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Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street S.W.
Washington, D.C. 20554

Re: *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25

Dear Ms. Dortch:

The CLECs' latest submission in this proceeding represents yet another significant retreat.¹ Recognizing that the record could not support permanent mandated reductions to price cap ILECs' tariffed special access rates, re-regulation proponents shifted to asking for the same rate reductions as "interim" relief (while the Commission would ostensibly continue to gather evidence). As AT&T demonstrated, these radical proposals to re-regulate rates and other terms of services that have, for years, exhibited falling prices, rising output and ever-increasing intermodal and intramodal competition remain patently unlawful even if repackaged as interim measures.² The CLECs' new *ex parte* is striking for its complete lack of response to AT&T's arguments. The CLECs do not attempt to defend any of the specific interim proposals that have been made.³ Nor do they try to explain why the precedents AT&T cited would not flatly bar these proposals, whether implemented through direct commands to modify tariffed rates and terms of service, as the proposals actually contemplated, or more indirectly through patently arbitrary and unsupported changes to the price cap rules, as the CLECs now apparently advocate.

Instead, the CLECs now hang their hopes on the *CALLS Order*,⁴ which they contend is all the precedent the Commission needs to take a "similar approach" in this proceeding.⁵ And by that, they apparently mean that the Commission should (i) impose massive "interim" special access rate reductions without any determination whether price cap LECs' existing rates are unjust and unreasonable or whether the new rates would be just and reasonable (and, indeed,

¹ Letter from Patrick J. Donovan (on behalf of twelve CLECs) to Marlene H. Dortch (FCC), filed January 30, 2008 ("CLEC 1/30/08 *Ex Parte*").

² See Letter from Gary L. Phillips (AT&T) to Marlene H. Dortch (FCC), filed January 15, 2008 ("AT&T 1/15/08 *Ex Parte*").

³ CLEC 1/30/08 *Ex Parte* at 2 n.4 (the CLECs "take no position" on the "merits of the various proposals for interim relief").

⁴ *Access Charge Reform*, Sixth Report and Order, 15 FCC Rcd. 12962 (2000) ("*CALLS Order*").

⁵ CLEC 1/30/08 *Ex Parte* at 2.

without a record that would even permit any such determinations); (ii) tack on an aggressive X-Factor, with no need for any analysis of anticipated productivity gains (and, again, no evidence to conduct any such analysis); and (iii) coerce price cap LECs into “voluntarily” accepting these new rates and X-Factors by offering them a choice between the rule changes and a proceeding to establish TELRIC-based rates that “[p]rice cap LECs will never choose.”⁶

As bad analogies go, this one is a doozy. The *CALLS Order* rule changes were based on a broad, industry-wide *agreement*, included an X-Factor that was solely a mechanism for transitioning to the agreed-upon rates rather than an attempt to account for anticipated productivity gains, were expected to be essentially revenue-neutral to the affected carriers, and were justified by the Commission on those grounds. The CLECs’ newfound reliance on a prior decision that is so plainly inapposite is particularly ironic because the *CALLS Plan* represented a carefully negotiated deal for large reductions in switched access rates while freezing the caps for special access services. Although the CLECs’ new proposal purports to ape individual elements of the *CALLS Order*, the “interim” relief they seek here would, in fact, radically undo the negotiated *CALLS* balance, retaining the massive reductions in switched access and piling on even more massive reductions in special access. Not surprisingly, the Commission’s actual rulings and experience with the *CALLS Plan* make crystal clear that the *CALLS Order* provides no support whatsoever for the CLECs’ requests here and, indeed, confirm that the Commission could not lawfully grant those requests.

The CLECs fail to mention, for example, that the Commission’s *CALLS Order* attempt to pick an X-Factor without a rigorous explanation of how it was derived was *reversed* by the Fifth Circuit.⁷ The court acknowledged that the *CALLS Plan* “X-Factor” was not intended to measure productivity gains and was merely an “interim” measure. The court nonetheless rejected the X-Factor ruling, admonishing the Commission that even in the unique *CALLS* circumstances it “need[ed] to provide a rational explanation of how it derived the precise percentage” and had “failed to show a rational basis as to how it derived” the figure it chose.⁸ “Otherwise,” the court explained, “the FCC would have free reign to set the X-Factor arbitrarily and capriciously.”⁹ Thus, far from supporting the CLECs’ case, the *CALLS* experience decisively refutes it: in urging the Commission to adopt an X-Factor estimate of productivity gains without *any* analysis of whether it has anything to do with the ILECs’ actual productivity gains (or anything else), the CLECs are asking the Commission to walk right into another judicial reversal.¹⁰

⁶ CLEC 1/30/08 *Ex Parte* at 1-3.

⁷ *Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313, 329 (5th Cir. 2001) (“*TOPUC*”); see also CLEC 1/30/08 *Ex Parte* at 1 n.2 (citing *CALLS Order* but omitting subsequent history).

⁸ *TOPUC*, 265 F.3d at 329.

⁹ *Id.*

¹⁰ The last time the Commission did undertake a “definitive analysis” of ILEC productivity (more than ten years ago) the resulting X-Factor was also reversed. *USTA v. FCC*, 188 F.3d 521, 525 (D.C. Cir. 1999). The issue of the X-Factor finally became moot only in 2003 when no party appealed the Commission’s order on remand from *TOPUC*. Order on Remand, *Access*

Nor does the *CALLS Order* remotely justify an involuntary flash-cut reduction of all (or any) special access price caps. The Commission was able to avoid rigorous determinations of the need for the CALLS switched access rate reductions and the reasonableness of the new rates *only* because the price cap LECs had *agreed* to the reductions. In fact, apart from the X-Factor reductions found to be unlawful, most of the additional reductions in switched access charges in the CALLS Plan were essentially revenue-neutral to the ILECs – *e.g.*, elimination of the Carrier Common Line Charge in favor of increased caps on the Subscriber Line Charge, and the replacement of \$650 million in revenue with a new, explicit universal service fund.¹¹ In assessing the reasonableness of these rate changes, the Commission relied heavily on the fact that the price cap LECs had consented to these rate reductions as part of a much larger, industry-wide agreement that resolved dozens of outstanding and intractable disputes: “The fact that the resolution of these issues was achieved through a joint proposal among a cross-section of LECs and IXC provides us with some indication that the proposal is within a zone of reasonableness.”¹² The Commission was further reassured that “[t]he rates proposed by CALLS are reasonable,” because the Commission “compared LEC revenues over the five-year period under the modified CALLS Proposal with what their revenues would be under the *status quo*, and conclude[d] that they are roughly the same.”¹³

Because no ILEC ever appealed the CALLS Plan rule changes that led to rate reductions, the Commission never had to defend them in court. But, in any event, the voluntary nature of those rate reductions obviously precludes any serious citation of the *CALLS Order* for the very different proposition that the Commission would get a free pass if it *unilaterally* imposed massive rate reductions in this proceeding without rigorously justifying the necessity and the reasonableness of its actions with the substantial record support that is utterly lacking here. Indeed, this, too, is further confirmed by the CALLS experience itself, because the only other aspect of the specific rate levels established in the *CALLS Order* that any party challenged was the creation of the \$650 million universal service fund – and, here too, the Fifth Circuit reversed the Commission. The court held that the Commission “d[id] not explain how it actually derived

Charge Reform; Price Cap Performance Review for LECs; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service, 18 FCC Rcd. 14976 (2003) (readopting 6.5 percent X-Factor for early years of CALLS Plan).

¹¹ *CALLS Order* ¶ 146.

¹² *CALLS Order* ¶ 48.

¹³ *CALLS Order* ¶ 41. The Commission explained that the plan reduced revenues relative to the *status quo* in the early years, but that the rule changes (*i.e.*, increased caps for the Subscriber Line Charge) could lead to compensating revenues in the later years, although the Commission expected competition to restrain and perhaps even further reduce rates at the end of the CALLS Plan period (*see id.*) – which is of course exactly what happened with respect to the special access services at issue here (which were not the focus of the CALLS Plan). *See also id.* ¶ 49 (rate reductions were part of a complex web of puts and takes, the CALLS proposal was “most appropriately judged as a single, cohesive proposal,” and the focus should be on “the reasonableness of the proposal taken as a whole”).

that figure,” and chastised the Commission for “invok[ing] the Goldilocks approach to rulemaking: noting that ‘some commentators argue that the size of the [fund] is too large [while] [o]ther commentators argue that the size. .. is too small,’ the FCC apparently believes that its approach is just right because it falls reasonably within the range of estimates.”¹⁴

As AT&T and others have demonstrated again and again, the CLECs’ rationales for overriding price cap LECs’ duly tariffed special access rates – such as adopting a 5.3 percent X-Factor merely because the Commission used that figure in 1995 based on data from the 1980s – do not rise even to the “Goldilocks” level of rigorousness that the Fifth Circuit found to be patently unlawful for an interim plan. Indeed, in stark contrast to the *CALLS Order* – which recognized that the Commission could not simply order radical rate reductions to one set of services without considering the impact on interstate services as a whole – the CLECs here myopically focus on patently arbitrary ARMIS-derived “returns” from special access with no acknowledgement that, by the same measures (and largely because of *CALLS*), the ILECs today often earn negative “returns” on switched access services. And contrary to the CLECs’ assertion (CLEC 1/30/08 *Ex Parte* at 1-2), the Commission has already rejected their proposed approach in this very proceeding. In its original NPRM, the Commission rejected almost identical interim relief proposals, and explained that even if a rate reduction is “interim,” the Commission still can prescribe special access rates and terms only when it can make definitive findings, on a complete record, both that carriers’ existing tariffed rates and terms are unjust and unreasonable and that proposed replacement rates and terms are themselves just and reasonable.¹⁵ The *CALLS Order* provides no possible basis to second-guess that Commission ruling.

The CLECs’ further suggestion (at 2-3) that the Commission can avoid these problems simply by offering price cap LECs the option of having their rates mandated based on forward-looking economic costs is fanciful. The Commission has repeatedly and consistently rejected attempts to order price cap LECs to charge rates based on forward-looking costs,¹⁶ and the

¹⁴ *TOPUC*, 265 F.3d at 328 (quoting *CALLS Order* ¶ 204).

¹⁵ See, e.g., Order and NPRM, *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, ¶ 130 (Jan. 31, 2005) (“we find the record inadequate for prescribing new special access rates pursuant to section 205 of the Communications Act”). To be sure, the NPRM sought comment on “what interim relief, *if any*” might be necessary during this proceeding, and the Commission suggested that it might adopt an interim X-Factor and sought comment on whether it could use 5.3 percent. *Id.* ¶ 131 (emphasis added). As AT&T and others have shown, however, an interim X-Factor of 5.3 percent, based solely on the fact that the Commission used that figure in the mid-1990’s, would be hopelessly arbitrary (and the CLECs do not defend that or any other specific proposal in their *ex parte*). See, e.g., AT&T 1/15/08 *Ex Parte* at 4-5. Indeed, the only data in the record that addresses ILEC productivity gains for recent years is the study submitted by Embarq, which showed that productivity gains were in fact in line with the X-Factor that was actually in place. See Embarq Comments, Staihr Decl. at 9-11 (Aug. 8, 2007).

¹⁶ See First Report and Order, *Access Charge Reform Order*, 12 FCC Rcd. 15982, ¶ 295 (1997) (“[w]e have decided not to require incumbent LECs to reinitialize PCIs on a TSLRIC basis at

Commission could not do so here without resolving numerous, complex methodological issues. The CLECs' response (at 3): no worries, TELRIC is available. The reality, of course, is that years of litigation across the country have essentially left both the Commission and the industry back at square one with regard to proper estimation of forward-looking costs, as the Commission recognized when it initiated a fundamental reconsideration of virtually every aspect of the TELRIC methodology.¹⁷ And the Commission's consistent rejection of TELRIC in the access context has been especially emphatic with respect to special access services: the question whether special access rates should be re-priced at TELRIC has been extensively litigated over the last decade, and both the Commission and the D.C. Circuit have repeatedly rejected requests virtually identical to the CLECs' request here.¹⁸ Indeed, the CLECs themselves effectively concede that this proposal is nothing more than a ruse designed to create the illusion of choice – they assure the Commission that there is no need “to be concerned” about the obvious difficulties of determining the forward-looking economic cost of special access because “price cap LECs will never choose” this option.¹⁹

Finally, CLECs continue to repeat misstatements concerning special access rates that AT&T has refuted multiple times.²⁰ For example, the CLECs continue to assert that price cap LECs' showings of price declines are invalid because they are based on “average revenue per voice grade equivalent,” which allegedly “masks price increases” for some special access services. In truth, AT&T, Verizon, Qwest, and others have submitted detailed evidence, taken from actual billing records, that confirms that prices have consistently declined in both price cap and pricing flexibility areas for both DS1 services and DS3 services.²¹ Rather than relying on

this time . . . the record in this proceeding is unclear on whether there is an accurate and convenient method for determining TSLRIC for purposes of reinitializing PCIs at this time”).

¹⁷ See AT&T Comments at 57-60 (Aug. 8, 2007); Notice of Proposed Rulemaking, *Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers*, 18 FCC Rcd. 20265, ¶ 5 (2003) (“the TELRIC rules have proven to take a great deal of time and effort to implement, and have been the subject of extensive criticism”).

¹⁸ Supplemental Order Clarification, *Implementation of Local Competition Provisions of the Telecomms. Act of 1996*, 15 FCC Rcd. 9587 (2000), *aff'd*, *CompTel v. FCC*, 309 F.3d 8 (D.C. Cir. 2002); Report and Order on Remand, *Implementation of Local Competition Provisions of the Telecomms. Act of 1996*, 18 FCC Rcd. 16978, ¶¶ 591-600 (2003); *USTA v. FCC*, 359 F.3d 554, 590-92 (D.C. Cir. 2004); see also *Covad Communications Co. v. FCC*, 450 F.3d 528, 543-46 (D.C. Cir. 2006).

¹⁹ CLEC 1/30/08 *Ex Parte* at 3. See, e.g., *Associated Gas Distributors v. FERC*, 824 F.3d 981, 1024 (D.C. Cir. 1987) (“when a condemned man is given the choice between the noose and the firing squad, we do not ordinarily say that he has ‘voluntarily’ chosen to be hanged”).

²⁰ CLEC 1/30/08 *Ex Parte* at 4.

²¹ SBC 2005 Reply, Casto 2005 Reply Decl. ¶¶ 27-29; AT&T 2007 Comments, Casto 2007 Supp. Decl. ¶ 57; Verizon 2007 Comments at 10-13 & Taylor Supp. Decl. ¶ 7; Qwest 2007 Comments, Cogan Decl. ¶¶ 16-17.

“average revenue per voice grade equivalent,” that record evidence separately analyzes DS1 and DS3 circuits and shows that for *both* DS1 circuits *and* DS3 circuits (no matter how the data are cut and in both real and nominal dollars), prices have unquestionably been falling for years. The CLECs also complain that some rates in some Phase II areas are above rates in Phase I areas, but no party has submitted any evidence that these Phase I price cap rates represent a competitive rate or the “correct” point of reference. As AT&T and others have repeatedly shown, price caps are an inherently mechanical and imprecise way to set prices that cannot account for all of the numerous supply and demand factors that affect prices in competitive markets, and for many years price capped special access rates were arbitrarily reduced each year by large percentage X-Factors that were never justified and that courts held to be unlawful. The Commission itself has always acknowledged that the price cap rates did not necessarily reflect the operation of marketplace forces and “explicitly recognized that Phase II pricing relief could lead to price increases for customers in some areas.”²² The CLECs’ mulish reliance on small absolute differences between some Phase I and Phase II rates as the “smoking gun” evidence that the most intrusive command-and-control regulation of these declining price services is warranted only confirms that there is no lawful basis for any of the CLECs’ proposals – regardless whether they are costumed with an “interim” label.

As the *GAO Report*²³ on which the CLECs purport to rely in factfound, the prices customers actually pay have significantly decreased since pricing flexibility was granted in both Phase I and Phase II pricing flexibility MSAs.²⁴ The GAO Report further acknowledged that the rate decreases (for both DS1 and DS3 services) are “consistent with the prospect of competition that FCC predicted” in the *Pricing Flexibility Order* that, once competitors have made sufficient sunk investment in alternative facilities, competition from these suppliers will prevent any anticompetitive pricing.²⁵ In short, the CLECs have not remotely made a case either for permanent or “interim” mandatory rate decreases, and the Commission should promptly reject these and other re-regulation requests.

Sincerely,

/s/ Gary L. Phillips

²² See Letter from FCC (Anthony Dale, Managing Director) to GAO (Mark Goldstein, Director, Physical Infrastructure Issues), at 2 (Nov. 13, 2006) *reprinted in* GAO Report, App. III (“FCC GAO Response Letter”); Fifth Report and Order, *Access Charge Reform*, 14 FCC Rcd. 14221, ¶ 155 (1999), *aff’d WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

²³ Gov’t Accountability Office, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services* (Nov. 2006).

²⁴ See *GAO Report* at 13.

²⁵ *Id.*