

**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, DC 20554**

In the Matter of	)	
	)	
Elimination of Rate-of-Return Regulation of Incumbent Local Exchange Carriers	)	RM No. 10822
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

**REPLY COMMENTS OF AT&T CORP.**

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February 13, 2004

## REPLY COMMENTS OF AT&T CORP.

### I. Introduction

AT&T Corp. (“AT&T”) submits these reply comments with respect to the above-captioned petition (“Western Wireless Petition”) in which Western Wireless Corporation (“Western Wireless”) urges the Commission to initiate a rulemaking to eliminate rate-of-return (“ROR”) regulation.<sup>1</sup> Western Wireless presents solutions that may well be necessary, especially if the Commission cannot move to a unified intercarrier compensation mechanism. Moreover, the current ROR regulation system is broken because it creates incentives for ROR incumbent local exchange carriers (“ILECs”) to overestimate systematically their revenue requirements and underestimate demand.

The FCC must rectify these failings. At a minimum, it should grant AT&T’s related forbearance petition (“AT&T Petition”) requesting that the Commission refrain from allowing ROR ILECs to seek shelter from rate challenges under the “deemed lawful” language of Section 204.<sup>2</sup> Further, the Commission should abolish implicit cost-shifting – currently accomplished through toll rate averaging and rate integration – and replace it with explicit support mechanisms for high-cost carriers. In this regard, the Commission should also grant the Rural Consumer Choice Coalition’s petition for

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<sup>1</sup> See *Elimination of Rate-of-Return Regulation of Incumbent Local Exchange Carriers; Federal-State Joint Board on Universal Service*, Petition for Rulemaking to Eliminate Rate-of-Return Regulation of Incumbent Local Exchange Carriers, RM No. 10822, CC Docket No. 96-45, at 1 (filed Oct. 30, 2003) (hereinafter “Western Wireless Petition”).

<sup>2</sup> See *AT&T Petition Pursuant to 47 U.S.C. Section 160(c) of the Communications Act for Forbearance from Enforcement of Section 204(a)(3) of the Communications Act, As Amended*, WC Docket No. 03-256, at 1 (filed Dec. 3, 2003) (hereinafter “AT&T Petition”).

reconsideration of the *MAG Order*. In addition, it should grant the Western Wireless Petition, particularly if comprehensive intercarrier compensation reform for ROR LECs is not imminent.

## **II. Because Customers Are Not Entitled to Refunds When Carriers Overearn, Rate-of-Return Regulation Is Broken and Must be Discarded.**

As Western Wireless explains in greater detail in its petition, the ROR regulatory system is broken and harms consumers nationwide, at least in part because court decisions have eviscerated key accountability provisions. A key element of a ROR regulation system had been the ability of a ROR carrier's customers to obtain refunds when the ROR carrier charges rates that result in substantial overearnings – that is, overearnings greater than the prescribed rate of return by either 0.4% in any individual access service category or 0.25% across all access service categories.<sup>3</sup> Because a ROR carrier can always file new tariffs to *raise* rates if it is underearning, but would not have an incentive to file new lower rates when it is overearning, the ability of access customers to obtain overearnings refunds provided a critical backstop. However, as a result of judicial application of the “deemed lawful” provision of Section 204(a)(3) of the Communications Act, as amended,<sup>4</sup> this overearnings protection has been eliminated whenever an ROR ILEC files tariffs on a “streamlined” basis.<sup>5</sup> “Streamlined” tariffs – which permit as little as seven days to review proposed rate changes – are “deemed lawful” unless they are suspended and investigated before taking effect.<sup>6</sup> Once such a

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<sup>3</sup> See 47 C.F.R. § 65.700(a), (b).

<sup>4</sup> See 47 U.S.C. § 204(a)(3).

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

tariff takes effect – that is, once it has been “deemed lawful” – refunds for overearnings are unavailable as a matter of law, no matter how much the carrier then overearns.<sup>7</sup>

In its petition, Western Wireless explains that customers of ROR ILECs have been powerless to seek financial redress while these carriers reap interstate overearnings of hundreds of millions of dollars – hundreds of millions of dollars *in addition* to the generous 11.25% return that the FCC allows.<sup>8</sup> For this same reason, AT&T filed a petition requesting that the Commission forbear from enforcing Section 204(a)(3). As discussed further in that petition, in the 2001-2002 monitoring period, “a total of 30 LECs earned a combined total of almost \$160 million in excess of the permissible maximum earnings level.”<sup>9</sup> Those carriers’ “achieved annualized earnings ranging from 11.73 percent to as much as 54.34% for special access, and from 11.82 percent to as much as 35.30 percent for switched traffic sensitive access.”<sup>10</sup> Because of the “deemed lawful” provision, AT&T explained, “those LECs’ overearnings are immunized from damages recovery to the extent that those amounts are attributable to unsuspended streamlined tariff filings.”<sup>11</sup>

In sum, without overearnings refunds, the current ROR regulatory system provides no disincentive against ROR carriers – or their agents – overforecasting revenue requirements and underforecasting demand when justifying new rates. As the

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<sup>7</sup> See *ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403, 411 (D.C. Cir. 2002).

<sup>8</sup> See Western Wireless Petition at 28-29 (noting that ROR carriers’ interstate overearnings were more than \$218 million in 2001-2002, \$92 million in 1999-2000, and \$121 million in 1997-1998).

<sup>9</sup> AT&T Petition at 11.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 12.

Commission recognized long ago, “a regulator may have difficulty obtaining accurate cost information as the carrier itself is the source of nearly all information about its costs.”<sup>12</sup> There is no longer any means for accountability or consumer protection.

To remedy this “one-way bias” in favor of the ILECs,<sup>13</sup> the Commission should grant AT&T’s petition requesting forbearance from enforcement of Section 204(a)(3), under which “streamlined” tariff filings are “deemed lawful” and, as a result, out of the reach of customers seeking recourse for their carriers’ overearnings. Alternatively, the Commission must otherwise grant the Western Wireless Petition and replace the broken ROR system with an alternative regulatory framework that removes these inherent flaws.

### **III. Toll Averaging Further Exacerbates ROR Regulation’s Incentives for Overforecasting Revenue Requirements and Underforecasting Demand, and Allows ROR Regulation to Distort Competition in Long Distance Markets.**

When combined with the Commission’s implementation of nationwide toll rate integration and rate averaging, ROR regulation’s incentives to boost rates by overforecasting revenue requirements and underforecasting demand are even more pernicious, because the ratepayers burdened by a ROR ILEC’s high rates are toll customers across the country, rather than solely in the ROR ILEC’s service territory. In any event, the burden of ROR regulation’s high rates must be shared among all industry participants through explicit support mechanisms, rather than through unlawful implicit support payments buried in access charges and nationwide averaged toll rates.

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<sup>12</sup> *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd. 2873, 2890 (¶ 31) (1989) (“*AT&T Price Cap Order*”).

<sup>13</sup> Comments of General Communication, Inc., Western Wireless Petition, at 8.

As discussed above, ROR regulation, particularly without overearnings protections, creates incentives for ROR LECs to boost rates by over-projecting revenue requirements and under-projecting demand. These incentives are exacerbated further by toll rate averaging and rate integration, which ensure that an ROR LEC pays no marketplace penalty for such behavior, because those high rates are recovered from consumers in other areas of the country. Under the Commission’s toll rate averaging rule, “[t]he rates charged by providers of interexchange telecommunications services to subscribers in rural and high-cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas.”<sup>14</sup> The stated purpose of the rate averaging rule was a universal service goal – to “ensure[] that interexchange rates for rural areas, or areas served by high cost companies, will not reflect the disproportionate burdens that may be associated with [access] recovery costs in these areas.”<sup>15</sup>

Economically, however, this means that as long as an ROR ILEC charges access rates above the nationwide average, the bill for the ROR ILEC’s excesses flows overwhelmingly to AT&T’s customers located in other areas of the country.<sup>16</sup> Thus, an

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<sup>14</sup> 47 C.F.R. § 64.1801(a).

<sup>15</sup> *Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934, as Amended*, Report and Order, 11 FCC Rcd. 9564, 9567 (¶ 6) (1996) (quoting *AT&T Price Cap Order*, 4 FCC Rcd. at 3132 (¶ 537) (1989)). Although the Commission in that Order was specifically addressing recovery of common line costs, the same holds true for recovery of high local switching and transport costs. The interstate “common line” costs that were the original target of rate averaging and rate integration are now recovered entirely from end user common line charges, and explicit Long Term Support and Interstate Common Line Support. See *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 19613 (2001) (“*MAG Order*”).

<sup>16</sup> In an analogous situation, the FCC recognized that applying toll averaging to state gross receipts taxes would allow states to “shift its tax burden to customers in other

ROR ILEC's customers will never have an incentive to demand that the ROR ILEC reduce even their originating access charges.

The Commission has directly recognized these dynamics with respect to access charges. The Commission stated:

On further consideration, it appears that the [LECs'] ability to impose excessive access charges is attributable to two separate factors. First, although the end user chooses her access provider, she does not pay that provider's access charges. Rather, the access charges are paid by the caller's IXC, which has little practical means of affecting the caller's choice of access provider (and even less opportunity to affect the called party's choice of provider) and thus cannot easily avoid the expensive ones. Second, the Commission has interpreted section 254(g) to require IXCs geographically to average their rates and thereby to spread the cost of both originating and terminating access over all their end users. Consequently, IXCs have little or no ability to create incentives for their customers to choose [LECs] with low access charges. Since the IXCs are effectively unable either to pass through access charges to their end users or to create other incentives for end users to choose LECs with low access rates, the party causing the costs – the end user that chooses the high-priced LEC – has no incentive to minimize costs. Accordingly, [LECs] can impose high access rates without creating the incentive for the end user to shop for a lower-priced access provider.<sup>17</sup>

Although the Commission reached these conclusions in reviewing CLEC access charges, there is no analytical basis for distinguishing access charges by ROR ILECs.

The Commission can, of course, *choose* to subsidize ROR ILEC networks. When it does so, however, the Act requires that such subsidies be explicit, and it prohibits implicit, access-based support. As the Fifth Circuit has held three times now, “the plain

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states, through the averaging process.” *Connecticut Office of Consumer Counsel v. AT&T Communications*, Memorandum Opinion and Order, 4 FCC Rcd. 8130, 8132 (¶ 17) (1989). In that case, the FCC permitted carriers to establish a separate surcharge to recover state gross receipts taxes. *Id.*

<sup>17</sup> *Access Charge Reform; Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 9923, 9935-36 (¶ 31) (2001) (footnote omitted).

language of § 254(e) does not permit the FCC to maintain any implicit subsidies.”<sup>18</sup>

Averaging access rates into nationwide toll rates clearly constitutes an implicit subsidy, as the Fifth Circuit has made clear that “the implicit/explicit distinction turns on the difference between direct subsidies from support funds and recovery through access charges and rate structures.”<sup>19</sup>

If the Commission is going to continue rate-of-return regulation for the ROR ILECs, the high switching and transport costs of ROR ILECs should be borne by the whole industry, not just by IXC that pick up and deliver traffic through the ROR ILECs. Placing the burden solely on IXCs serving rural areas penalizes those IXCs for doing so, and places them at an artificial competitive disadvantage when competing in the lower cost Regional Bell Operating Company (“RBOC”) territories against carriers – such as the RBOCs – that originate traffic only in those lower cost areas, or wireless carriers that originate calls over their own networks outside of the access charge system.

Accordingly, if the Commission continues to permit ROR ILECs to operate under a rate-of-return system, it must provide explicit support to reduce ROR ILEC access charges down toward the nationwide average. The Commission already has a proceeding open in which it could do so: the Rural Consumer Choice Coalition filed a petition for reconsideration of the *MAG Order*, seeking to have the Commission convert its unlawful,

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<sup>18</sup> *COMSAT Corp. v. FCC*, 250 F.3d 931, 938 (5<sup>th</sup> Cir. 2001); *Alenco Comm. v. FCC*, 201 F.3d 608, 623 (5<sup>th</sup> Cir. 2000); *Texas Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 425 (5<sup>th</sup> Cir. 1999) (“*TOPUC I*”).

<sup>19</sup> *Alenco*, 201 F.3d at 623.

implicit support for access to interexchange services into lawful, explicit support.<sup>20</sup> The Commission must move ahead to grant that petition.

#### **IV. Conclusion**

The FCC should implement comprehensive intercarrier compensation reform for ROR LECs and all carriers as soon as possible. If that is not imminent, for the foregoing reasons the Commission should grant the Western Wireless Petition. In addition, the Commission should grant forthwith AT&T's petition for forbearance from enforcement of Section 204(a)(3), and it should grant the Rural Consumer Choice Coalition's petition for reconsideration of the *MAG Order*.

Respectfully submitted,

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February 13, 2004

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<sup>20</sup> See *Rural Consumer Choice Coalition Petition for Reconsideration*, CC Docket No. 00-256 (filed Dec. 28, 2001) (seeking reconsideration of *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd. 19613 (2001)).