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

RE: *Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) From Enforcement of Certain of the Commission's Accounting Rules*, WC Docket No. 07-21

Dear Ms. Dortch:

On April 21, 2008, AT&T and AdHoc Telecommunications Users Group participated in a joint *ex parte* meeting in the above-referenced matter. David Lawson of Sidley Austin LLP and the undersigned represented AT&T. Jim Blaszak of Levine, Blaszak, Block & Boothby, LLP and Susan Gately of Economics & Technology, Inc. represented AdHoc. The AT&T and AdHoc representatives met with Commissioner Robert McDowell, John Hunter, Special Counsel to Commissioner McDowell, Angela Giancarlo, Chief of Staff and Senior Legal Advisor to Commissioner McDowell, Scott Bergmann, Senior Legal Advisor to Commissioner Adelstein, and Chris Moore, Legal Advisor to Commissioner Tate.

AT&T reiterated points it has made in its earlier filings in this proceeding. First, it remains undisputed that *none* of the Byzantine cost allocations required by the monopoly-era rules from which AT&T seeks forbearance is used by the Commission or any state to set any rate for any service. Nor, as AT&T explained in its April 18 *ex parte*, will any of this allocated cost data ever be needed to apply the Commission's price cap formula to AT&T through X-factors (which are calculated on the basis of total company data, not the arbitrarily allocated data at issue here), exogenous cost adjustments (which are allocated among price cap baskets on the basis of revenues, not costs), or above-cap or band filings (which AT&T has *never* made and would have the burden of justifying if it ever did).

Rather, AdHoc contends that the mere fact that it has *asked* the Commission in the pending special access rulemaking proceeding to rely upon special access rates-of-return that AdHoc has calculated from past cost allocation data justifies forcing AT&T to continue to labor under the entire cost allocation apparatus indefinitely. But as AT&T and others have repeatedly demonstrated, the use of accounting profit rates based upon fully distributed costs to demonstrate that individual services are "overpriced" would be economic nonsense even if the Commission had insisted that carriers do their best to divine what portions of shared employees, buildings and

networks are “caused” by the growing numbers of individual services that share them. Of course, the Commission has done no such thing. Recognizing that “profits” based upon such accounting allocations are too arbitrary ever to take seriously, the Commission has always rejected requests that it rely upon – *or even require reporting of* – service-specific rates of return.¹ And now any attempt to use allocated costs for such a purpose would be even more nonsensical since the Commission abandoned any attempt to keep the allocation process current many years ago when it froze the vast majority of the allocations at year 2000 levels (and some of the separation studies used to generate the year 2000 factors were already several years old at that time). The arbitrary allocations that preceded and prompted that freeze are thus now even more divorced from reality, as the freeze itself has resulted in an enormous mismatch between rapidly growing special access demand and frozen special access investment allocations. Hence, according to ARMIS, AT&T’s special access accounting rate of return is, absurdly, over 100%, while it is *negative* for switched access. That is why even AdHoc has now conceded that it does not propose that any of the allocated accounting cost data actually be *used* to reinitialize price caps or set rates, but only that the Commission credit its service-specific profit calculations as the “canary in the coal mine” that demonstrates that AT&T is exercising market power that is not constrained by existing price cap rules. But the Commission has already recognized that the data could not support that conclusion,² and, given that AdHoc already has in hand many years of this meaningless “excessive profits” data, that canary would already have sung to anyone that rejects the consensus economic view and perceives any meaning in the allocation-based accounting “profits.”

¹ Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, 380 (1990) (“Our sharing and adjustment mechanisms are based on total interstate rate of return, and that is the only earnings data used in the price caps plan. We accordingly determine that we should remove from ARMIS, for LECs under the price cap plan, any rate of return reporting that requires data at less aggregated levels than total interstate earnings”); Order on Reconsideration, *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd. 2637, ¶ 200 (1991) (“We also reject requests that we expand [rate of return] reporting requirements, for example through further disaggregation. We do not believe that additional reporting requirements are needed to evaluate whether rates under price caps are just and reasonable in light of their costs and profits”); Report and Order and Notice of Proposed Rulemaking, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd. 14853, 137 (2005) (“We note that our decision to treat the non-common carrier provision of broadband Internet access transmission as a regulated activity under Part 64 will affect the results of computations of the rate or return earned on interstate Title II services. This is not a matter of practical concern with respect to most incumbent LECs regulated under the *CALLS* plan or price caps, because earnings determinations are not used in determining their price cap rates”).

² Order and Notice of Proposed Rulemaking, *In Re Special Access Rates for Price Cap Local Exchange Carriers*, 20 FCC Rcd. 1994, ¶¶ 129-30 (2005) (“Even if the Commission had enough data, moreover, we question [the] central reliance on accounting rate of return data to draw conclusions about market power. High or increasing rates of return calculated using regulatory cost assignments for special access service do not in themselves indicate the exercise of monopoly power”).

Second, because the manner in which AT&T apportions the accounting costs of common facilities among jurisdictions and services under these rules can have no impact on any rate, AdHoc is plainly wrong in suggesting that the Commission could justify denying AT&T's forbearance petition on the ground that the rules are needed to prevent cross-subsidization. AT&T simply has *no* ability to use accounting cost "misallocations" to recover competitive service costs from regulated service customers, and thus the Commission could not possibly show the "strong connection" required by the forbearance statute between *these particular cost allocation rules* and any federal policy in protecting against cross-subsidization by AT&T. Of course, to the extent any legitimate cross-subsidization concerns exist in today's dynamic and highly competitive marketplace, AT&T will continue to be subject to sections 254(k) and 272(e)(3), and AT&T has additionally committed that it will, going forward, certify annually to the Commission that it does not engage in any improper cross-subsidization. But as AdHoc's utter inability to proffer *any* connection between AT&T's ability to engage in cross-subsidization and the amounts of accounting costs that AT&T allocates to particular services should make abundantly clear, the Commission would have no hope of sustaining a finding that its enforcement of 254(k), 272(e) or any other cross-subsidization-based rule or policy would be aided by continuing to require AT&T to allocate costs.

AdHoc's response is that even if there is no legitimate basis for a Commission finding that cost allocation rules remain necessary to prevent AT&T from using supposed access bottlenecks to engage in cross-subsidization of competitive services, the Commission has already made such a finding – and is now stuck with it. Both the premise and the conclusion are wrong. First, AdHoc reads far too much into the *LD Nondominance Order*³ itself. There, the Commission ticked off the long list of "continuing" legal obligations to which BOCs were still subject after reclassification of their long distance services as nondominant. Although the cost allocation rules were among those requirements – because they were at that time "continuing" legal obligations on all BOCs – there was no suggestion that the Commission intended to foreclose the pending forbearance showing by AT&T that, *as to AT&T*, the cost allocation rules no longer serve any regulatory purpose and, specifically, have absolutely no impact on AT&T's incentive or ability to engage in cross-subsidization. Having not yet addressed AT&T's forbearance petition or confronted AT&T's specific showing, the Commission was entitled in the *LD Nondominance Order* to list the cost allocation rules as one of many "continuing" legal obligations that it had previously found "important" to aid against cross-subsidization. After all, Verizon and Qwest, unlike AT&T, remain subject to some rate-of-return regulation, under which accounting cost misallocation could, at least in theory, remain relevant to cross-subsidization.

But, as the D.C. Circuit has repeatedly held, a forbearance petition must be decided within the statutory deadline upon its *merits*. The Commission must now determine whether, as to AT&T, there remains a strong connection between the rate-of-return era cost allocation rules and any cross-subsidization policy designed to ensure just and reasonable rates and protect consumers and the public interest. There is *no* such connection, and AdHoc's suggestion that the

³ Report and Order and Memorandum Opinion and Order, *Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements; 2000 Biennial Regulatory Review Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules; Petition of AT&T Inc. for Forbearance Under 47 U.S.C. § 160(c) with Regard to Certain Dominant Carrier Regulations for In-Region, Interexchange Services*, 22 FCC Rcd. 16440 (2007) ("*LD Nondominance Order*").

Commission just repeat its statements in the *LD Nondominance Order* that cost allocation rules are “important” without confronting AT&T’s unrebutted showing that that is no longer true for AT&T is a recipe for sure reversal. And granting AT&T’s forbearance petition on its merits would not in any way signal a retreat from the *LD Nondominance Order*. AT&T will continue to comply with §§ 254(k) and 272(e)(3), and the Commission will retain all of the oversight information. In this regard, the fact that the access services that AdHoc contends are bottlenecks are all *tariffed* and thus imputed at the tariffed rates ensures imputation transparency,⁴ and AT&T will comply with § 254(k) by certifying annually that it does not engage in any improper cross-subsidization.⁵

Finally, AT&T confirmed its continuing commitment to provide both the Commission and state regulators with data that they truly require for legitimate regulatory purposes. AT&T will continue to maintain highly disaggregated ARMIS books of account under part 32 that list in great detail AT&T’s investments and expenses in hundreds of separate types of assets and investments on a total company basis – the forbearance petition addresses only the arbitrary *allocation* of the amounts recorded in those Part 32 accounts among jurisdictions and services.⁶ And, of course, in the highly unlikely event the Commission somehow found a need for some type of allocated cost data in the future, AT&T could again allocate the data in any affected Part 32 accounts based upon whatever parameters were deemed appropriate and would comply with any lawful requirement to that end within a reasonable time frame. But there is plainly no need and no lawful justification to require AT&T to continue to carry out the full-blown cost allocation process any longer given that it serves no present regulatory purpose.

Respectfully submitted,

/s/ Robert W. Quinn

⁴ AT&T will comply with § 272(e) post-forbearance by recording imputation in the appropriate Part 32 ARMIS account (Account 5280) and specifying the amounts of imputation in footnotes to Reports 43-01, 43-02, and 43-03. AT&T will also continue to comply with the LD Nondominance Order requirement that it describe and file its affiliate transaction and imputation methodology by filing an annual letter with the Commission. And to the extent that AT&T’s revenue reporting must show debits to nonregulated revenues reflecting imputed access charges, that obligation, too, will be unaffected, because the petition does not seek forbearance from any revenue reporting requirements.

⁵ Under current FCC Rules, BOCs are deemed to comply with their § 254(k) obligations through the filing of Cost Allocation Manuals. See 47 C.F.R. §§ 64.901-904 (2007). That is why those rules were referenced in the *LD Nondominance Order*. As described above, post forbearance, AT&T proposes to evidence compliance with that statutory obligation via certification. The Commission relies upon certifications as an effective compliance tool in a wide variety of contexts. Indeed, even rate-of-return mid-sized carriers are permitted to demonstrate compliance with § 254(k) through their own certifications.

⁶ Attached hereto is a chart entitled “Regulatory Accounting Overview” summarizing the structure of existing accounting reporting requirements.

Regulatory Accounting Overview

ARMIS 43-01
Summary

1) Costs and revenues are recorded within applicable Part 32 Uniform System of Accounts.

