOC. SBC's proposal seeks exactly this result, which is plainly unlawful and should be rejected for a third time.

in detail, AT&T will limit its comments here to addressing the few new issues raised by the BOCs' opening comments.

Most significantly, although the BOCs have never satisfactorily demonstrated that the costs of compliance with the OI&M rules are significant, the BOCs' recent filings make clear that, even if they had incurred such costs, those costs would be caused not by the OI&M rules, but by the BOCs' own inefficiencies and choices of how to operate and structure their separate long-distance operations. Specifically, Verizon has repeatedly claimed – though never supported – that the cost of complying with the OI&M rules is substantial, and in its comments it asserts that it will incur $300 million in costs from 2002 to 2006, on top of additional costs prior to 2002. Verizon at 15. But BellSouth has already admitted that it outsources its OI&M services, and that "[t]he costs associated with a single primary contract account for the majority of BSLD OI&M costs. The total annual cost of this contract is now $3,311,000." *See Ex Parte* Letter of Mary L. Henze, BellSouth, to Marlene Dortch, FCC, CC Docket No. 96-149, at 3 (Sept. 15, 2003). According to BellSouth, its "organization and network strategy" has "helped contain on-going costs." *Id.*

That the magnitude of these costs is especially small and easily dwarfed by the benefits of ensuring fair competition in telecommunications markets is shown by calculating the per customer monthly cost of compliance with these rules. BellSouth has approximately 3 million long distance customers. *BellSouth Marks One Year Milestone Offering Long Distance Service*, Press Release of BellSouth (Sept. 23, 2003). Even assuming that the $3.3 million is also the amount of costs that BellSouth would itself incur if it were providing OI&M services on an integrated basis (even though the BOCs have claimed that they could perform such services far more efficiently themselves), the OI&M restrictions are currently costing BellSouth about *9*

cents per customer per month. This figure shows why the BOCs have been able to compete in long distance markets even with the OI&M rules in place – because those rules do not in fact impose any significant competitive handicaps.

The contrast between Verizon's claims that its OI&M costs are hundreds of millions of dollars and BellSouth's submissions that its costs are about $3.3 million precludes any valid claim that the Commission must eliminate its OI&M rules because it causes substantial costs. If, in fact, Verizon is incurring hundreds of millions in OI&M costs (a claim that it has never proven), then the answer is not to eliminate the pro-competitive OI&M rules, but rather for Verizon to restructure its operations and, as the Act intended, "become increasingly efficient, streamlined, and innovative" (*see* Verizon at 15) in order to reduce those costs.[8] Indeed, perhaps the best solution would be for Verizon to consider retaining BellSouth to manage its OI&M costs.

BellSouth – perhaps having been tipped off by Verizon that BellSouth's forthright submissions undercut Verizon's already questionable and overblown cost claims – attempts to explain away the differences among BOCs in OI&M costs by claiming that they are the result of "different business plan[s]" and a different "network architecture," which has "mitigated [BellSouth's] costs associated with the OI&M restrictions." BellSouth at 12 n.23, 13. But that is precisely the point. BellSouth has chosen, in its own words, to "mitigate" any OI&M costs

[8] For example, Verizon asserts that, with the OI&M restrictions in place, it could not begin to reduce any alleged costs until 2006. Verizon at 15 n.22. But that is apparently because Verizon elected to create a single entity (named GNI) to provide OI&M and other services to the underlying long distance network in each of its states. GNI must therefore remain as a distinct entity until § 272 sunsets in the last state, which is no earlier than 2006 for Verizon. But of course, Verizon chose to structure its operations in that matter; nothing in the Act, once § 272 sunsets in a state, forbids Verizon from integrating its local and long distance services (including OI&M services) in a state even if other states remain subject to § 272.

whereas Verizon apparently has not. The Commission need not alter its pro-competitive rules to reward an inefficient carrier.[9]

In all events, as AT&T has previously explained, the claims of the BOCs (Verizon and SBC) that assert they do incur significant costs because of the OI&M rules are not only unconvincing, but unsupported and unexplained. *See* AT&T at 28 & nn.17, 18; *see also, e.g.*, Selwyn Decl. ¶¶ 29-32 (filed Dec. 10. 2003); AT&T Oct. 1 2003 *Ex Parte*, at 4-5 (Exh. J to AT&T Comments); AT&T Oct. 31 2003 *Ex Parte*, at 3-4 (Exh. K to AT&T Comments). Verizon, for example, provided merely bottom-line percentages of the expenses it claims could be saved, but it consistently failed to provide data, records, and workpapers that could test Verizon's methodologies, assumptions, and calculations. AT&T Oct. 1 2003 *Ex Parte*, at 2-3 (Exh. J to AT&T Comments). In these circumstances, that evidence is simply not verifiable and the Commission would act arbitrarily if it relied on such information as grounds to find that BOCs incur significant OI&M costs. *See, e.g.*, *Ralpho* v. *Bell*, 569 F.2d 607, 629 (D.C. Cir. 1977) (agency acts arbitrarily where it does not "give[] an opportunity to meet evidence which the [agency] intended to consider in making its decision"). And in prior decisions, the Commission has refused to rely on analyses that it claimed merely represented "an educated

[9] BellSouth claims (at 12-13) that its costs savings relative to Verizon are also the result of its decision to own fewer facilities than it leases. Verizon, having now to confront evidence of BellSouth's far lower cost structure, will surely claim that its high OI&M costs are the result of a decision to purchase its own network facilities and not its inefficiency. However, whether or not the BOC affiliate owns or leases the underlying facilities could not possibly account for the tremendous difference in costs alleged by BellSouth and Verizon. In this regard, the personnel performing OI&M services for BellSouth's long distance affiliates are not likely also to be performing those services on an integrated basis for local facilities, which is where Verizon tries to place the blame for its high costs. Nevertheless, the personnel performing BellSouth's OI&M apparently can do so at less expense than Verizon's personnel. Further, and in all events, the discrepancy shows that Verizon has no valid basis to claim that it can save hundreds or tens of millions of dollars in costs if the OI&M rules were eliminated. If Verizon's § 272 affiliate does own far more facilities than BellSouth's, then Verizon will have far higher OI&M costs even if it performs those services on an integrated basis.

guess about what might happen" in the future where there are "many variables not reflected in these analyses and much uncertainty about those variables that are included." *Qwest 9-State Order*, 17 FCC Rcd. 26303, ¶ 417 (2002). The BOCs' cost data certainly fails that test, and the Commission would act inconsistently with these past decisions if it accepted the BOCs' data with no further scrutiny.

BellSouth – recognizing that it cannot possibly claim that elimination of the OI&M rules is necessary to reduce costs – also argues that the real reason the rules should be eliminated is so that the BOCs "have the flexibility to structure their operations in the future." BellSouth at 13. But of course, Congress has already determined that, so long as the § 272 restrictions remain in place (and they should remain in place until the BOCs' market power is fully dissipated), the BOCs cannot be given "flexibility" to structure their long distance operations, because they have powerful incentives to abuse that flexibility and structure their operations in ways to benefit their affiliates and discriminate against rival carriers. Thus, Congress already determined that BOCs should "structure their operations" by creating separate long distance affiliates that operate on a truly independent basis from the BOC. The Commission might rationally allow the BOCs some "flexibility" to share administrative and marketing services, but Congress's operate independently requirement precludes the Commission from providing the BOCs with flexibility to create a § 272 affiliate with a network that is nominally separate but is in fact operated, installed, and maintained by the BOC itself.

Because the BOCs have not shown either that they in fact incur high OI&M costs or that they could not avoid any such costs through improvements in efficiency, they also argue that the OI&M rules impose a competitive handicap exclusively on the BOCs. *See, e.g.,* Verizon at 18; Qwest at 11-13 & Axberg Decl. According to the BOCs, their customers must endure

longer response times and more points of contact as a result of the OI&M rules. But as AT&T has previously explained, this is precisely what long distance carriers must endure as a result of the BOCs' market power over local facilities needed to provide long distance. Thus, if AT&T receives a call from a consumer reporting a service problem, then in almost all cases it, too, must notify the BOC if it appears the trouble is on the local side of the network. *Cf.* Verizon at 18. And if Verizon claims the local network is not causing the problem, then AT&T's personnel must be informed of this claim and then perform their own network verification. *Id.* Likewise, as MCI explains, every unaffiliated carrier must follow "handoff and coordination procedures when obtaining access services from the BOCs. MCI alone requires a substantial number of employees whose sole task is to negotiate and coordinate with the BOCs throughout the access circuit installation and repair process." MCI at 5; *see also* Americatel at 6-7.[10] The OI&M rules therefore do not impose any competitive handicap on the BOCs, but rather are necessary merely to ensure a level playing field.

When – as here – all else has failed, the BOCs do not hesitate to trot out their shop-worn claims that broadband deployment might be slowed if the Commission does not adopt the latest BOC de-regulatory scheme, and the OI&M rules are no exception. Verizon thus argues that the OI&M rules "skew the economic incentives for BOCs to invest in fiber deployment" and

[10] If the BOCs believe that this process is "diverting funds that could be used far more productively in the market," Verizon at 18, then the appropriate response is not to eliminate rules that would allow only the BOCs but not unaffiliated rivals to reduce those expenses. Rather, the BOCs should focus on improving their ability to offer inputs needed to provide long distance services to reduce their affiliates' expenses. Because § 272 requires such improvements to be offered on a non-discriminatory basis to all carriers, that will ensure that even more funds are "used far more productively in the market." *See* MCI at 5-6 (if the access provisioning and repair processes were "automated and predictable," then there would be less burdens in coordination).

place the BOCs at "an artificial competitive disadvantage" in broadband and frame relay services. Verizon at 2, 16-17. This is pure nonsense.

For the very same reasons just discussed, the OI&M rules create a level playing field in these markets. With respect to frame relay and ATM markets, interexchange carriers purchase – and have no choice but to purchase – the vast majority of the underlying local facilities used to provide those services from the BOCs. Thus, the IXCs providing these services, rather than "spending funds on innovation or increased efficiency," must "focus their efforts on providing customers with a 'combined' service package that appears integrated, notwithstanding that the provisioning of the local and long distance portions is not integrated." Verizon at 17-18. Likewise, broadband providers must purchase unbundled facilities from the BOC and integrate them with their own facilities to provide a seamless package. And of course, cable broadband providers are generally not providing packages of broadband services bundled with long distance services, so the existence of the OI&M rules places no competitive handicap on the BOCs vis-à-vis the cable providers. These claims that OI&M rules affect broadband services in any material way are simply false. Further, and as explained above, *see supra* pages 15-16, the Commission has found that, because of the new technologies used in providing advanced services, the BOCs' abilities to discriminate against competing providers is heightened. Thus, the OI&M rules provide correspondingly greater pro-competitive benefits when applied to broadband services. For these reasons, there is absolutely no merit to Verizon's claim that § 706 of the Act supports elimination of the OI&M rules. *See, e.g.*, Verizon at 18-19 n.27. The OI&M rules are themselves "measures that promote competition in the local services market." § 706. And, in all events, the fact that the Commission has already determined that § 10(d) of the Act prohibits the Commission from applying "regulatory forbearance" to the

OI&M rules strongly suggests that the Commission could not rely on § 706 (which provides that the Commission may use regulatory forbearance to accomplish the goals of § 706) as a basis to eliminate the OI&M rules.

C. The OI&M Safeguards Are The Most Effective Way To Prevent Cost Misallocation And Discrimination.

As AT&T showed previously, the OI&M rules are critical, pro-competitive safeguards that implement § 272's purposes of preventing the BOCs from acting on their incentives to misallocate costs and discriminate against long-distance rivals. AT&T at 22-28 & nn.10, 12; MCI at 4-7: Sprint at 2-3; Americatel at 8. The BOCs assert that the OI&M rules are an overbroad mechanism and that the risks of anti-competitive conduct can be addressed through other regulatory safeguards. *E.g.*, Verizon at 8-13; Qwest at 5-11. These claims have no merit.

First, the OI&M safeguards are not overbroad, but in fact require *less* regulatory oversight than the "enforcement" mechanisms that the BOCs would have the Commission rely upon to detect anticompetitive conduct. As the Commission explained in 1999, an "outright prohibition" on shared OI&M is "necessary" to avoid the "burdensome regulatory involvement that would be necessary to detect and deter" cost misallocation and other anticompetitive conduct. *Third Order on Reconsideration* ¶ 20 (citing *Non-Accounting Safeguards Order* ¶ 163). The entire premise of Congress's decision to require the BOCs to offer long distance services through a separate affiliate that operates independently from the BOC is that the Commission could not otherwise use regulatory tools, including the other requirements of § 272, to detect anticompetitive conduct. If cost allocation rules and other safeguards were sufficient by themselves, Congress could have disposed of separate affiliate and operational independence requirements altogether and relied on the Commission's enforcement ability to protect competition. But it did not, precisely because it has been recognized for decades that the

Commission does not have the institutional resources to monitor adequately the conduct of vertically integrated local carriers that control bottleneck monopolies.[11] If the Commission were to eliminate the structural benefits provided by an outright prohibition of joint BOC-affiliate OI&M provision, it would have to explain why this Commission is better suited to detect and remedy anticompetitive conduct than its predecessors – and, as Americatel points out, prior Commissions have never been able to explain adequately why they decided to eliminate other structural safeguards. *See* Americatel at 10-11 (citing the reversal of the Commission's *Computer III* decision eliminating separate affiliates for enhanced services because the Commission never adequately explained its rationale).

Second, the regulatory safeguards relied upon by the BOCs are simply not effective, as AT&T has previously explained and as the Commission has previously found. AT&T at 22-28. The only new arguments made by the BOCs concern competition and the biennial audits. With respect to the latter, Verizon and USTA argue that anticompetitive conduct is not likely because competition will prevent the BOCs from misallocating costs and discriminating. Verizon at 10; USTA at 4. The problem is that the facts simply do not support

[11] *See*, *e.g. SBC-Ameritech Merger Order* ¶¶ 14, 211, 363 ("decades of experimentation" have demonstrated that regulation alone "could not fully monitor and control such exclusionary and discriminatory behavior" and that "structural solutions" are "vitally necessary;" they are an effective way to "ensure a level playing field" between a BOC and its rivals and they achieve that goal in a way that avoids "engaging in detailed regulatory oversight"); *Bell Atlantic/GTE Merger Order* ¶ 260; Reply Comments of the United States Department of Justice, at 10, CC Docket No. 96-149 (filed Aug. 30, 1996) (sharing of services between BOC and its § 272 affiliate "would make cost misallocation possible even in a regime of extensive record keeping by the BOC and vigilant auditing by the Commission. The Commission could not practically detect any but a miniscule percentage of the occasions on which BOC personnel devoted unrecorded time to affiliate problems"); *U.S.* v. *Western Elec. Co.*, 673 F. Supp. 525, 530-32, 567-79 (D.D.C. 1987) (finding that "despite the decades-old requirements in the Communications Act . . . and various FCC regulations requiring non-discrimination, equal access, and proper cost allocations, and notwithstanding the Commission's own persistent and dedicated efforts for a number of years, the FCC was unable to prevent or to remedy major anticompetitive abuses by the Bell System"), *aff'd*, 969 F.2d 283, 298 (D.C. Cir. 1990).

the theory: the BOCs do not conceivably face the type of robust and sustainable local competition that would be necessary to discipline their incentives to harm unaffiliated long distance rivals. The inescapable fact is that, with respect to their local operations, BOCs remain classified as dominant carriers, and under the Commission's rules, dominant carriers have "market power." The Commission has never before attempted to reverse that classification and could not possibly deem the BOCs to face effective competition in local markets. Certainly on the record in this proceeding the BOCs have failed to show that they lack market power and thus no longer have the incentive and ability to harm unaffiliated rivals in the long distance markets. The BOCs' stray and unsupported claims that competition from VoIP and wireless has led to recent declines in the demand for the BOCs retail services is unsupported and falls far short of demonstrating that BOCs no longer control bottleneck facilities that are needed to provide long distance services.[12] In this regard, IXCs and wireless carriers remain highly dependent on the BOCs' special access services and, as AT&T and others have shown, the BOCs control this market and have exploited that control to earn an average rate of return of about 40% and to extract more than *$5 billion* in annual revenue from captive customers.[13]

The BOCs' additional claims (Verizon at 11-12; Qwest at 7; BellSouth at 11) that the § 272(d) biennial audits, as implemented, provide an effective check on the BOCs' anticompetitive conduct are simply laughable – or would be, if the anticompetitive conduct that the audits failed to detect and deter were not so serious. The BOCs' conduct with regard to the

[12] In this regard, even the BOCs' § 272 affiliates would currently be deemed dominant were it not for section 272 safeguards including the OI&M restrictions. The Commission is currently considering in other proceedings whether to deem the § 272 affiliates non-dominant even if § 272 safeguards have sunset, but whatever the outcome there, the Commission could not possibly find in this proceeding that not just the affiliates but the BOCs themselves lack market power.

[13] *See In re AT&T Corp.*, Petition for Mandamus, No. 03-1397 (D.C. Cir.).

biennial process has been an embarrassment, and it shows how desperate the BOCs have become (and how unconvincing the remainder of their arguments are) that they would point to the audits as an effective process to detect, deter, and remedy their discriminatory conduct. To begin with, the audits to date proceed on the basis that the BOCs are barred from providing OI&M services, and thus in no way do they show that the audits could detect abuses in the joint provision of OI&M services. But more fundamentally, the biennial audit process is broken and is in desperate need of substantial repair before the Commission could even hope to claim that, despite decades of prior failures in FCC regulations such as audits to prevent anticompetitive conduct (*see supra*), biennial audits would supplant the pro-competitive protections offered by the OI&M rules.

Verizon's claims that, after "[f]our years of experience with the application of section 272," it has already conducted "two biennial audits, which have revealed no material violations of the Commission's rules" border on bad faith. In fact, the first audit covered only a few months of Verizon's long distance operations and, despite significant flaws in the design and execution of the audit, resulted in the issuance of a *Notice of Apparent Liability* for violations of § 272.[14] Further, the second biennial audit of Verizon was released publicly in unredacted form just this month – a delay that occurred because Verizon *again* refused to disclose the full contents of the auditor's findings even though the Commission had *twice* before issued clear and unambiguous rulings that public disclosure of the full reports was vital. As a result of these delays, in the nearly four years since Verizon was first authorized to provide long distance, only very limited biennial audits have been released to the public and only after significant and

[14] Further, as AT&T's comments showed, despite its flaws, the audit in fact uncovered misconduct by Verizon that was pervasive and that went far beyond the findings in the Commission's *NAL*.

wholly unjustified delay. Given this record, as well as the Commission's decidedly lax enforcement of the audit requirement, it is ludicrous to suggest that the biennial audits would protect competition if the OI&M rules were eliminated.

III. THE COMMENTS CONFIRM THAT THE COMMISSION COULD NOT ELIMINATE BOTH THE JOINT OWNERSHIP AND OI&M RULES.

As explained by AT&T and MCI, the Commission would quite plainly violate the Act if it eliminated *both* its OI&M and joint ownership rules. Consistent with statutory construction requirements, section 272(b)(1) must have independent meaning, but if the Commission's implementing rules are eliminated, then the "operate independently" requirement will mean nothing more than what is already prohibited by other subsections of § 272. AT&T at 31; MCI at 1.

According to SBC – the only BOC that even addresses this point (SBC at 7) – § 272(b)(1) imposes a "qualitative standard" that provides the Commission with a guide to interpreting "more specific requirements in section 272(b)(2)-(5). SBC's claim is utterly unconvincing. To begin with, the plain text of § 272(b)(1) provides no hint that it does not, in fact, impose a distinct requirement but only a interpretative guide. To the contrary, it flatly states that the § 272 affiliate "shall operate independently." § 272(b)(1). This is not the language of a "guide," but of a command. Further, the structure of § 272(b) also contradicts SBC's interpretation of § 272(b)(1). If § 272(b)(1) were merely a guide to interpreting the remainder of § 272(b), then it would make no sense for Congress to make it a distinct subsection of § 272(b) along with the requirements of § 272(b)(2)-(5). In this regard, Congress in § 274(b) required a BOC's separate affiliate for electronic publishing to be "operated independently" from the BOC, and then in 9 subsections of § 274(b) provided additional and more particular separation requirements. That structure, if it had been adopted in § 272(b), would be more consistent with

SBC's view that the operate independently requirement can be viewed as an interpretative guide to § 272(b)(2)-(5).[15] Finally, SBC's strained interpretation of § 272(b)(1) as merely imposing a interpretative guide is flatly inconsistent with Congress's intent in adopting an separate affiliate requirement in the first place. *See Second Non-Accounting Safeguards Reconsideration Order* ¶¶ 47-51. If the only independence obligations imposed by Congress were those in § 272(b)(2)-(5), then the separate affiliate requirement would effectively require only a shell affiliate that is separate only on paper. *Cf. id*. ¶ 50 (rejecting BOC interpretation of § 272 that its purpose is only to make transactions "entirely transparent" and is not also designed to prevent "integrated" operations). For all these reasons, § 272(b)(1)'s "operate independently" requirement must be (as it has been since 1996) a distinct obligation, not an interpretative guide to other requirements of § 272(b).

[15] Nevertheless, even the structure in § 274(b) is not so clear that the Commission would be barred from adopting additional requirements to effect operational independence beyond those in § 274(b)(1)-(9). The point is that the structure Congress used in § 274(b) demonstrates that the structure it used in § 272(b) precludes SBC's interpretation that the separate "operate independently" requirement in subsection 272(b)(1) is merely an interpretative guide.

CONCLUSION

For the foregoing reasons, the Commission should retain its current rules implementing section 272(b)(1)'s "operate independently" requirement.

Respectfully submitted,

/s/ Leonard J. Cali

LEONARD J. CALI
LAWRENCE J. LAFARO
ARYEH S. FRIEDMAN
AT&T CORP.
One AT&T Way
Bedminster, NJ 07921
(908) 532-1831

DAVID L. LAWSON
MICHAEL J. HUNSEDER
SIDLEY AUSTIN BROWN & WOOD, LLP
1501 K Street, NW
Washington, D.C. 20005
(202) 736-8000

Counsel for AT&T Corp.

December 22, 2003

CERTIFICATE OF SERVICE

I hereby certify that on this 22nd day of December, 2003, I caused true and correct copies of the forgoing 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 22, 2003
Washington, D.C.

/s/ Michael J. Hunseder

Michael J. Hunseder

SERVICE LIST

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Room CY-B402
Washington, D.C. 20554[16]

Qualex International
Portals II
445 12th Street, SW, Room CY-B402
Washington, D.C. 20554

Janice Myles
Wireline Competition Bureau
445 12th Street, SW
Room 5-C327
Washington, D.C. 20554

Michael E. Glover
Edward Shakin
Joseph DiBella
VERIZON
1515 N. Courthouse Rd., Suite 500
Arlington, VA 22201

John H. Harwood II
Lynn R. Charytan
Polly B. Smothergill
WILMER, CUTLER & PICKERING
2445 M Street, N.W.
Washington, D.C. 20037-1420

Andrew D. Crain
Qwest Services Corporation
607 14th Street, N.W.
Suite 950
Washington, D.C. 20005

Alan Buzacott
MCI
1133 19th Street, N.W.
Washington, D.C. 20036

[16] Filed electronically via ECFS

Anu Seam
SBC Communications, Inc.
1401 I Street, N.W.
Suite 400
Washington, D.C. 20005

Stephen L. Earnest
BellSouth Corporation
675 West Peachtree Street
Suite 4300
Atlanta, GA 30375-0001

Robin E. Tuttle
United States Telecom Association
1401 H Street, N.W.
Suite 600
Washington, D.C. 20005-2164

John Benedict
Sprint Corporation
401 9th Street, N.W., #400
Washington, D.C. 20004

Robert H. Jackson
Americatel Corporation
Reed Smith LLP
1301 K Street, N.W.
Suite 1100 – East Tower
Washington, D.C. 20005