SIDLEY AUSTIN BROWN & WOOD LLP

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NEW YORK
SAN FRANCISCO

1501 K STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com

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TOKYO

WRITER'S DIRECT NUMBER
202-736-8088

WRITER'S E-MAIL ADDRESS
dlawson@sidley.com

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Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W., TW-A-325
Washington, D.C. 20554

Re: *Verizon Petition for Forbearance from the Prohibition of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) of the Commission's Rules,* CC Docket No. 96-149.

Dear Ms. Dortch:

This letter responds to arguments and information submitted by Verizon in its reply comments in the above-captioned proceeding. As detailed below and in the attached *ex parte* declaration of Dr. Lee Selwyn, there is no basis for the Commission to forbear enforcement of the section 272(b)(1) prohibition against a BOC and its section 272 affiliate sharing network operating, installation, and maintenance ("OI&M") functions.

Verizon continues to decline to provide supporting material for the only "new" information it even purports to submit – the alleged high costs of compliance with the OI&M restriction. Such unsupported cost claims are undeserving of any weight in this proceeding. Moreover, claims that the OI&M restriction hinders full and fair competition are belied by the reality of the marketplace, where BOCs have been able to capture substantial interLATA market shares shortly after receiving section 271 authority. Rather than hindering competition, the OI&M restriction promotes competition by attempting to ensure that the BOC competes on a level playing field, placing BOCs and their affiliates in the same position as their competitors in the local and interLATA markets.

The comments of AT&T and others demonstrated that eliminating the OI&M restriction would give BOCs a substantial and unfair advantage over fledgling local competitors and would allow the BOCs to leverage their monopoly power in local markets into the long distance market.[1] These competitors undisputedly depend, in the vast majority of circumstances, on a BOC's network facilities – and thus BOC OI&M services for those network facilities – to

[1] AT&T Comments at 5-7.

provide competing services. If BOCs and their section 272 affiliates could share OI&M functions, they would be able to provide end-to-end service functions unavailable to other competitors.

Verizon stresses that local exchanges are, by definition, "*open* to competitive entry" once 271 authority is granted, and thus a competing carrier may also "use its own facilities ... and use a single OI&M workforce to install, operate, and maintain those facilities."[2] As the Commission has frequently recognized, however, the mere fact that a local market is technically "open" does not rid the BOC of market power of mean that the local market is fully competitive. Indeed, the restrictions of section 272 are premised on the fact that section 271 allows BOCs to enter the interLATA market while they still command overwhelming market power, and thus "have both the incentive and ability to discriminate against competitors in incumbent LECs' retail markets."[3] The OI&M restriction, like the other section 272 restrictions, thus already assumes that local exchange markets are *open* to potential competition. Verizon's claim that the OI&M restriction is unnecessary simply because the *opportunity* exists for competition in its local exchange markets amounts to nothing more than a direct challenge to the statutory scheme, and provides no reason to forbear its enforcement.

Verizon's separate contention that facilities-based competition in fact "is flourishing,"[4] simply ignores the marketplace realities.[5] And Verizon's claim that there is a healthy percentage of facilities-based competition in the local exchange business market is based on a gross misreading of the BOCs' own overstated claims in their "UNE Fact Report."[6] As Dr. Selwyn establishes, Verizon's estimates of such facilities-based competition are based in part on a methodology that treats CLEC purchase of special access as the CLEC's self-deployment of their own loops, thereby vastly inflating the CLEC share of deployed facilities, even though, for purposes of OI&M services, the CLEC is as dependent upon the BOC for such services in the context of special access as it is with other BOC facilities.[7] Verizon's claims of significant facilities-based competition in the business market are wildly exaggerated, as has been established in the Commission's *UNE Triennial Review* proceeding.[8]

Verizon also places great weight on its claim that competition is thriving in certain markets where there is no similar OI&M restriction.[9] As Dr. Selwyn has detailed exhaustively,

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[2] Verizon Reply at 5.

[3] *SBC/Ameritech Merger Order* ¶¶ 12, 190; *Non-Accounting Safeguards Order*, ¶ 9.

[4] Verizon Reply at 5.

[5] Selwyn Reply Declaration, ¶¶ 4-13 (attached to AT&T Comments).

[6] *See* Verizon Reply 5-6 & n.3.

[7] Selwyn Ex Parte Dec. ¶¶ 21-23.

[8] Selwyn Ex Parte Dec. ¶ 21.

[9] Verizon Reply at 10-11.

however, Verizon depends on "apples to oranges" comparisons of disparate markets, and ignores its dominance of even these handpicked markets.[10] For example, the competitive advantages of operational integration in intraLATA markets is reflected by the fact that BOCs continue to hold nearly a 50% market share despite the clear disadvantage that, before BOCs gain section 271 authority, *all* of their intraLATA toll customers are required to select a separate interLATA carrier.[11] Once BOCs receive section 271 authority, however, they will be able fully to leverage such competitive advantages, as reflected by certain BOCs' recent successes in regaining intraLATA market shares they had lost.[12]

Similarly, Verizon claims that BOCs retain relatively small shares of the information services markets. In fact, the BOCs dominate the market sectors where they have chosen to compete (such as single mailbox services to residential and small business customers and DSL-based high speed Internet access).[13] Moreover, the BOCs' inability to dominate the provision of other information services springs from market factors that are wholly independent of the BOCs' ability to provide integrated service with no OI&M restriction.[14]

At its core, Verizon's reply continues to rely most heavily on a rehash of the same arguments the BOCs presented (and the Commission rejected) in challenging the OI&M rule at multiple stages of the *Non-Accounting Safeguards* proceedings.[15] Thus, Verizon asserts that section 272(b)(1)'s requirement that the BOC and section 272 affiliate "operate independently" cannot be read to include the OI&M restriction,[16] and that other non-structural section 272 requirements make the OI&M restriction unnecessary.[17] The Commission has already responded to each of these contentions, and has provided more than adequate support for its interpretation of section 272(b)(1) as precluding shared OI&M functions. Applying traditional rules of statutory construction,[18] the Commission stressed that shared OI&M services would "inevitably"

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[10] Selwyn Ex Parte Dec. ¶¶ 27-40.

[11] Selwyn Ex Parte Dec. ¶ 31.

[12] Selwyn Ex Parte Dec. ¶ 32.

[13] Selwyn Ex Parte Dec. ¶¶ 34, 36.

[14] Selwyn Ex Parte Dec. ¶¶ 34-36.

[15] *Non-Accounting Safeguards Order* ¶ 163; *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 12; *Non-Accounting Safeguards Third Order On Reconsideration*, ¶ 20.

[16] *E.g.* Verizon Reply at 13 ("[I]f Congress had intended to prohibit sharing of OI&M services, it would have done so in section 272 explicitly ... .").

[17] *E.g.* Verizon Reply at 12-13 (claiming that section 272(e)'s nondiscrimination requirements already "prevent discrimination in favor of the section 272 separate affiliate."); *id.* at 16 (arguing that Verizon is prevented from "misallocating its costs" through the Commission's "accounting rules, cost allocation manuals, and biennial cost allocation audits").

[18] *E.g. Non-Accounting Safeguards Order* ¶ 155 (recognizing that this interpretation of operate-

lead to a level of BOC/affiliate integration that was precluded by the operate independently requirement of section 272(b)(1).[19] For example, such shared services "would inevitably afford access to the BOC's facilities that is superior to that granted to the affiliate's competitors."[20] The Commission separately recognized that allowing such shared OI&M services would create "substantial opportunities for improper cost allocation."[21]

Verizon dismisses these conclusions, asserting that (despite the Commission's repeated contrary findings) there is nothing unique about OI&M network services that justifies treatment different than other administrative services where the Commission has approve sharing.[22] Verizon provides no analysis, however, for this blanket charge that the Commission was mistaken when it deemed the BOCs' networks, and services directly concerning those networks, fundamentally different than other BOC services. These network facilities are the basis for the BOCs' market power, and are virtually always required inputs for the BOCs' competitors. The Commission has long recognized that network-specific functions are especially susceptible to BOC discrimination with potentially devastating consequences for competitors dependent on these facilities.[23] The Commission likewise long ago recognized the unique opportunities for cost misallocation concerning network services and related expenses.[24] Until the BOCs' control of bottleneck local facilities dissipates, therefore, the OI&M restriction (like the related bar on joint ownership of network facilities) is a necessary corollary to any requirement that a BOC and affiliate "operate independently."

Nor are the other requirements of section 272 (such as section 272(e)'s nondiscrimination requirement) adequate substitutes for the type of structural separation imposed by the OI&M and other "operate independently" requirements under section 272(b)(1). Enforcement of such nonstructural requirements require both detection and an effective complaint process. Moreover, by the time the complaint process has run its course, the damage to competitors and competition is done. And the BOCs have shown a willingness to breach and endlessly litigate enforcement of even their clearest legal obligations, as reflected in the Commission's recent imposition of a

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independently requirement "is based on the principle of statutory construction that a statute should be construed so as to give effect to each of its provisions"); *id.* ¶ 156 (reasoning that the "structural differences in the organization of [sections 272(b) and 274(b)] suggest that the term 'operate independently' in section 272(b)(1) should not be interpreted to impose the same obligations ... as section 272(b)").

[19] *Non-Accounting Safeguards Order* ¶ 163.

[20] *Non-Accounting Safeguards Order* ¶ 163.

[21] *Non-Accounting Safeguards Order* ¶ 163.

[22] Verizon Reply at 12-13; 16-17.

[23] *E.g. Non-Accounting Safeguards Order*, ¶¶ 158-166.

[24] *See BOC Separations Order*, 95 F.C.C. 2d 1117, 1144 (¶ 70) (1983).

record-setting $6 million fine against SBC for having "willfully and repeatedly" violated the "plain" conditions of the SBC/Ameritech merger.[25] Similar repeated BOC violations have led the California Public Utilities Commission, for example, recently to recognize that its "confidence in non-structural safeguards has waned significantly over the past years."[26] This Commission also has elsewhere stressed the need for structural safeguards, because BOCs can discriminate in a myriad subtle forms, and it is "impossible for the Commission to foresee every possible type of discrimination."[27]

Verizon also claims that structural safeguards like the OI&M restriction are unnecessary because it typically operates under price-cap regimes and thus "has no incentive to misallocate the costs of its competitive services to regulated accounts."[28] Dr. Selwyn demonstrates, however, that price caps can, in fact, *increase* the incentives for cost misallocation.[29] Under a price cap regime, a BOC has freedom to shift profits from one affiliate "pocket" to another without ever being forced to pass through "excess" profits to regulated customers.[30] Thus, for example, a BOC could overcharge its section 272 affiliate for services it also provides to competing IXCs (and thereby set an unfairly high rate for competitors under section 272(e)), while separately undercharging the affiliate for services it does not provide to competitors, all without a concern about how such pricing would impact the rates it charged regulated customers.

Perhaps most tellingly, Verizon continues to refuse to provide backup support for its claims that elimination of the OI&M restriction will save it well over $100 million.[31] Instead,

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[25] In the Matter of SBC Communications, Inc. Apparent Liability for Forfeiture, File No. EB-01-IH-0030, FCC 02-282 (rel. Oct. 9, 2002), ¶ 1. As the Commission concluded: "In state after state, throughout the Ameritech region, SBC force competing carriers to expend time and resources in state proceedings trying to obtain what SBC was already obligated to offer, causing delays in the availability of shared transport." *Id.* ¶ 24.

[26] CPUC Decision 02-09-050, at 257 (September 19, 2002). Over just the past thirteen months, the California Public Utilities Commission has imposed fines against SBC of $27 million and $25 million – each records when imposed – for anticompetitive and unlawful conduct in California. *See The Utility Consumers' Action Network v. Pacific Bell* (U 1001 C), Case 98-04-004, Final Opinion on Pacific Bell's Marketing Practices and Strategies, D.01-09-058 (Sept. 20, 2001) ($25 million fine); *The Utility Consumers' Action Network v. Pacific Bell Telephone Company*, Case 02-01-007, Presiding Officer's Decision (Sept. 27, 2002) ($27 million fine, per settlement).

[27] *SBC-Ameritech Merger Order*, ¶ 206.

[28] Verizon Reply at 17.

[29] Selwyn Reply Dec. ¶¶ 35-36; Selwyn Ex Parte Dec. ¶¶ 45-46.

[30] Selwyn Reply Dec. ¶ 35.

[31] Verizon Reply at 18 (explaining it refused to include "backup data in its petition" because "these data are confidential" and disclosure would give competing carriers "insight into the

commenters and this Commission are called on simply to trust Verizon's cost claims. Given Verizon's pointed refusal to provide backup data it admits is available, the alleged cost-savings are entitled to no weight, and certainly cannot justify a finding that Verizon has met its forbearance burden.[32] Moreover, the supplemental information that Verizon has submitted undermines, rather than supports, the credibility of its cost estimates.[33] For example, Dr. Selwyn points out Verizon's cost-savings estimates rest in part on the claim that the section 272 affiliate would save *95%* of its expenses for third-party "professional services" because of OI&M integration. Yet no information or analysis is presented to support this astounding savings claim, which appears to ignore entirely the costs of additional Verizon technicians needed to perform such OI&M services.[34] Verizon's cost-savings claims, therefore, besides being unsupported, are on their face incredible and incomplete.[35]

But whatever costs and inefficiencies the OI&M requirement imposes on BOCs and their section 272 affiliates, they are *no different* than the costs and inefficiencies faced by the BOCs' competitors, and they are outweighed by the potential anticompetitive effects that would result if the OI&M requirements were eliminated prematurely. Competitors, dependent on the BOC's network, also cannot respond as a single team to provide end-to-end service. The added burdens of the OI&M requirement, therefore, do not and cannot place BOCs and their section 272 affiliates at any competitive disadvantage vis-à-vis their competitors; instead, it places them on equal footing. That the BOCs are not placed at any competitive disadvantage is shown conclusively both by their continued stranglehold on local exchange markets and by their success in expanding market shares in the long-distance market shortly after gaining section 271 authority. As AT&T showed in its opening comments, Verizon itself quickly gained up to 34.2% market share in long distance,[36] and SBC recently predicted its interLATA share would reach 30% within a year of market entry and exceed 60% after just three years.[37]

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company's cost of service").

[32] Verizon claims that such information is being withheld because it is "confidential" and could benefit its competitors if publicly disclosed (Verizon Reply at 18), but Verizon does not even attempt to explain why disclosure subject to a Commission protective order would not address these concerns.

[33] *See* Selwyn Ex Parte Dec. ¶¶ 4-7.

[34] Selwyn Ex Parte Dec. ¶ 4.

[35] *See* Selwyn Ex Parte Dec. ¶¶ 4-7.

[36] AT&T Comments at 4-5.

[37] Bear, Stearns & Co. Inc., Equity Research, *Highlights From Meeting With SBC Management* (Sept. 10, 2002). SBC had signed up 21% of its Texas access lines for SBC long distance through the first quarter of 2001 (nine months after gaining section 271 authority), and Verizon reported gaining a 17.9% long distance market share in Massachusetts ten months after gaining section 271 authority. Selwyn Reply Dec. ¶ 6.

Remarkably, Verizon contends that the BOCs' successes in entering the interLATA market "are beside the point," contending that they are the result of marketing and sales efforts and innovative pricing.[38] Yet the central purpose of all of the section 272 restrictions, including those regarding OI&M services, is to ensure that BOCs and competitors "compete on a level playing field."[39] Section 272 is not aimed at creating the most efficient, cost-effective way for BOCs to provide in-region and interLATA services. Rather its purpose is to ensure that competition (including long distance competition) remains healthy during the time period when the BOCs have 271 approval but also continue to dominate local markets.[40] That the BOCs are able to compete effectively in the interLATA market despite some costs imposed by section 272, including the OI&M requirement, is precisely the point, and shows that elimination of such requirements is unnecessary to promote full and fair competition.

Finally, Verizon makes no effort to establish, as it must under section 160, that elimination of the OI&M regulation will benefit consumers or is otherwise in the public interest. As shown by Dr. Selwyn, there is no reason to conclude on this record that any cost savings from an elimination of the OI&M requirement will be passed through to consumers.[41] The BOCs' continued domination of local exchange markets means that they would not be forced by competition to pass on such savings (especially given that the BOCs' nonfacilities-based competitors will continue to face their same OI&M costs). There also is serious reason to question that any such cost savings can or will be passed through to customers of the section 272 affiliate.[42] There simply is no record here to support the BOCs' bare assertion that any savings arising from an elimination of the OI&M requirement, unavailable to competitors of the BOCs and their section 272 affiliates in the current market, will further competition, reduce rates, or otherwise benefit consumers.

* * *

Under these circumstances, no reasonable basis exists for the Commission to reverse its previous considered judgment that the "operate independently" requirement of section 272(b)(1) bars shared OI&M functions by the BOCs and their section 272 affiliates. Nor have the BOCs

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[38] Verizon Reply at 8.

[39] *Texas 271 Order* ¶ 395.

[40] *E.g. Non-Accounting Safeguards Order* ¶ 9 (recognizing that section 272's separate affiliate and related requirements are "designed, in the absence of full competition in the local exchange marketplace, to prohibit anticompetitive discrimination and cost-shifting"); *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 5 (same).

[41] Selwyn Ex Parte Dec. ¶¶ 8-11.

[42] Selwyn Ex Parte Dec. ¶¶ 7, 10.

presented evidence to justify forbearance of this important requirement under section 160. Verizon's petition for forbearance thus should be denied.

Sincerely,

/s/ David L. Lawson

David L. Lawson

Enclosure