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

In the Matter of	)	
Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	)	**WC Docket No. 02-112**

REPLY COMMENTS OF AT&T CORP.

David L. Lawson	**Mark C. Rosenblum**
Michael J. Hunseder	**Lawrence J. Lafaro**
SIDLEY AUSTIN BROWN & WOOD, LLP	**Aryeh S. Friedman**
1501 K Street, NW	**AT&T CORP.**
Washington, D.C. 20005	**295 North Maple Ave.**
(202) 736-8000	**Basking Ridge, NJ 07920**
	(908) 221-2717

Counsel for AT&T Corp.

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AT&T Corp. ("AT&T") respectfully submits these reply comments and the attached Reply Declaration of Lee L. Selwyn ("Selwyn Reply Dec.") pursuant to the Commission's Notice of Proposed Rulemaking, *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, FCC 02-148, (May 24, 2002) ("*Notice*").

<u>INTRODUCTION AND SUMMARY</u>

The comments in this proceeding overwhelmingly demonstrate that, without exception, the Bell Operating Companies ("BOCs") have maintained and will continue to maintain a firm grip on the bottleneck facilities needed to provide long distance and other telecommunications services far longer than three years after they receive section 271 authorization in a state. This is the critical fact in this proceeding, because it was Congress' recognition that the BOCs would retain such post-entry market power – and hence the incentive and ability to impede competition – that led Congress to enact the section 272 structural, transactional, and accounting safeguards and to empower the Commission to maintain those safeguards for as long as necessary to protect consumers and competition.

The appropriate response to this marketplace reality is clear: to prevent the BOCs from using their persistent local market power to harm long distance (and local) competition, the Commission should extend the section 272 safeguards for at least another three years. This is not only the view of competing carriers that must rely on the BOCs for essential inputs, but also of state commissions. The state commission comments and orders show, for example, that even in the earliest section 271-authorized states, the BOCs enjoy "continued dominance" over bottleneck local facilities. The state commissions also catalogue hundreds of BOC violations of plans designed to measure the BOCs' performance in maintaining open local markets. The state commission comments confirm what has long been obvious: the BOCs have made calculated decisions to violate these requirements, because the fruits of their monopoly abuse far exceed even the hundreds of millions of dollars in fines and penalties that those anticompetitive actions have triggered. And the state commissions report that the BOCs' performance has not improved after section 271 authorization – yet another obvious demonstration that local markets are *not* fully competitive even years after section 271 authorization. Indeed, the relevant market power evidence is entirely one-sided – the BOCs cannot point to a shred of empirical or other evidence that could support a reasoned prediction that the local markets in any state are likely to be sufficiently competitive three years after section 271 authorization to obviate the need for section 272 safeguards. *All* of the evidence is to the contrary.

For that reason, the BOCs seek to draw attention away from the critical market power inquiry. They claim, for example, that the Commission may not even consider the competitive conditions in local markets, but must instead allow the section 272 safeguards to sunset, regardless of anticompetitive effects, absent "new" and "compelling" circumstances that Congress did not anticipate. There is no basis in the statute (or sound policy) for this absurd construction. Even more absurd, however, is the BOCs' revelation that section 272 is an all-or-nothing proposition for each RBOC, and that as the three year anniversary of Verizon's New York authorization approaches, for example, section 272 automatically ceases to apply to *any* of the Verizon states. As explained below, each of the BOCs' statutory arguments is an entirely baseless distraction and should be treated as such.

When section 272 is applied as written and the focus properly remains on the market power inquiry that must guide the Commission's sunset inquiry, the BOCs' few remaining arguments in favor of an immediate and total sunset of all section 272 safeguards are readily dismissed. The BOCs contend that structural separation and the need to rely upon two companies to provide end-to-end long distance service is a serious competitive handicap. That is a remarkable assertion given the BOCs' unrivalled market share in section 271-authorized states. In any event, the BOCs' long distance affiliates are, in fact, no worse off than other long distance providers, which must almost always turn to the BOCs for the local access links necessary to provide end-to-end long distance services. Nor can the BOCs' claims that the section 272 safeguards are costing them billions be credited. Those "cost-benefit" analyses are entirely unsupported and unaccompanied by any documentation that could allow them to be independently verified, conflict with the BOCs' own certified public statements, contain the most obvious flaws, and simply ignore the enormous competitive benefits – in revealing and discouraging market power abuses – associated with the section 272 safeguards.

As the comments in this proceeding confirm, the section 272 safeguards are a unique and invaluable tool for regulators and competitors to detect, deter, and remedy the BOCs' considerable and increasing incentives and abilities to impede long distance competition. And the BOCs' marketplace conduct – accelerating section 271 applications and unprecedented long distance successes – belies any claim that the competitive or administrative costs of complying with section 272 are remotely comparable.

In short, the section 272 safeguards should be retained even if the Commission (like other lawmakers and regulators) had not determined that recent events counseled in favor of retaining and strengthening accounting and other safeguards to protect the public. Given the "tawdry evidence of accounting practices gone wildly astray," Statement of Commissioner Michael Copps on Accounting Issues, August 20, 2002, there should be no question that section 272 safeguards must be extended with respect to all BOCs and for at least another three years after the expiration of the initial three year period.

I. IT IS INDISPUTABLE THAT A BOC RETAINS SUBSTANTIAL LOCAL MARKET POWER IN A STATE MORE THAN THREE YEARS AFTER RECEIVING SECTION 271 AUTHORITY IN THAT STATE.

The comments overwhelmingly confirm that the BOCs continue to maintain substantial local market power, even in states where they long ago satisfied the section 271 competitive checklist. Thus, in Texas, the second state where a BOC received section 271 authorization, the PUC reports that "SWBT's continued dominance over local exchange and exchange access services still hinders the development of a fully competitive market." Texas PUC at 3. In Texas and other states where the BOC has received interLATA authorization, "competition is just emerging," particularly in residential markets. *Id.* at 4; *see also infra* note 12. In fact, the Texas PUC notes that competition may be *diminishing*, in view of the "current status of the financial markets," the lack of "access to capital," and the "bankruptcy of many competitive carriers.

Texas PUC at 3.[1] For all these reasons, the Texas PUC concludes that SWBT retains market power and "retains both the incentive and ability to discriminate against competitors and to engage in anti-competitive behavior." *Id.* at 3.

Likewise, in Missouri, another section 271-authorized state, the Missouri PSC performed a recent survey of competition and concluded that for local exchange services in most Missouri exchanges, "competition from widely available CLEC-owned facilities did not exist for business or residential basic local service." Missouri PSC at 3. And for access services, the Missouri PSC found that the "SWBT was the dominant provider of exchange access services within its service territory," and that those services are "not subject to effective competition." *Id.* And in Pennsylvania, where Verizon was found to satisfy the competitive checklist nearly a year ago, the PA PUC's comments make clear that the local market there is not sufficiently competitive to warrant removal of the section 272 safeguards. PA PUC at 4-5.

Other state commissions also agree that it is far too early to consider removing section 272 safeguards. Thus, the Wyoming PSC states that because "competitive developments have been slower than many anticipated," the Commission should retain structural separation to "assur[e] that [the BOCs] cannot use their remaining monopoly positions in the local market to take advantage of the local market." Wyoming PSC at 2. The Washington UTC concludes that "there is every reason to believe that in today's financial climate and given the situation faced by many competitive LECs, it will take *much longer* than three years envisioned by Congress for robust, sustainable competition to develop." Wash UTC at 2 (emphasis added).[2]

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[1] Since SBC received section 271 authorization, "over 41 CLECs have filed for bankruptcy protection," and a "considerable number of carriers have either exited the marketplace or appreciably reduced the areas in the state in which they provide services." *Id.* at 4 & n.7.

[2] In New York, the first state in which a BOC was authorized under section 271, the PSC has previously demonstrated that Verizon remains dominant in all local markets, particularly in the

The state commissions are correct. In addition to market statistics, AT&T and other commenters have provided substantial evidence that the BOCs continue to discriminate against rivals and misallocate costs, conduct that can only occur if the BOCs retain market power.[3] State commissions monitoring post-271 BOC performance have also responded to the request in the *Notice* (¶ 15) by reporting significant violations of state performance plans. In Texas, for example, the PUC found "continuing performance deficiencies" in SWBT's provision of access to competitors. Texas PUC at 1-2. SWBT's compliance with the state's performance plan since it received section 271 authority has been nothing less than dismal. According to the Texas PUC, since November 1999, SWBT has "paid over *$23 million* in Tier 1 and Tier 2 damages to other carriers and the State of Texas." *Id.* at 6 (emphasis added). Further, in the most recent six months for which data is available, the Texas PUC reports that "SWBT had "over 525 separate violations" of the state performance plan. *Id.* SWBT's performance has not improved at all since it received section 271 authority: "there does not appear to be a significant trend downward" in either the number of violations or the amount of fines. *Id.* The Texas PUC

provision of access services that is most relevant here. *See Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, Case 00-C-2051, (NYPSC June 15, 2001); *see also* TWTC at 4-5; CompTel at 8-9; WorldCom at 4-6. The NYPSC's comments in this proceeding do not address local competition in New York, because the NYPSC states that "Verizon has no plans to integrate its long distance affiliate into its network operations at this time." NYPSC at 1. Verizon makes a half-hearted effort to claim that its competition in its markets are "flourishing" (Verizon at 6-7), but as Dr. Selwyn explains and as AT&T has fully explained in the Commission's Triennial Review proceedings, Verizon's claims are vastly overstated. *E.g.*, Selwyn Reply Dec. ¶¶ 11-13. And Verizon's particular claim that competition is the "strongest" in states where the BOCs have section 271 authorization (Verizon at 7) has already been convincingly rebutted by Dr. Selwyn's initial declaration. *See* Selwyn Dec. ¶ 27 & Att. 2

[3] *See* AT&T at 21-43 & Selwyn Dec. ¶¶ 49-73; Sprint at 14-16 (discussing millions of dollars in fines incurred by BOCs for noncompliance with various federal requirements); CompTel at 13-15 (discussing BellSouth's efforts to obtain information for section 272 long distance affiliate by threatening to withhold access to BellSouth local network).

concludes that, although performance plans "theoretically" provide incentives for SWBT to ensure conditions are appropriate for the local market to become fully competitive, the Texas PUC "has not documented this intended effect on SWBT's performance" (*id.*) – a sure sign of local market power that has proven (and will continue) to persist for years after SWBT obtained section 271 authority.[4]

Further, the comments confirm that the two biennial audits that have been conducted have uncovered numerous and troubling violations of section 272 – misconduct that is apparent even though one audit report still has kept significant findings under seal and neither audit was conducted with the rigor necessary to fully test the BOCs' compliance. *E.g.*, AT&T at 23, 44-46; CompTel at 9-10, 20. The BOCs claim that the audits found only "minor issues" with compliance (SBC at 15), but that is simply not true. Indeed, the state commissions, which rely heavily on the audits (*see infra*), disagree with the BOCs that these initial audits found no violations, and uniformly state that the Commission should extend the section 272 safeguards precisely because the "results of the second biennial audit will be crucial."[5]

The BOCs' principal reply is to assert that discrimination and cross-subsidization are "more theoretical than a real-world possibility." SBC at 2. Of course, those statements are alone patently insufficient to rebut the specific instances of such misconduct reported by competitive carriers and state regulators and revealed in section 272 audits. In all events, the BOCs' theories

[4] Likewise, in Missouri, the PSC reports that SWBT has since April 2001 "paid over $1.6 million to CLECs and over $620,000 to the Missouri treasury for Tier 1 and Tier 2 damages." Missouri PSC at 3. SWBT's performance has *not* improved over time, but instead, the Missouri PSC finds that SWBT's performance has stayed the same, with "no apparent improvement." *Id.*

[5] Wash UTC at 2; *id.* (because initial audits "found exceptions to compliance" with section 272, the Commission and state regulators should ensure they are "corrected by the RBOCs and not repeated in the future"); Texas PUC at 8-9 ("the second audit will allow for the implementation of remedial measures and monitoring of any problems and issues identified in the first audit").

as to why they cannot possibly discriminate or misallocate costs are flawed and have been rejected by the Commission.

For example, SBC repeats claims it made in defense of its merger with Ameritech that it could not discriminate against rival IXCs because discrimination is not "possible" and any market-affecting discrimination would be readily "apparent to competitors and regulators." SBC at 10-11; *cf. SBC-Ameritech Merger Order* ¶ 223.[6] However, as the Commission concluded when it previously rejected those arguments, a BOC can "deny, delay, or degrade access service to [IXC] competitors," in ways that are "more subtle and less detectable." *Id.* ¶¶ 214, 223.[7] And as described below, all of this conduct is made *more* likely by virtue of the BOC mergers since the passage of the Telecommunications Act. *Id.* ¶ 227. The BOCs also claim that fears of cost misallocation and cross-subsidization are a "relic from the past," particularly because the BOCs today operate under a "pure price cap regime." SBC at 13; *see* Verizon at 18; Qwest at 13. However, as the comments and Dr. Selwyn explains, BOCs still retain incentives and ability to cross-subsidize under price cap regulation. Selwyn Reply Dec. ¶¶ 30-37; TWTC at 9, 12-13. For these reasons, the risk of BOC discrimination and cost misallocation is far more than a theoretical concern – it presents a real and substantial threat to the great "strength of competition in the interexchange market." *SBC-Ameritech Merger Order.* ¶ 213.

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[6] Memorandum Opinion And Order, *Applications Of Ameritech Corp., Transferor, And SBC Communications Inc., Transferee, For Consent To Transfer Control Of Corporations,* 14 FCC Rcd. 14712 (1999) ("*SBC/Ameritech Merger Order*").

[7] For example, a BOC could fail to provision enough equipment, so that the rival experiences higher blocking rates; or, the BOC could delay the installation of trunks, and otherwise "slow roll" provisioning or upgrading of a service requested by the rival. *Id.* ¶¶ 219, 223. And the BOCs are able to "'fine tune their networks to favor their own interexchange operations." *Id.* ¶ 219.

II. THE BOCs' LEGAL "INTERPRETATIONS" OF SECTION 272(f)(1) ARE IMPERMISSIBLE.

Rather than attempt to rebut the overwhelming evidence of enduring local market power that, under any rational approach, mandates extension of the section 272 safeguards, the BOCs largely rely on a series of misinterpretations of the Act as the basis for their claims that Congress somehow limited the Commission's authority to extend the section 272 safeguards, and that the Commission therefore has no choice but to allow those safeguards to sunset.

A. Congress Did Not Require The Commission To Find "Compelling" Or "Unanticipated" Circumstances To Be Present Before The Section 272 Safeguards Could Be Extended.

The BOCs each claim that Congress created some type of "statutory presumption" in section 272(f)(1) that the section 272 safeguards would apply for only 3 years after receipt of section 271 authorization,[8] even though Congress explicitly provided the Commission with broad authority to extend the *minimum* 3 year period by rule or by order. With regard to that provision, the BOCs contend that the Commission may "override" this alleged presumption only if it finds "some new development" that provides a "compelling reason" to continue the requirements of section 272.[9] The standard proposed by the BOCs has no foundation in the Act's language or purpose.

The BOCs' reading of the statute is directly contrary to the clear intent and core purpose of section 272. Congress recognized that, even upon receipt of section 271 authorization, a BOC's local markets in a state will be merely open to competition, and will not be fully competitive for some time – precisely how long Congress could not predict. *Non-Accounting*

[8] *See* BellSouth at 4; Qwest at 3; Verizon at 3; USTA at 3-4.

[9] Verizon at 3; Qwest at 3 (safeguards cannot be extended unless there is a finding of circumstances that were "unanticipated" at the time the statute was adopted); BellSouth at 3, 6, 9.

Safeguards Order ¶¶ 9, 13;[10] *see* Texas PUC at 2; *see also* Selwyn Reply Dec. ¶ 4. Accordingly, Congress gave the Commission broad authority to extend the section 272 safeguards that is in no way conditioned on any finding of new or special circumstances. Indeed, the BOCs have it precisely backwards – the possibility of no material change in marketplace conditions three years after section 271 authority is the very reason that Congress granted the Commission authority to extend the section 272 safeguards. It turns the statute on its head to suggest that where there is no material change – *i.e.*, where the BOC retains market power three years after section 271 authorization – that the Commission is required to allow the section 272 safeguards to sunset. Accordingly, any rational exercise of the Commission's section 272(f)(1) authority necessarily must examine BOC market power, and whether that market power can be expected to have dissipated three years after section 271 authority is granted.[11]

Notwithstanding Congress' clear concern in section 272 that the BOCs must not be permitted to use their enduring dominance in local markets to harm competition in interLATA markets, some BOCs claim that "the Commission need not consider local competition in examining the sunset of section 272." Qwest at 4-5; BellSouth at 14-16. According to these BOCs, section 272 was not enacted to protect local competition, which means that competitive

[10] First Report and Order and Further Notice of Proposed Rulemaking, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21905 (1996) ("*Non-Accounting Safeguards Order*") (the Commission's rules should be in place "until facilities-based alternatives to the local exchange and exchange access services of the BOCs make those safeguards no longer necessary").

[11] The state commission, in particular, agree that the Commission should require a showing of fully competitive markets and alternative sources of supply before considering the removal of section 272 safeguards. *See, e.g.*, Wash UTC at 2 (Commission should not "lift[] the safeguards too soon," *i.e.*, before "robust, sustainable competition . . develop[s]"); Missouri PSC at 3, 4 (retain safeguards "until such time as the BOC no longer has an incentive and the ability to discriminate against long distance competitors or to engage in other anti-competitive conduct"); Texas PUC at 3 ("prudence demands that the sunset period be extended *until the conditions which necessitated the creation of competitive safeguards no longer exist*") (emphasis added)

conditions in local markets are entirely irrelevant to the sunset of section 272 safeguards. Qwest at 4-5. This astonishing claim displays a complete ignorance of the "fundamental postulate underlying modern telecommunications law" – that the BOCs' will have both the incentive and ability to use their control over bottleneck local facilities to discriminate against competitors in *long distance* (and other) retail markets in order to favor their own competing retail operations. *SBC-Ameritech Merger Order* ¶¶ 12, 190. The Commission must consider local market conditions in order to determine whether the BOCs are likely to retain those incentives and abilities to harm retail long distance competition for more than three years after section 271 authority is granted. *See, e.g.* Texas PUC at 3-4.

In all events, there plainly have been significant "new developments" (*e.g.,* Verizon at 3) that Congress did not anticipate, and that further confirm that the section 272 safeguards must be extended. Congress expected the erosion of the BOCs' bottleneck monopolies and the introduction of local competition to occur to occur much more quickly than it has. As summarized above and as described in the comments, local competition has been extremely slow to develop[12] – in large measure because the BOCs and incumbent LECs have resisted at every turn and refused to implement the Act's market opening requirements. The slow development of local competition is a compelling circumstance that Congress did not anticipate, and that by itself justifies the extension of section 272 safeguards, even under the BOCs' fabricated standard.

Moreover, other compelling and unanticipated circumstances that easily justify the continuation of section 272 requirements arise from the anticompetitive effects of the mergers of several of the largest dominant LECs. Congress plainly anticipated that incumbent LECs would

[12] *E.g.*, Wyoming PSC at 2 ("[c]ompetitive developments have been slower than many anticipated"); Wash. UTC at 1 ("competition is not developing as quickly as Congress had hoped"); Missouri PSC at 3 ("competition in Missouri has not reached the level envisioned by Congress")

invade each other's local markets and provide significant local competition – and, indeed, at least some BOCs developed extensive plans to do just that. *See, e.g., Bell Atlantic-GTE Merger Order*, ¶¶ 100-26 & App. C;[13] *SBC-Ameritech Merger Order* ¶¶ 67-100 & App. B. However, the BOCs abandoned those plans (*see id.* ¶ 79) and instead have chosen to merge with one another, reducing the benefits of this potential competition. In approving those mergers, the Commission found that the remaining large incumbent LECs "not only will have *more* incentive to discriminate against rivals, but also will have a *heightened* ability to inhibit competitors' provision of services." *SBC-Ameritech Merger Order* ¶ 194 (emphasis added); *Bell Atlantic-GTE Merger Order* ¶¶ 173-78.[14]

Indeed, with regard to interLATA markets in particular, the Commission determined that BOCs "with section 271 authority to offer interexchange services to in-region customers will have an incentive to discriminate" against independent IXCs – discrimination that the mergers exacerbated and that is "particularly acute with regards to advanced or customized access services for which detection of discrimination is most difficult." *SBC-Ameritech Order* ¶ 196; *id.* ¶¶ 212-35.[15] Given these findings, it would plainly be arbitrary for the Commission to

[13] Memorandum Opinion And Order, *Application Of GTE Corp., Transferor, And Bell Atlantic Corp., Transferee, For Consent To Transfer Control,* 15 FCC Rcd. 14032 (2000) ("*Bell Atlantic-GTE Merger Order*").

[14] While the BOCs proposed conditions that were alleged to offset these harms, the BOCs have often failed meaningfully to fulfill (or have affirmatively violated) those conditions. *See* Selwyn Dec. ¶ 31. Moreover, as described below, it is highly significant that one of the conditions the BOCs proposed to offset the competitive harms of these mergers was a separate affiliate structure for their advanced services operations. *See SBC-Ameritech Merger Order* ¶ 211.

[15] Moreover, the Commission rejected claims, like those the BOCs make here, that regulators have developed proper tools to detect and prevent discrimination: "With the increased network complexity, and the possibility for new types of discrimination, comes also an increased difficulty in detecting discrimination. In such a situation, past experience with the interconnection of plain vanilla, or POTS service, becomes increasingly less useful as a regulatory tool for preventing, detecting, and remedying discrimination." *SBC-Ameritech Merger Order* ¶ 220.

determine that BOCs' ability to discriminate and engage in cost misallocation has been substantially reduced. Thus, even if the Commission had to rely on some "new" or "unanticipated" circumstance before extending the section 272 safeguards – which it plainly does not – the slow development of local competition and the substantially increased incentives and ability to discriminate and misallocate costs arising from multiple BOC mergers would provide ample grounds for refusing to allow section 272 to sunset.

B. Application of a Sunset on a BOC-by-BOC Basis Is Contrary To The Act.

The BOCs' additional interpretation of section 272(f)(1) is simply frivolous. For the first time ever, the BOCs (with the exception of Qwest) advance their claim that the Act must be interpreted so that the section 272 requirements apply on "all-or-nothing" basis, and thereby sunset *throughout* the region in which the RBOC operates three years after a BOC is authorized under section 271 in *any single* state. Verizon at 3-6; SBC at 19-21; BellSouth at 4-13; USTA at 4-6. Under this theory, for example, because Verizon received section 271 authority for New York in December 1999, Verizon need not follow the section 272 requirements for *any* of its BOCs in other states after December 2002 – even in states where Verizon has not yet been authorized to provide in-region interLATA services. The Bells contend that this absurd result is compelled by the plain text of the Act; in fact, the BOC construction violates the text, structure, and core purposes of the Act.

Section 272(f)(1) states that, absent Commission action,

> the provisions of this section . . . shall cease to apply with respect to . . . the interLATA telecommunications services of a Bell operating company 3 years after the date such *Bell operating company or any Bell operating company affiliate* is authorized to provide interLATA telecommunications service under section 271(d).

47 U.S.C. § 272(f)(1) (emphasis added). The BOCs assert that use of the phrase "or any Bell operating company affiliate" must apply so that an *entire* RBOC is relieved of section 272

obligations three years after any one of the individual “affiliate[d]” BOCs – such as the BOC in New York or Texas – receives in-region interLATA authority under section 271. All of the BOCs controlled by a single RBOC, the theory goes, are “affiliate[s]” of the single BOC that has received authorization.

Contrary to the BOCs’ reading, the phrase “Bell operating company or Bell operating company affiliate” in section 272(f)(1) simply reflects the fact that section 271 applies both to BOCs and to BOC affiliates, particularly the BOCs’ section 272 affiliates. Specifically, section 271(a) bars *both* a “Bell operating company” and “any affiliate of a Bell operating company” from providing interLATA services and section 271(d)(1) permits *either* a “Bell operating company or its affiliate” to apply to the Commission for authorization to provide in-region, interLATA services in a particular state. Accordingly, in section 272(f)(1), it is necessary to refer to the “authoriz[ation]” of a “Bell operating company *or* any Bell operating company affiliate” precisely because, under section 271(d), a BOC and/or its section 272 affiliate in any given state could apply and be authorized to provide in-region, interLATA services.[16]

Congress’ use in section 272(f)(1) of the term “any [BOC] affiliate,” therefore, certainly does not demonstrate any intention that the sunset would apply on a regional, BOC-by-BOC basis to *all* affiliated BOCs. Rather, the “[BOC] affiliate” in section 272(f)(1) can only refer to the section 272 affiliates that a BOC must create in a state where it is authorized to provide in-region, interLATA service, and not more broadly to any affiliated BOC operating in some other

[16] *See also* Texas PUC at 2 (“Clearly, Congress intended to establish a link between FTA sections 271 and 272. Moreover, by authorizing the FCC to extend section 272 requirements, Congress did not intend for such requirements simply to be ‘flash cut’ three years after a BOC received 271 approval. Rather, the Texas PUC believes that the section 272 requirements were established to monitor the BOCs’ relationship with its long distance affiliate, while fostering the emerging competitive market”).

state.[17] Because Congress used the terms "BOC or BOC affiliate" in sections 271 and 272 to refer to the long distance and manufacturing affiliates that were to be created, there is no merit to the BOCs' claims (*e.g.*, Verizon at 4) that applying section 272(f)(1) on a state-by-state basis would render the phrase "any Bell operating company affiliate" superfluous. Rather, it is clear that the sunset provisions in section 272(f)(1) are triggered only for the BOC or the BOC affiliates operating in the particular state where section 271 authorization has been obtained.[18]

The BOCs' reading not only is inconsistent with the text of sections 271 and 272(f)(1), but also affirmatively violates the structure of those two sections, and would be unlawful if adopted.[19] Under the BOCs' reading of section 272(f)(1), a BOC like Verizon could obtain 271 authorization in one state, triggering the sunset of section 272 in three years (unless extended by

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[17] The absurdity of the BOCs' "regional" approach is highlighted by their mergers: if the BOCs are correct, then SBC's authorization in Texas also now triggers the sunset provisions for BOCs that SBC has acquired throughout the country. It simply makes no sense to assert that Congress believed that section 272 safeguards could sunset in a state simply because of the affiliations created by such corporate transactions.

[18] In this regard, section 272(f)(1) also specifically references "the date" a BOC "is authorized . . . under section 271(d)," which in turn expressly and repeatedly refers to "authorization . . . in any in-region *State*." *See, e.g.*, 47 U.S.C. § 271(d)(1) (emphasis added); *see id.* § 271(d)(1)(B) (referring to the "State that is the subject of the application"); § 271(d)(3) (referring to "the authorization requested in the application for each State"). Thus, when read in conjunction (as they must be), sections 271(d) and section 272(f)(1) plainly mean that the requirements of section 272 apply on a state-by-state basis, and cannot sunset in any state until a minimum of three years after the BOC in the state is authorized under section 271 to provide in-region, interLATA services.

[19] There is no reason to resort to legislative history where, as here, the text, structure, and purpose all point in the same direction. *See Gemsco, Inc.*, v. *Walling*, 324 U.S. 244, 260 (1945) ("The plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction"). In all events, the legislative history the BOCs cite does not at all support the inference they derive from it. The versions of the bill that included a specific reference to a state were replaced by the current language in the Act, which simply incorporates the state-by-state approach in section 271. Congress gave no indication that it purposefully removed the language in prior versions referring to "states" in order to mandate the BOCs' regional approach to the section 272 sunset.

the Commission) for *any* Verizon BOC, even those that do not apply for section 271 authorization during that period. In the BOCs' view, after that three years, Verizon's BOCs in other states would not *ever* be required to comply with section 272. But that is plainly inconsistent with the Act: section 271(d)(3)(B) requires the Commission, before granting a section 271 application in a state, to find, *inter alia,* that "the requested authorization *will be carried out* in accordance with the requirements of section 272." § 271(d)(3)(B) (emphasis added). Because section 271, by the use of the future tense, clearly calls for a BOC to comply with section 272 *after* it receives authorization, it would violate the structure of the Act if the section 272 requirements were to sunset in a state prior to the BOCs' receipt of section 271 authorization. This alone demands rejection of the BOCs' interpretation.[20]

In fact, even if the BOCs were correct that the text of section 272(f)(1) required their "BOC-by-BOC" approach, the fact that section 271 requires the applicant BOC to comply with section 272 after section 271 authorization would mean that the Commission should use its authority under section 272(f)(1) to extend the section 272 requirements so that none of the section 272 safeguards sunset until at least 3 years after the BOC obtains section 271 authority in *all* of its states. That is the only "BOC-by-BOC" approach that could ensure that the BOC in each state obeys the section 271 mandate to carry out its authorization under the terms of section 272 and no longer has market power. Indeed, the state commissions contend that this is the only practical reading of the sunset requirements. Wyoming PSC at 2; Wash UTC at 3 ("as a practical matter, it makes little sense for the statutory requirements to expire in some states as long as they

[20] For similar reasons, the BOCs' interpretation squarely violates the purposes of the Act. Congress wanted to protect interLATA competition even after a BOC obtains section 271 authorization, but under the BOCs' view, the Commission is without authority to ensure that the BOCs in states that receive section 271 authorization after section 272 would sunset cannot use their market power to harm the interLATA market.

are still in effect in others"); PA PUC at 5 ("it would make more economic sense to retain the long-distance affiliates until they collapse in all areas at once").[21]

III. THE BOCs VASTLY EXAGGERATE THE COSTS OF COMPLIANCE WITH SECTION 272

The BOCs' principal policy argument in favor of allowing the section 272 safeguards to sunset is that the structural separation requirements and the other section 272 safeguards are too costly, and prevent the BOCs from competing on equal grounds. SBC at 1, 5-8; Verizon at 9-11; BellSouth at 12-13, 19-20; Qwest at 5-6, 13-15. However, the evidence the BOCs' submit to support this intensely factual claim is particularly scanty.

Indeed, some RBOCs provide no evidence at all, and seek to rely solely on past Commission statements in the *Computer III* proceedings that, based on the facts and particular markets at issue in that proceeding, the costs of structural separation outweighed the benefits. *E.g.* BellSouth at 12-13, 19-20, Qwest at 5-6, 13-15. What the BOCs entirely fail to mention is that the court of appeals has repeatedly found fault with these Commission pronouncements in *Computer III*, and specifically rejected the cost-benefit analysis that was used to justify eliminating structural separation in this market.[22] In each case, the court of appeals remanded

[21] In this regard, it is revealing that the BOCs have *never* presented their novel interpretation of the sunset of section 272 in any of their section 271 filings, particularly those subsequent to the BOCs' initial authorizations. Rather, after obtaining authorization in New York in December 1999, Verizon has filed applications in a number of states, and in each case pledged that it would abide by the requirements of section 272 – even though it now contends that those safeguards, absent Commission action, would sunset in those states in December 2002, three years after its New York authorization. In Verizon's pending application for Virginia, for example, Verizon has submitted its standard application and supporting declarations pledging that it will comply with section 272 – but under the interpretation of section 272(f)(1) it advances here, Verizon could be required to comply with section 272 in Virginia for little more than one month – and not at all in states where it has not yet applied for section 271 authority.

[22] *See, e.g.*, *California* v. *FCC*, 39 F.3d 919, 930 (9th Cir. 1994) (as in prior orders, "the FCC has similarly failed to provide support or explanation for some of its material conclusions regarding prevention of access discrimination," and thus "once again," its "cost-benefit analysis is flawed

the Commission's orders to allow them additional opportunities to justify its conclusion that non-structural safeguards were as effective as structural separation. Despite over eight years since the court of appeals' last remand, the Commission has yet to issue an order that justifies the view that the BOCs rely on here. Moreover, the cost-benefit analysis for the interLATA market even more heavily weighs in favor of structural separation, given the substantial harm that BOCs with enduring market power can inflict on the interLATA market. *See* Selwyn Reply Dec. ¶ 25. Indeed, that is precisely why Congress expressly determined by enacting section 272 that, despite any costs, structural separation and numerous other safeguards were beneficial and necessary, at least until the BOCs' local markets became fully competitive. Thus, while the costs of section 272 safeguards are a relevant factor in the decision to extend the section safeguards, the BOCs can in no way justify a sunset of those safeguards where they produced no actual evidence of their costs, and instead seek to rely on outdated Commission statements involving entirely different services.

Only one BOC, Verizon, even attempts to introduce evidence that quantifies the supposed costs of section 272 compliance. Verizon at 9-11 & Howard Dec.[23] However, the declarations that Verizon submits are little more than conclusory statements that opine generally about costs, without any specific discussion of how those costs were derived and without any backup material that could be used to verify independently these claims. *See* Selwyn Reply Dec. ¶¶ 26-27. Accordingly, these declarations should be given little weight, at least until Verizon produces the

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and [must be] set aside."); *see also California* v. *FCC*, 905 F.2d 1217 (9th Cir. 1990); *California* v. *FCC*, 4 F.3d 1505 (9th Cir. 1993).

[23] SBC's comments include unsupported claims that elimination of some section 272 safeguards would result in savings for some SBC departments ranging from 20 to 75 percent. SBC at 7-8. As the Commission has concluded in other proceedings, statements like these that are not reinforced by declaration or other evidence are entitled to less weight.

back-up materials used to derive the cost figures their declarants calculated. Moreover, as Dr. Selwyn points out in his reply declaration, the BOCs have in other contexts commented that the costs of integration are substantial – in the hundreds of millions of dollars – yet here, they provide no information regarding the costs of integration of their section 272 affiliates. *Id.* ¶ 28.

Further, as the comments point out, the Commission's Orders implementing section 272 already have provided numerous opportunities for the BOCs and their section 272 affiliates to share services and take advantage of other economies. *E.g.*, WorldCom at 7-9; TWTC at 17-20. Even though these joint activities present risks of anticompetitive behavior, and could also easily have been prohibited entirely, the Commission permitted such activities, which substantially reduced the BOCs' costs of compliance with section 272. In fact, it is obvious that the integration that the Commission has allowed provides significant benefits to the BOCs' section 272 affiliates – surely no other company but a BOC affiliate could only recently begin offering long distance services and capture significant market share by using just 800 employees, as Verizon has done. *See* WorldCom at 8; *see also* Selwyn Reply Dec ¶¶ 6-8. These facts belie any notion that section 272 compliance costs are significant. Indeed, the costs of section 272 compliance have not deterred the BOCs from submitting many additional applications to provide long distance services through these allegedly costly separate affiliates. That is because the BOCs know the costs are insignificant compared to the benefits they can obtain by leveraging the power over bottleneck facilities into the long distance market.

Finally, all of the evidence and argument that the BOCs put forward in support of their claims that structural separation and section 272 safeguards are too costly can be rebutted by pointing to the undisputed fact that in merger proceedings both SBC and Verizon themselves *proposed* to the Commission that they operate their advanced services operations for the next several years by creating separate affiliates. *Bell Atlantic-GTE Merger Order* ¶¶ 246, 248, 260-262; *SBC/Ameritech Merger Order* ¶¶ 211, 348-49, 363. Indeed, these BOC claimed, and the Commission found, that these advanced services separate affiliates would be modeled "largely" on the affiliates Congress mandated in section 272. *Id.* ¶ 364; *Bell Atlantic/GTE Merger Order* ¶ 263. These BOCs would not have proposed and agreed to these separate affiliate conditions if the costs of maintaining such affiliates were as significant as these BOCs now claim.

Moreover, the Commission's *Orders* approving these merger conditions found that this "structural mechanism" (even though the affiliates were in fact significantly less separate that those under section 272) was an effective way to "ensure a level playing field" between a BOC and its rivals. *SBC/Ameritech Merger Order* ¶ 363; *see Bell Atlantic/GTE Merger Order* ¶ 260 ("strict compliance" with a "separate affiliate condition *will* mitigate the substantial risk of discrimination"). These recent orders (far more recent than the Commission's statements in *Computer III* that the BOCs rely on) therefore reflect the Commission's determination that separate affiliate structures can be a cost-effective method for preventing discrimination and otherwise policing BOC misconduct. *SBC-Ameritech Merger Order* ¶ 211.

IV. OTHER SAFEGUARDS ARE INADEQUATE BY THEMSELVES TO DETECT AND DISCOURAGE BOC MISCONDUCT.

A. Section 272 Provides Unique Benefits That Other Commission Safeguards By Themselves Cannot.

The BOCs also claim that, despite Congress' decision to impose detailed structural, accounting and transactional safeguards in section 272, the benefits provided by those safeguards are minimal, and can be obtained instead by relying on other provisions of the Act and Commission rules. SBC at 12-14; Verizon at 14-15; BellSouth at 18-20; Qwest at 12-13. These claims are entirely meritless. Indeed, given that most of the rules that the BOCs cite were in effect in 1996, Congress would not even have enacted section 272 if it believed those rules could be effective in policing the BOCs' misconduct and eliminating discrimination and cost misallocation. Rather, the comments confirm that section 272, when properly implemented and vigorously enforced, provides substantial and unique benefits that promote competition in telecommunications markets.

In particular, the state commission comments confirm the enormous value of the section 272 safeguards in detecting, deterring and remedying BOC misconduct. Thus, the Texas PUC concludes that, if section 272 safeguards are eliminated, regulators "will lose a valuable means to ensure [the BOC's] compliance with its obligations to provide access to the local exchange and exchange access markets that [the BOC] controls." Texas PUC at 3. The Washington UTC states that section 272 safeguards "provide necessary consumer and competitive protections that cannot otherwise be obtained." Washington UTC at 3.

The state commission comments also confirm the value of particular section 272 safeguards, like the biennial audit. The Missouri PSC reports that "without the section 272 audit process, there is no way to detect and deter discrimination and anti-competitive behavior." Missouri PSC at 4; *see* Wash UTC at 3 ("maintaining a separate affiliate makes the audit process easier and provides more transparency to the transactions to be audited"); PA PUC at 4 ("audits can produce useful information for policymakers such as the PUC"); Texas PUC at 8-9. Further, the PA PUC reports that the separate structure and accounting provisions of section 272 "assist[] the PA PUC in its ability to design rates," and the "ability to readily identify costs and revenues from the business segment is *critical* to ongoing rate review" PA PUC at 5. And more generally, the PA PUC asserts that the collapse of separate affiliate requirements would "perpetuate[] what appears to be a continual reduction in available information." *Id.* at 4. As these comments show, section 272 can provide unique, pro-competitive benefits that, contrary to the BOCs' claims, cannot be obtained from other existing rules and provisions of the Act.[24] In fact, the Commission itself recently rejected the argument that its existing safeguards are a more effective and less costly mechanism for preventing discrimination than structural separation. In the *SBC-Ameritech Merger Order*, ¶ 206, the Commission determined that adopting the proposed separate affiliate structure benefited competition because "reliance on existing regulatory safeguards is misplaced." That is because even though the Commission "issues rules to prevent discrimination," it is "impossible for the Commission to foresee every possible type of discrimination." *Id.*; *see id.* ¶ 220. Accordingly, the Commission found that "SBC's offer to establish a separate subsidiary for advanced services is directly responsive" to concerns regarding the Commission's ability to detect discrimination – but achieves that goal in a way that avoids "engaging in detailed regulatory oversight." *Id.* ¶ 211.

B. The Commission Must Retain the Prohibition Against Joint OI&M.

Verizon (at 15-16) and SBC (at 9) make a separate plea for the Commission to "eliminate immediately" the Commission's longstanding rule against the sharing of operation, installation, and maintenance ("OI&M") services between the BOC and its section 272 affiliate.[25] These requests should be rejected.[26]

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[24] In this regard, the BOCs rely heavily on the pro-competitive safeguards found in section 251(g) and in section 251(c), which they assert will continue to apply and protect competition after section 272 is allowed to sunset. *See* SBC at 12; BellSouth at 18. But that claim is disingenuous, because the BOCs have vigorously contended in other Commission proceedings that the Commission's requirements under those sections should be eliminated or at least drastically cut back.

[25] *See* 47 C.F.R. § 53.203(a); *Non-Accounting Safeguards Order* ¶¶ 158-70; *see also BOC Separations Order*, 95 F.C.C. 2d 1117, 1144 (¶ 70) (1983).

[26] As an initial matter, the proposal to eliminate this rule prior to the sunset of section 272 was – quite properly – not contained in the Commission's *Notice*, and could not be adopted without issuing a new notice of proposed rulemaking. *E.g., Shell Oil Co.* v. *EPA*, 950 F.2d 741, 751 (D.C. Cir. 1991).

As the Commission found in 1997, the prohibition against joint OI&M is a critical requirement that ensures both that the section 272 affiliate in fact "operates independently" from the BOC and also that the BOC does "not discriminate" in favor of its section 272 affiliate. 47 U.S.C. §§ 272(b)(1), 272(c)(1); *Non-Accounting Safeguards Order* ¶¶ 163. With regard to the operate independently requirement, the Commission concluded that joint OI&M would violate that requirement, because joint OI&M creates "the opportunity for such substantial integration of operating functions as to preclude independent operation." *Id*. The Commission has recognized since at least 1983 that "sharing of such services would require 'excessive, costly, and burdensome regulatory involvement in the operations, plans, and day-to-day activities of the carrier [in order] to audit and monitor the accounting plans necessary for such sharing to take place.'" *Id.* (quoting *BOC Separations Order*, 95 F.C.C.2d 1144, ¶ 70). Rather than attempt to engage in such oversight, the Commission properly determined to ban joint OI&M altogether.

The BOCs claim that the Commission unfairly singled out and banned joint OI&M services, while it permitted BOCs to share other functions, such as "finance, human resources, legal and accounting." Verizon at 17. To be sure, the risks of cost misallocation and non-independent operation are present for these ancillary services as well, and the Commission could also properly have banned the BOCs from jointly sharing those services, in order to further assure that the section 272 affiliate operates independently from the BOC. However, the Commission was well within its authority to ban joint OI&M, because, as the Commission found, "allowing the same individuals to perform such *core functions* on the facilities of both entities would create *substantial opportunities* for improper cost allocation." *Non-Accounting Safeguards Order* ¶ 163 (emphases added). The operation, installation and maintenance of networks and network facilities represents the heart of a telecommunications company – and for the BOC, relates directly to the source of the BOCs' bottleneck control over local exchange and exchange access facilities. Permitting joint OI&M gives rise to myriad joint and common costs that could easily and undetectably be misallocated. Contrary to the BOCs' claims, attempting to separate those costs between a BOC and its affiliate is difficult – and the consequences of error more severe – than attempting to separate the costs of ancillary services like an accounting or human resources department. Accordingly, the Commission should continue to ban joint OI&M.

Moreover, the prohibition against joint OI&M is also necessary to ensure the BOC section 272 affiliate does not enjoy an unfair advantage over rival carriers, in violation of section 272(c)(1)'s broad and unqualified antidiscrimination provision. *Non-Accounting Safeguards Order* ¶¶ 163, 197. Verizon asserts that the "OI&M restriction puts Verizon at a significant disadvantage in competing with carriers that are able to offer an integrated service platform using their own local and long distance facilities." Verizon at 20; *see also* SBC at 9. But Verizon can make such a claim only because it ignores the substantial market power that it and other BOCs retain over exchange access, even in markets where they have obtained section 271 authority. Because of that local market power, rival carriers of the BOCs are generally *not* able to offer "integrated service platforms using their own local and long distance facilities." *See* Selwyn Reply Dec. ¶ 16. Accordingly, when Verizon complains that it and its section 272 affiliate "cannot respond as a single team that can maintain end-to-end service," Verizon at 20, it is describing *precisely* what a competing carrier must do to offer such services. Selwyn Dec. ¶¶ 16, 19. Because the BOCs' market power endures long after section 271 authorization, rival carriers (like the BOC section 272 affiliate) generally must rely on the BOC for access to last mile access facilities. *Id.* ¶¶ 17-18.[27] The prohibition against joint OI&M, therefore, is absolutely necessary

[27] Verizon claims that rival carriers "use their own fiber-based last mile facilities" to serve their customers, but that claim is flatly wrong, as Dr. Selwyn explains, and as AT&T has set forth in

to prevent the BOC section 272 affiliate from gaining an unfair advantage over rival carriers – and, consistent with Congress' purposes, to "ensure that BOCs compete on a level playing field." *Texas 271 Order* ¶ 395;[28] *see* Selwyn Reply Dec. ¶¶ 22-25.

Thus, contrary to Verizon's claim (at 20) that the OI&M ban "serves no purpose" and inhibits the section 272 affiliate from offering services in the same way as unaffiliated competitors, precisely the opposite is true – which is why the Commission adopted its rule in the first place, and why it could not rationally abandon it now, before the BOCs' market power has fully dissipated. *See Non-Accounting Safeguards Order* ¶ 163 ("allowing a BOC to contract with the section 272 affiliate for [OI&M] services would *inevitably* afford the affiliate access to the BOC's facilities that is superior to that granted to the affiliate's competitors") (emphasis added).

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detail in its comments in the Commission's Triennial Review proceeding. In fact, in the vast majority of cases, AT&T purchases these facilities as special access from incumbent LECs.

[28] Memorandum Opinion And Order, *Application By SBC Communications Inc., et al., Pursuant To Section 271 Of The Telecommunications Act Of 1996 To Provide In-Region, InterLATA Services In Texas,* 15 FCC Rcd. 18354 (2000) (citation omitted).

CONCLUSION

For the foregoing reasons, and the reasons stated in AT&T's Comments, the Commission should extend the section 272 safeguards to all BOCs for at least another three years.

Respectfully submitted,

/s/ Aryeh S. Friedman

David L. Lawson
Michael J. Hunseder
Sidley Austin Brown & Wood, LLP
1501 K Street, NW
Washington, D.C. 20005
(202) 736-8000

Mark C. Rosenblum
Lawrence J. Lafaro
Aryeh S. Friedman
AT&T Corp.
295 North Maple Ave.
Basking Ridge, NJ 07920
(908) 221-2717

Counsel for AT&T Corp.

August 26, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 26th day of August, 2002, I caused a copy of the foregoing to be served on the following via first class mail, postage pre-paid:

/s/Patricia A. Bunyasi

____

Patricia A. Bunyasi

Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, SW
Room CY-B402
Washington, D.C. 20554
(filed electronically)

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

Janice Myles
Wireline Competition Bureau
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554 (by e-mail)

Steve Ellenbeckler-Chairman
Steve Furtney-Deputy Chairman
Kristin H. Lee-Commissioner
Hansen Building
2515 Warren Avenue
Suite 300
Cheyenne, WY 82002

Jonathan Askin
Teresa K. Gaugler
Association for Local Telecommunications Services
888 17th Street, N.W.
Washington, D.C. 20005

Angela N. Brown
BellSouth Corporation
Suite 4300
675 West Peachtree Street
Atlanta, GA 30375-0001

Jonathan D. Lee
Maureen Flood
CompTel
1900 M Street, N.W., #800
Washington, D.C. 20002

Praveen Goyal
Covad Communications Company
600 14th Street, N.W.
Washington, D.C. 20005

Richard M. Rindler
Patrick J. Donovan
Paul O. Gagnier
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300

Natelle Dietrich
Marc Poston
Attorney for the Missouri Public Service Commission
P.O. Box 360

Washington, D.C. 20007

Terry L. Etter
David C. Bergmann
Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215

NASUCA
8300 Colesville Road, Suite 101
Silver Spring, MD 20910

Lawrence G. Malone
Brian Ossias
Public Service Commission of the State of New York
Three Empire State Plaza
Albany, New York 12223

Blair A. Rosenthal
Sharon J. Devine
Qwest Services Corp.
Suite 700
1020 19th Street, N.W.
Washington, D.C. 20036

Suzanne Yelen
Rebekah T. Goodheart
Wiley Rein & Fielding LLP
1776 K Street, N.W.
Washington, D.C. 20006

Wanda Montano
US LEC Corp.
Three Morrocroft Centre
6801 Morrison Blvd.
Charlotte, NC 28211

Jefferson City, MO 65102

Michael J. Travieso
Maryland People's Counsel
Suite 2102
6 St. Paul St.
Baltimore, MD 21202

Seema M. Singh, Esq.
Jose Rivera-Benitez, Esq.
NJ Division of the Ratepayer Advocate
31 Clinton Street, 11th Floor
P.O. Box 46005
Newark, NJ 07101

Maryanne Reynolds Martin
Pennsylvania Public Utility Commission
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

Anu Seam
Gary L. Phillips
Paul K. Mancini
SBC Communications Inc.
1401 Eye Street, N.W., Suite 400
Washington, D.C. 20005

Norina Moy
Jay C. Keithley
Richard Juhnke
Sprint Corporation
401 9th Street, N.W., #400
Washington, D.C. 20004

Roger B. Borgelt
Assistant Attorney General
Consumer Protection Division
Public Agency Representation Section
P.O. Box 12548
Austin, Texas 78711-2548

Rebecca Klein
Brett A. Perlman
Public Utility Commission of Texas
1701 N. Congress Avenue
Austin, Texas 78711-3326

Thomas Jones
Christi Shewman
Wilkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20036

Robin E. Tuttle
Lawrence E. Sarjeant
Indra Sehdev Chalk
Michael T. McMenamin
1401 H Street, N.W.
Suite 600
Washington, D.C. 20005

Joseph DiBella
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909

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

Richard J. Metzger
Focal Communications Corporation
7799 Leesburg Pike
Suite 850 North
Falls Church, VA 22043

John Sumpter
PAC-West Telecomm, Inc.
1776 March Lane
Suite 250
Stockton, CA 95207

Carole J. Washburn
Secretary
Washington UTC
1300 S. Evergreen Park Drive SW
P.O. Box 47250
Olympia, WA 98504-7250

Lynda L. Dorr
Secretary
Public Service Commission of Wisconsin
610 North Whitney Way,
P.O. Box 7854
Madison, Wisconsin 53707-7854