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July 19, 2010

EX PARTE NOTICE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Portals II, Room TW-A325
Washington, DC 20554

Re: Jurisdictional Separations and Referral to the Federal-State Joint Board, CC Docket No. 80-286

Dear Ms. Dortch:

On July 18, 2010, the undersigned on behalf of AT&T Inc. met with Honorable John D. Burke, Commission, Federal-State Joint Board on Separations and Vermont Public Service Board during the NARUC Summer Meeting in Sacramento. Also present was Dave Svanda of Svanda Consulting. AT&T summarized its April 27, 2010 comments filed in response to the State Members' Proposal for Interim Adjustments to Jurisdictional Separations Allocation Factors and Category Relationships. All of AT&T's interstate and intrastate rates have either been deregulated or are governed by price caps. No matter how the Commission might adjust factors that impact cost allocations among service or plant categories or jurisdictions, none of those changes could have any effect on any of AT&T's rates. When the FCC granted forbearance from certain of its cost assignment rules, AT&T agreed that, if a state requested allocated cost information, it would provide the state the information it needed for regulatory purposes. AT&T also emphasized that any interim adjustments would still be arbitrary and would not produce reliable results.

In accordance with section 1.1206(b)(2) of the Commission's rules, this letter is being filed electronically with your office. Please feel free to contact me if you have any questions.

Sincerely,

Linda S Vandeloop

Linda Vandeloop

Attachment

cc: Honorable John D. Burke

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

In the Matter of	)	
	)	
Jurisdictional Separations and Referral to the Federal-State Joint Board	)	CC Docket No. 80-286

COMMENTS OF AT&T INC.

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April 29, 2010

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COMMENTS OF AT&T INC.

AT&T Inc. ("AT&T") respectfully submits these comments in response to the *Notice* issued by the Federal-State Joint Board ("Joint Board") in CC Docket No. 80-286, released March 30, 2010,[1] seeking comment on the State Members' Proposal for Interim Adjustments to Jurisdictional Separations Allocation Factors and Category Relationships ("Interim Proposal").[2]

INTRODUCTION AND SUMMARY

The Joint Board should not recommend any further consideration of the State Members' proposal for interim adjustments to the separations allocation factors. Implementing the proposed adjustments would serve no regulatory purpose, would create needless and expensive "make work" for carriers, and would be arbitrary. The State Members' submission, however, does serve one useful purpose – it offers yet another, powerful refutation of the claims of those asking the Commission to re-regulate the price cap incumbent local exchange carriers' ("ILECs'") special access services. In the Commission's special access proceeding, the

[1] Public Notice, *Federal-State Joint Board On Separations Seeks Comment On Proposal For Interim Adjustments To Jurisdictional Separations Allocation Factors And Category Relationships Pending Comprehensive Reform And Seeks Comment On Comprehensive Reform*, CC Docket No. 80-286, FCC 10J-1 (released March 30, 2010) ("*Notice*").

[2] *Notice,* at Appendix.

proponents of regulation have simplistically relied on estimates of the ILECs' service category-specific "returns" derived from ARMIS data as a basis for re-regulation. The entire premise of the State Members' proposal, however, is that current cost allocation factors have "no basis in fact" and reflect a gross understatement of price cap carriers' special access costs as reported in ARMIS. This strongly confirms AT&T's previous showings that the regulation proponents' estimates of special access returns are wildly overstated.

With respect to the merits of the State Members' proposal, the interim adjustments they propose would serve no legitimate purpose, and would be arbitrary and unlawful. All of AT&T's interstate and intrastate rates have either been deregulated or are governed by price caps. As the Commission has recognized repeatedly, price caps break the link between the costs reported in ARMIS and rates. Accordingly, none of the State Members' proposed interim adjustments would have any real-world effect on anything. No matter how the Commission might adjust factors that impact cost allocations among service or plant categories or jurisdictions, none of those changes could have any effect on any of AT&T's rates for interstate *or* intrastate voice, data, video or any other services. The other largest carriers that account for the vast majority of access lines in the United States, are likewise almost entirely governed by price caps (or are deregulated) at both the federal and state levels,[3] and therefore the State Members' proposals would require substantial effort and investment *for no good reason*.

Just two years ago, the Commission held that Section 10 of the Act *requires* the Commission to forbear from applying any cost allocation rules that make carriers gather and report data that the *Commission* does not routinely use for any ongoing federal regulatory

[3] *See* Comments Of The United States Telecom Association, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, at 6 (April 19, 2010).

purpose.[4] The Commission held that regulations that force one set of competitors – here, price cap ILECs – to spend millions annually to establish and maintain systems for gathering accounting data that the Commission does not use are unnecessary and affirmatively harmful and cannot lawfully be retained under Section 10. The State Members' proposal, however, asks the Commission to adopt exactly those sorts of requirements. Accordingly, even if the Commission adopted such a proposal as new rules applicable to the price cap carriers (and to do so, it would have to initiate and complete a full notice and comment rulemaking proceeding), such carriers could immediately file petitions for forbearance that the Commission would be required to grant under well-established D.C. Circuit and Commission forbearance precedents. It would plainly be arbitrary to adopt new cost allocation requirements that so blatantly ignore the standards of Section 10 and that would so obviously become the immediate target of meritorious forbearance petitions.[5]

The State Members' proposal, moreover, is clearly arbitrary and unnecessarily burdensome. Their special access-related proposals would require new revenue-based cost allocations. The State Members do not assert that revenue-based re-allocation would yield meaningfully accurate cost allocations; to the contrary, they expressly disclaim any long-term endorsement of revenue-based allocations. For its part, the Commission has previously rejected revenue-based cost allocation proposals. And any gains in "accuracy" produced by the new cost

[4] Memorandum Opinion and Order, *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules; Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, 23 FCC Rcd. 7302 (2008) ("*AT&T Cost Allocation Forbearance Order*").

[5] *AT&T Cost Allocation Forbearance Order*, 23 FCC Rcd. 7302, ¶ 32 (Commission does not "have authority under sections 2(a) and 10 of the Act to maintain federal regulatory requirements that meet the three-prong forbearance test with regard to interstate services in order to maintain regulatory burdens that may produce information helpful to state commissions for intrastate regulatory purposes solely").

allocations would fall far short of correcting the many intractable problems with ARMIS cost allocations; the "re-allocated" costs would remain arbitrary and inaccurate.

The State Members' convoluted Cable and Wire Facility ("C&WF") proposal is equally arbitrary. The State Members' contend that the "25% basic [interstate] allocator for local loop facilities assigned to C&WF category" – a fixed allocator that has been in place since the early years of the Bell System breakup – must be increased to reflect increases in interstate uses of local loops and related plant since the factor was established.[6] But the fixed 25% allocator was never intended to reflect relative usage but to promote other Commission policies; the Commission recognized in 1984 that any usage-based allocator would be hopelessly arbitrary given the fixed nature of loop costs (which was fine under a rate of return regime in both state and federal jurisdictions when the goal was merely to earn a fair overall return). Changing those jurisdictional allocation factors today would implicate broader policy goals that have implications that extend well beyond the scope of this proceeding. In any event, the State Members' particular C&WF allocation proposals are hopelessly arbitrary in numerous respects, ignoring the increasingly blurred lines between "voice," "data" and other services, arbitrarily and discriminatorily treating costs depending upon whether ILEC lines are used by affiliates or third parties, pre-judging the answer to complex regulatory classification questions that the Commission itself has not answered, and, in the end, picking the specific proposed allocation percentages completely out of thin air with an obvious bias toward interstate allocation.

Moreover, making these arbitrary allocations would be extremely burdensome. To make the arbitrary allocations the State Members contemplate, carriers would be required to invest enormous sums in new tracking and reporting systems that do not currently exist for both

[6] Interim Proposal, at 10.

carriers' regulated affiliates as well as carriers' *non-regulated* affiliates. The C&WF proposal, for example, would require carriers to make allocations to eight different service categories for each access line (five of which the Commission has never used before). AT&T has *fifty million* access lines. AT&T does not have a centralized billing database, and thus would have to create completely new teams of people to canvass multiple, incompatible billing systems to gather and interpret the necessary data and put it in the format proposed by the State Members. It would cost a small fortune to build and maintain these systems, and the data would remain in constant, rapid flux. The suggestion that all of this could be accomplished in the next few months is simply irresponsible. And to repeat: all of these efforts and expenditures would be to create sets of data that the Commission *would not use for any regulatory purpose*.

In short, the last thing that the Joint Board should recommend to the Commission is that it spend its scarce resources designing and implementing "interim" separations rules that would not be used for any federal (or legitimate state) purpose, that would be extremely burdensome for carriers to implement, and that would still produce arbitrary and inaccurate allocations. The Commission instead should spend its time and energy completing the pending rulemaking proceeding and eliminating the separations rules altogether (at least with respect to carriers that are no longer subject to rate of return regulation) as it reforms intercarrier compensation and universal service.

As noted, however, the State Members' submission does serve one useful purpose, because it convincingly explains why proposals in the special access proceeding to impose new regulations on ILEC special access services based on service category-specific ARMIS-based returns are wholly baseless.[7] In that proceeding, proponents of re-regulation have argued that service category-specific special access returns can be computed from ARMIS data. These ARMIS-derived returns make for great headlines. But as AT&T, other ILECs, the Commission, the GAO, NRRI, and others have recognized, those ARMIS-derived service category-specific returns are meaningless.[8] This is so for numerous reasons – ARMIS data were never meant to be used to calculate service category-specific returns in the first place, and, in all events, the historical inaccuracies of the cost allocations, greatly compounded by the separations freeze, has resulted in ILEC special access costs being greatly *understated* in ARMIS.

The State Members' submission strongly confirms these points. As they concede, ARMIS-derived special access returns are meaningless because "[t]he current separations allocation factors and categorizations *no longer have any basis in fact*."[9] As the State Members explain, the allocations used in ARMIS have become increasingly arbitrary, because, among other things, "[s]ince the 1980's there have been significant changes in the nature of local

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[7] *See, e.g.*, Public Notice, *Parties Asked To Comment On Analytical Framework Necessary To Resolve Issues In The Special Access NPRM*, WC Docket No. 05-25, RM-10593 (released Nov. 5, 2009).

[8] *See, e.g.*, Comments of AT&T Inc., *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 67-72 & attached Declaration Of Ron Hilyer And Thomas Makarewicz (filed Jan. 19, 2010) (demonstrating that ARMIS cost allocations are meaningless and cannot be fixed by revenue-based reallocations); Peter Bluhm With Dr. Robert Loube, *Competitive Issues In Special Access Markets*, Revised Edition, National Regulatory Research Institute, at 70 (First Issued Jan. 21, 2009) ("NRRI Report") ("[T]he RBOCs contend that the ARMIS figures are virtually meaningless. We agree with the RBOCs."); Gov't Accountability Office, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, at 15, 40 (Nov. 2006) (acknowledging that "price-cap incumbents state that ARMIS cannot be used to make competitive assessments due to outdated accounting rules, including such things as arbitrary cost allocations and the inclusion of certain revenues but not the corresponding costs" and concluding overall that the Commission needs to collect "more complete and reliable data.").

[9] Interim Proposal, at 3 (emphasis added).

exchange carrier plant."[10] To make matters worse, "the continued freeze of jurisdictional separations allocation factors and category relationships has led to a stale system that no longer adequately represents a just and reasonable allocation of costs."[11] "[T]he current allocation of costs between the state and interstate jurisdictions is governed by separations studies that are nine years old" and thus "[b]ased on their age alone, these studies are unlikely to reflect current conditions."[12] And, as the State Members further emphasize, "the freeze and the FCC staff directive to ignore direct assignment rules have led to a mis-alignment of special access costs."[13] Accordingly, the State Members propose a substantial shift of costs to interstate special access services – which would dramatically reduce the calculated service category-specific returns that regulation proponents have proffered in that proceeding (but that still would overstate price cap ILEC returns).

I. REQUIRING AT&T TO REVISE SEPARATIONS FACTORS AND CATEGORY RELATIONSHIPS WOULD SERVE NO REGULATORY PURPOSE.

The State Members' correctly recognize that as a result of the 2001 separations freeze, the current jurisdictional and service category cost allocations "no longer have any basis in fact."[14] The State Members therefore propose that the Joint Board recommend to the Commission that this year, rather than simply extending the separations freeze for another year when the current freeze expires, the Commission should instead force carriers to make certain

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[10] *Id.* at 10.

[11] *Id.* at 1; *see also id.* at 5 (The "use of the same frozen categorization percentages that they used in 2001, regardless of the actual uses of their current plant, is not sufficient to properly separate costs between jurisdictions.").

[12] *Id.* at 2.

[13] *Id.* at 5.

[14] *Id.* at 3.

"adjustments to . . . existing cost allocation factors" and update their regulatory accounting books accordingly.[15]

The Joint Board should not recommend any further consideration of these proposals, for the simple reason that the Commission would not use these revised allocation factors for any federal regulatory purpose. Indeed, the Commission has squarely held that Section 10 of the Act *requires* forbearance from any allocation factors that, like those proposed, would not be routinely used for any ongoing regulation of any *interstate* services. It would be patently arbitrary for the Commission to adopt burdensome accounting requirements that would not be used for any regulatory purpose and which would obviously be subject to immediate, meritorious forbearance petitions.

First, AT&T's rates are governed by price caps at both the federal level and the state level in all 22 states in which AT&T has ILEC operations, and for many services in many jurisdictions AT&T's rates have been deregulated. As the Commission has noted, price caps sever the link between rates and costs.[16] Although the Commission originally retained certain vestigial features of the rate-of-return system at the federal level, such as the sharing and low-end adjustment mechanisms, the Commission eliminated the last of those measures a decade ago.[17]

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[15] *Id.*

[16] Report and Order, *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards*, 6 FCC Rcd. 7571, ¶ 55 (1991) ("*Computer III Remand Order*"), *vacated in part Sub. Nom., California* v. *FCC*, 39 F.3d 919 (9th Cir. 1994), *cert. denied*, 514 U.S. 1050 (1995).

[17] Fifth Report And Order And Further Notice Of Proposed Rulemaking, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, 14 FCC Rcd. 14221, ¶¶ 163-64 (1999) ("*Pricing Flexibility Order*"). When it eliminated the low-end adjustment, the Commission considered retaining it and specifying "the cost allocation rules LECs would use to segregate costs and revenues from services in price cap regulation from the costs and revenues of services outside of price cap regulation," but it rejected that alternative because such rules would be "burdensome for carriers and the Commission and is inconsistent with the deregulatory framework envisioned by Congress when it adopted the Telecommunications Act of 1996." *Id*. ¶

Accordingly, the Commission has repeatedly recognized that cost allocations no longer serve any regulatory purpose and have no effect on a price cap carrier's rates: "because price cap regulation severs the direct link between regulated costs and prices, a carrier is not able automatically to recoup misallocated nonregulated costs by raising basic service rates, thus reducing the incentive for the BOCs to shift nonregulated costs to regulated services."[18]

Precisely *because* ARMIS-reported costs no longer play any role in determining a price cap carrier's rates, the Commission has been steadily phasing out the very separations mechanisms that the State Members wish now to "temporarily" resurrect and make more complicated. The Commission began, of course, with the separations freeze itself, which was done in recognition of the fact that separations procedures had become "outdated regulatory mechanisms that are out of step with today's rapidly-evolving telecommunications marketplace."[19] The Commission next issued several biennial review orders streamlining

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166. Indeed, the Commission concluded that "[b]urdening the low-end adjustment mechanism with cost allocation rules . . . would undercut a major reason for retaining the low-end adjustment," while eliminating the low-end adjustment "might enable the Commission to relax, for that LEC, any accounting rules necessitated only by the rate-of-return-based low-end adjustment mechanism." *Id.* The Commission subsequently did so.

[18] *Computer III Remand Order* ¶ 55; *see also California* v. *FCC*, 39 F.3d 919, 926-27 (9th Cir. 1994); *United States* v. *W. Elec. Co.*, 993 F.2d 1572, 1580 (D.C. Cir. 1993) ("[price cap regulation] reduces any BOC's ability to shift costs from unregulated to regulated activities, because the increase in costs for the regulated activity does not automatically cause an increase in the legal rate ceiling"); 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, ¶ 181 (1996).

[19] Report and Order, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 16 FCC Rcd. 11382, ¶ 1 (2001) ("*Separations Freeze Order*"). The purpose of the freeze was to make the FCC's cost accounting procedures simpler and more stable and predictable, and indeed, the freeze was intended to *prevent* shifts in costs due to the anticipated growth of the Internet and packet switched services. *Id.* ¶ 12.

various aspects of the accounting rules.[20] In the *Wireline Broadband Order*, when the Commission permitted broadband Internet access transmission to be offered on a non-common-carrier basis, the Commission specifically *refused* to amend the cost allocation rules and instead required carriers to continue to classify such costs as regulated, because the "costs of changing the federal accounting classification of the costs underlying this transmission would outweigh any potential benefits."[21]

And most recently, the Commission granted price cap carriers forbearance from the cost allocation rules altogether. The Commission's central holding in the *AT&T Cost Allocation Forbearance Order* was that the cost assignment system is not necessary or even used for any regulatory purpose. Accordingly, the Commission granted forbearance from those rules: "we conclude that there is *no current federal need* for the Cost Assignment Rules, as they apply to AT&T, to ensure that charges and practices are just and reasonable, and not unjustly or

[20] *See, e.g.*, Report and Order in CC Docket Nos. 00-199, 97-212 and 80-286, *2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2*, 16 FCC Rcd. 19913 (2001) *(Phase 2 Order*); Report and Order, *Federal-State Joint Conference On Accounting Issues; 2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and ARMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase II; Jurisdictional Separations Reform and Referral to the Federal-State Joint Board; Local Competition and Broadband Reporting*, 19 FCC Rcd. 11732, ¶¶ 14, 21, 23, 26, 39, 50 (2004).

[21] Report and Order, *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, 20 FCC Rcd. 14853, ¶¶ 130-34 (2005) ("Requiring that incumbent LECs classify the provision of broadband Internet access transmission provided on a non-common carrier basis as a nonregulated activity under part 64 would mean, among other matters, that incumbent LECs would have to develop, and we would have to review, methods for measuring the relative usage that this transmission and the incumbent LECs' traditional local services make of incumbent LECs' transmission facilities. . . . [the Commission agreed that such an analysis] would impose significant burdens on [LECs] with little discernible benefit. . . . The proceedings to set these measures would be both resource-intensive and, given the changes in network technology from the time when the part 64 cost allocation rules were developed, likely to lead to arbitrary cost allocation results").

unreasonably discriminatory; to protect consumers; and to ensure the public interest."[22] The Commission recognized that its "ratemaking methods and those of our state counterparts have evolved considerably" and no longer rely on separated data.[23] It specifically noted that the elimination of "features of the original price cap regime that required rate-of-return accounting inputs" had "eliminated ongoing tinkering with price caps," and therefore the Commission no longer routinely uses or needs allocated accounting data.[24] As the Commission concluded, the forbearance statute simply does not permit the Commission to retain accounting requirements when there is "not a current need."[25]

For these reasons, none of the State Commissioners' proposals would serve any regulatory purpose. Modifying the cost allocations for special access would not have any regulatory impact on any of AT&T's special access rates; modifying the Cable and Wire Facilities allocations would not have any regulatory impact on the rates for any of AT&T's voice, data, or video services.

The State Commissioners' only answer to this is a single sentence: they claim that "the FCC and certain states allow exogenous changes to price cap company rates in recognition of separations changes."[26] In fact, in the very passage of the *Separations Freeze Order* they cite, the Commission "specifically f[ound] . . . that, based on the nature of the changes to Part 36 that we are adopting, price cap carriers *shall not* be allowed to claim exogenous cost adjustments

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[22] *See AT&T Cost Allocation Forbearance Order*, 23 FCC Rcd. 7302, ¶¶ 11 (emphasis added); *see id.* ¶ 45 ("we view it as inconsistent with the public interest, under section 10, to maintain costly requirements in exchange for benefits that are speculative in nature and for *uses that do not currently exist*" (emphasis added)).

[23] *Id.* ¶ 17.

[24] *Id.* ¶ 19.

[25] *Id.* ¶ 20; *Cellular Telecomms. & Internet Ass'n* v. *FCC*, 330 F.3d 502, 512 (D.C. Cir. 2003).

[26] Interim Proposal, at 3 n.12.

under Part 61 of the Commission's rules as a result of the implementation of the freeze."[27] The Commission saw "no grounds upon which to allow for exogenous cost changes, including exogenous adjustments based on projections of where cost levels would be if not for the existence of the freeze."[28]

Notably, the State Commissioners' proposal would result in a very substantial shift in costs from the *intra*-state jurisdiction to the *inter*-state jurisdiction, and therefore if the Commission did permit exogenous adjustments in this instance, those adjustments would result in sharp *increases* in the interstate price caps – further evidence that, after a decade of separations freezes, the CALLS plan, and various other rate freezes and merger conditions, there is no ARMIS basis to claim that federal price caps today are too high. And, none of the state commissions in AT&T's 22-state region has ever routinely granted an exogenous adjustment to price caps for separations changes, and the great majority of them would have no authority to do so even for the relatively small portion of intrastate lines or services that remain subject to intrastate price caps.[29]

The State Members do not specify how they believe the Commission should implement their proposal. If they are suggesting that the Commission should merely modify the percentage allocations in the existing separations rules, such changes would not apply to AT&T at all because AT&T has already received forbearance from those rules. If they are suggesting that the

[27] *Separations Freeze Order*, 16 FCC Rcd. 11382, ¶ 55 (2001) (emphasis added) (cited at State Commissioners' Letter at 3 n.12).

[28] *Id.*

[29] The Illinois Public Utility Commission, for example, has specifically rejected an exogenous adjustment for separations changes. *Illinois Bell Telephone Company Annual Rate Filing for Noncompetitive Services Under an Alternative Form of Regulation*, Order, Docket 95-0182, released June 21, 1995, pp. 4-5; *Illinois Bell Telephone Company Annual Rate Filing for Noncompetitive Services Under an Alternative Form of Regulation*, Docket 98-0259, released June 29, 1998, pp. 3-5.

Commission should promulgate a completely new set of rules intended to apply to the price cap carriers, that would require a full notice and comment proceeding at the Commission to justify the imposition of such rules – a proceeding that would undoubtedly consume considerable time and resources of the Commission. Moreover, if such new rules were adopted, AT&T could immediately file a petition seeking forbearance from these rules and, under the forbearance precedents of the D.C. Circuit and the Commission, the Commission would be *required* to grant the petition.[30]

As the D.C. Circuit has made clear, a regulation is "necessary" within the meaning of Section 10 only if there is a "strong connection between what the [Commission] has done by way of regulation and what the agency permissibly sought to achieve with the disputed regulation."[31] Here, however, there would be *no* connection at all between the new allocation procedures proposed by the State Commissioners and any legitimate regulatory purpose of the Commission. And even if there were a couple of states that might find such data useful in certain kinds of proceedings, that would be no basis for denying forbearance: the Commission recently held that it does not "have authority under sections 2(a) and 10 of the Act to maintain federal regulatory requirements that meet the three-prong forbearance test with regard to interstate services in order to maintain regulatory burdens that may produce information helpful to state commissions for intrastate regulatory purposes solely."[32] It would be manifestly arbitrary and unreasonable to

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[30] Under Section 10, the Commission "*shall* forbear from applying any regulation or any provision" of the statute if it determines that the three specifically enumerated criteria are satisfied. *See AT&T Inc.* v. *FCC*, 452 F.3d 830 (D.C. Cir. 2006) (holding that declining to decide a forbearance petition "violates section 10's plain language," even when the Commission is still considering (in other proceedings) whether the regulations even applied).

[31] *Cellular Telecomms. & Internet Ass'n*, 330 F.3d at 512.

[32] *AT&T Cost Assignment Forbearance Order*, 23 FCC Rcd. 732, ¶ 32. As the Commission noted, "when a need exists" for specific information by a state commission for "monitoring" or other legitimate state purposes, "AT&T can develop such information to meet those state-

adopt new regulatory burdens that serve no real regulatory purpose and that would so clearly require forbearance if challenged. Notably, in the year and half since AT&T implemented the relief given in the cost allocation forbearance order, no state has complained that AT&T would not provide state-specific financial information.

II. THE PROPOSED REVISIONS WOULD PRODUCE INACCURATE RESULTS AND WOULD BE EXTREMELY BURDENSOME AND COSTLY FOR CARRIERS TO IMPLEMENT.

In addition to serving no useful purpose, the State Members' Interim Proposal would *not* produce even remotely accurate cost assignments,[33] and would impose significant additional burdens on carriers.[34]

A. The State Members' Proposal Would Not Produce "Accurate" Cost Allocations.

Both the State Members' special access and Cable and Wire Facility proposals rely on allocation methods that are inherently arbitrary and could not lawfully supply the basis for regulation.

First, the State Members' describe their special access proposal as a "modif[ication]" of the "direct assignment of both C&WF and COE investment."[35] In fact, their proposal has nothing at all to do with the direct assignment of costs. Historically, to directly assign the cost of plant to particular services, ILECs were required to conduct usage and other studies to determine

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specific requirements." *Id.* ¶ 34; *id.* Statement of Commissioner McDowell ("Section 10 does not allow us to maintain a requirement merely 'just in case' it is needed in the future").

[33] *See Notice* at 2 (asking "whether and to what extent the State Member's Interim Proposal would improve the accuracy of the apportionment of regulated costs between the intrastate and interstate jurisdiction").

[34] *See Notice* at 2 (asking "whether the procedures set forth in the State Member's Interim Proposal raise implementation or operational issues that would have a significant impact on carriers").

[35] Interim Proposal, at 7.

how the plant was actually used and then allocate the cost of the plant to jurisdictions and service categories based on those studies. Carriers, however, have not been required to conduct such studies since the Commission froze the separations allocations in 2001, and the State Members recognize that such direct cost studies are extremely burdensome and infeasible here.[36] The State Members' therefore propose an *alternative* to direct assignment. They propose that the cost of plant instead be allocated using relative revenues as a *proxy* for how the cost of plant is incurred and that costs should be allocated to jurisdictions and service categories based on those measures.

The Commission has consistently found, however, that revenue-based allocations do not provide accounting data that are robust enough to support regulation. For example, when the Commission initially required carriers "to file manuals for separating the costs of regulated telecommunications services from the costs of nonregulated activities,"[37] Bell Atlantic sought to allocate "Customer Service" costs by using the "ratio of nonregulated *revenues* to total revenues."[38] The Commission rejected this approach, finding that "this apportionment factor is inconsistent" with the Commission's determination that "revenues measure only the ability of an activity to bear costs, and not the amount of resources used by the activity."[39]

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[36] Interim Proposal, at 7 ("many carriers no longer have employees with experience in performing such studies. Given the short time prior to expiration of the freeze, we do not believe it is realistic to propose that such studies be required in 2010").

[37] Memorandum Opinion and Order, *Bell Atlantic Operating Companies' Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs*, 4 FCC Rcd. 496, ¶ 1 (1989).

[38] *Id.* ¶ 82 (emphasis added).

[39] *Id.* ¶ 83. *See also, e.g.,* Notice of Proposed Rulemaking, *Separation Of Costs Of Regulated Telephone Service From Costs Of Nonregulated Activities; Amendment Of Part 31, The Uniform System Of Accounts For Class A And Class B Telephone Companies, To Provide For Nonregulated Activities And To Provide For Transactions Between Telephone Companies And Their Affiliates,* 104 F.C.C. 2d 59, ¶ 46 (1986) ("We do not include revenues [as a cost allocator]

Revenue-based cost allocations are also distorted by arbitrary pricing fluctuations that naturally occur in competitive marketplaces, regulatory pricing adjustments (often based on public policy that have nothing at all to do with costs), and other non-cost-causative factors. The State Members themselves recognize this, and they affirmatively disavow any "general support for jurisdictionally assigning costs based on revenues."[40]

The State Members likewise provide additional examples of how their allocation proposals would misallocate costs: with respect to their proposal for allocating Cable and Wire Facilities ("C&WF") costs to subcategories, the State Members explain that "there is a difference between billed lines and engineering loops. For example, under our proposal a customer's line would be assigned to subcategory 1.4 if the customer ordered both voice and data. This would be true even if the carrier actually provides the service using two separate loops. Similar inaccuracies could arise within subcategories 1.5 through 1.7."[41]

As discussed above, the State Members' proposal would bring reported special access costs *closer* to reality, and would certainly eliminate arguments made frequently in the special access proceedings that service category-specific special access "returns" are high. The State

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because revenues measure only the ability of an activity to bear costs, and not the amount of resources used by the activity."); Report and Order, *Separation Of Costs Of Regulated Telephone Service From Costs Of Nonregulated Activities; Amendment Of Part 31, The Uniform System Of Accounts For Class A And Class B Telephone Companies, To Provide For Nonregulated Activities And To Provide For Transactions Between Telephone Companies And Their Affiliates*, 2 FCC Rcd. 1298, ¶ 160 (1987) ("We will not accept the Centel argument that revenues be included as a factor in computing the general allocator. Centel has not provided any argument to controvert the NPRM's argument that 'revenues measure only the ability of an activity to bear costs, and not the amount of resources used by the activity.'"); *see also* Interim Proposal at 14 (recognizing that "[u]nder this proposal a carrier could invest in advanced services; yet it would not experience a shift in costs assigned to the interstate jurisdiction until its customers actually begin to buy the advance services made possible by the new investment").

[40] *Id.* at 8.

[41] *Id.* at 12.

Members' analysis is consistent with similar findings by the National Regulatory Research Institute ("NRRI"), which showed that a revenue-based cost allocation would dramatically increase reported special access costs relative to the current allocations (and thus dramatically reduce any service category-specific "returns" calculated using ARMIS data).[42] But as the State Members themselves concede, there are many additional problems with the current ARMIS data that their proposal does not even purport to address,[43] and as AT&T has previously shown, these sorts of "back of the envelope" revenue-based adjustments do not adequately "correct" for the flaws in the current allocations.[44] In all events, given the Commission's prior findings that such allocations serve no regulatory purpose, there can be no legitimate justification for saddling carriers and the Commission with the costs of implementing new procedures merely to obtain "less inaccurate" results.

The State Members' Cable and Wire Facility proposal is, if anything, even more arbitrary than its special access proposal. First, the State Members claim that the "major factor" affecting overall cost assignment is the "25% basic allocator for local loop facilities assigned to C&WF category 1.3," and that there is now a need to change this basic allocation factor to account for "significant changes" in the nature of local plant.[45] What the State Members ignore, however, is that the 25% allocator, which was adopted in 1986, has *never* been a cost-based allocation nor

[42] National Regulatory Research Institute, *Competitive Issues in Special Access Markets* (rev. ed. 2009), at 71 ("No adjustment technique is available to us that could match the accuracy of direct assignment studies actually performed by the carriers themselves").

[43] Interim Proposal, at 9 ("We further clarify that our proposal here is not intended to address all areas where special access related separations reform is needed," and "we recognize that our interim proposal does not address a variety of issues on this point").

[44] Comments of AT&T Inc., *Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25, at 67-72 (filed Jan. 19, 2010); *id.*, at attached Declaration Of Ron Hilyer And Thomas Makarewicz On Behalf Of AT&T Inc., ¶¶ 20-36.

[45] Interim Proposal, at 10.

has it ever been based on actual intrastate usage of loops, but instead has always been a somewhat arbitrary, policy-laden allocation designed to further broader Commission policies, especially universal service.[46] Any reconsideration of that allocator, therefore, raises broad policy issues that go well beyond the State Members' stated concerns, and indeed, would likely need to be aired before the Federal-State Joint Board on Universal Service as well.

Moreover, the subcategories that the State Members propose are arbitrary. Under their proposal, carriers would reclassify loops as "voice," "data," or "video," or some combination, but these categories are completely arbitrary. Indeed, the very technological and market forces that are "changing the nature of loop plant" are also blurring and dissolving the lines between "voice," data," and "video" – these categories are losing discrete meaning in an increasingly IP-based world.

The State Members' proposal also arbitrarily treats costs differently depending on whether the service is provided through an affiliate or at wholesale to a third party retailer. Under the State Members' proposal, when classifying a loop, a carrier would be forced to look across *all* of its affiliates, to determine all of the uses that any of its affiliates are making of that loop. So, for example, if the ILEC is providing the use of a loop to an unregulated video affiliate, the ILEC would have to include video in its classification and record the costs of the loop a certain way. But if the ILEC provided use of the loop to an *un*-affiliated company, which used it to provide video, the ILEC would record the costs of the loop a different way – even though the uses of the loop were identical. This differential treatment, however, would be discriminatory and lead to competitive imbalances.

[46] Report and Order, *Federal-State Joint Board on Universal Service*, 4 FCC Rcd 6773, ¶ 8 (1997) ("The allocation of those costs to the interstate jurisdiction is fixed at 25 percent, or at a transitional step toward that level, and thus is unrelated to actual interstate usage.")

The State Members are also jumping the gun on a number of other broader, important issues, and its proposal would pre-judge the answer to a number of questions that the Commission itself has not considered or answered. For example, the proposal simply assumes regulatory classifications of unregulated interstate services, even though the Commission has not definitely ruled on the regulatory classification of such services. Here again, the State Members' proposals have far broader ramifications that the Members' relatively narrow set of concerns.

Finally, the actual percentage allocations that the State Members would assign to each of these services is purely arbitrary. The State Members offer no analysis or support whatsoever for the allocations they have picked, and indeed, their chosen percentages are unsupported. Although courts have recognized that there will inevitably be some arbitrariness to any choice such as this involving a specific number or line, an agency cannot simply pick a number out of hat, and the State Members have offered the Joint Board no basis on which to recommend these percentages.[47]

B. Adopting The State Member's Proposal Would Place Significant New Burdens On Carriers And The Commission.

Given that the State Members' revenue-based cost assignment proposal would serve no regulatory purpose (as shown in Part I, *supra)* and could not produce meaningfully accurate cost assignments, it should be rejected even if its implementation would impose little or no burden on carriers. In reality, however, the State Members' proposal would be extraordinarily burdensome – for both carriers and the Commission – providing yet another reason for the Joint Board to reject it. Moreover, the notion that the State Members' Interim Proposal could be implemented

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[47] *See, e.g., Owner-Operator Independent Drivers Association, Inc.* v. *Federal Motor Carrier Safety Administration,* 494 F.3d 188, 204 (D.C. Cir. 2007) (agency's "decision to plot the data point for Hour 13 and beyond at Hour 17 – instead of at Hour 13 (or some other point) – was entirely unexplained in the RIA and final rule. This complete lack of explanation for an important step in the agency's analysis was arbitrary and capricious.").

prior to July 1, 2010 is a fantasy, and could be accomplished, if at all, only if carriers were to reallocate extraordinary amounts of their scarce resources away from their ordinary business of expanding broadband, wireless and other offerings to the task reallocating the costs in their regulatory books in a manner that would not make them accurate or have any impact on any rate or any federal or state initiative.

The State Members' Interim Proposal for reallocating Cable and Wire Facility (C&WF) costs starkly illustrates the extraordinary burdens its implementation would impose. Under the proposal, the Commission would adopt new rules to create new subcategories for C&WF, for a total of eight such subcategories (*e.g.*, voice only lines, voice and data lines, voice and video lines, data and video lines, and so on). Carriers would then be required to examine their bills and determine which lines go in which subcategory.

Enormous resources would be required to implement this proposal. AT&T serves approximately *50 million* lines. Therefore, even if AT&T maintained a central database of billing information for each line and even if these bills all clearly identified the categories of the proposed service breakdowns, the State Members' Proposal would require AT&T to deploy substantial resources and employees to developing new systems that could mechanically extract the necessary data from the bills for each of the 50 million lines. But in fact AT&T sells, provisions, and bills lines through several different affiliates and through multiple organizations within each affiliate. Consequently, AT&T's billing data is spread throughout multiple incompatible databases, among different affiliates and different organizations within each affiliate. Any attempt to categorize AT&T's 50 million lines, therefore, would require AT&T to invest considerable resources to develop brand new systems and processes capable of extracting the proposed data from these many disparate databases. The complexity of this task is further complicated by the fact that many of AT&T's billing records for its 50 million lines are not organized into the neat subcategories in the State Members' Proposal, which would require further investments in new teams to create special studies for these purposes. There would also be considerable cost to maintain these systems, as carriers change service offerings and add new ones each year.[48]

The State Members' proposal also would impose very significant burdens and costs on the Commission. Every carrier has different billing systems, and each carrier would have to devise a method to map the lines billed in those systems to the C&WF subcategories proposed by the State Members' Proposal. Left to their own devices, each carrier inevitably would adopt a different approach, creating the potential that carriers would be allocating lines, and hence costs, with significant differences. Moreover, to the extent that these new allocation procedures affect a particular carriers' rates or other regulatory obligations (as explained above, they would have no such impact on AT&T), carriers would have strong incentives to artificially allocate lines and revenues to regulated services so as to inflate the costs being allocated to those services, which in turn will justify higher rates or government support.[49]

To address these issues, the Commission would have to adopt new rules and regulations governing precisely how carriers are to map their billed lines into the proposed C&WF categories, and adopt audit and enforcement procedures for doing so, thus imposing significant burdens on both the Commission and carriers that would have to work together to develop such

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[48] *Accord* Interim Proposal, at 11 ("Because the [allocation] method [it proposes] uses input information derived directly from billing records, and because advanced service take rates can change rapidly, we recommend that the following adjustments be performed every year, even if the freeze continues").

[49] *Accord Id.* at 8 ("Our proposal should not be viewed as general support for jurisdictionally assigning costs based on revenues. This method might not be reasonable on a long-term basis, given the potential to game cost assignments through rate adjustments").

rules, regulations and enforcement procedures, as well as additional burdens on the Commission, which would have to implement them.

The State Members claim that their proposed allocation methods are only a "safe harbor" and that if the carriers or Commission believe that the proposed procedures would produce excessively inaccurate results or are overly burdensome, carriers are "free" to instead "make a one-time adjustment to their separations factors using direct assignments based on an analysis of the actual uses of plant and using pre-freeze separations rules."[50]

Foremost, the Commission has expressly recognized that pre-2001 allocation procedures were fundamentally flawed.[51] Indeed, it was precisely because of those recognized flaws that the Commission decided to adopt the freeze in the first place while it conducted proceedings to revise those flawed allocation procedures.[52] Thus, the State Members' proposal that the Commission essentially reinstate those allocation procedures and adopt its proposal as a "safe harbor" is, frankly, absurd; it is literally a proposal that the Commission adopt procedures that it

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[50] *Id.* at 9. *See also id.* at 12 ("use of billing records to populate subcategory line counts would be a 'safe harbor.' Carriers would have the option of performing an actual study of line usage to determine allocation of lines within subcategories 1.3 to 1.7 if they believed the safe harbor approximation is unreasonable. A state commission or the FCC could also direct that a carrier complete such a study if either believed the safe harbor approximation is unreasonable in a particular case.").

[51] *See, e.g.*, Notice of Proposed Rulemaking, *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, 12 FCC Rcd. 22120, ¶¶ 12-13 (1997) (it is necessary to undertake a "comprehensive review" of the allocation rules, given that telephone networks had "changed substantially since the jurisdictional separations rules were first established in 1947" and that "[t]he introduction of new network control technologies changes the way services are delivered and thus calls into question the validity of the service distinctions specified in the separations rules.").

[52] Report and Order, *Jurisdictional Separations and Referral to the Federal-State Joint Board*, 16 FCC Rcd. 11382, ¶ 1 (2001) (freezing separations allocations at 2001 levels because the then-existing cost allocation rules were "outdated regulatory mechanisms that are out of step with today's rapidly-evolving telecommunications marketplace.").

found to produce grossly inaccurate results and to be overly burdensome more than ten years ago – those assignment procedures have only become less accurate since then.

Moreover, implementing those decades-old procedures would be extremely burdensome. As a result of the 2001 freeze, AT&T and other carriers were no longer required to maintain the personnel and systems necessary to implement the pre-freeze direct assignment requirements. Consequently, any attempt to conduct such studies today would require carriers to divert employees to that task and to create – virtually from scratch – entirely new direct allocation studies and systems that are compatible with their much changed and expanded infrastructure. As the State Members ultimately must concede: "Many carriers no longer have employees with experience in performing such studies. Given the short time prior to expiration of the freeze, we do not believe it is realistic to propose that such studies be required in 2010."[53]

In all events, the State Members' proposal fails to acknowledge that, in 2008, the Commission expressly found that even applying the frozen 2001 separations allocation rules was overly burdensome and served no legitimate purpose, and thus granted forbearance from continued compliance with those allocations procedures for AT&T and others.[54] Any recommendation by the Joint Board to have the Commission require carriers to adopt the far more complex, costly and inaccurate allocation procedures that existed prior to the 2001 freeze

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[53] Interim Proposal, at 7.

[54] *See* Memorandum Opinion And Order, *Petition of AT&T Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules; Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160 From Enforcement of Certain of the Commission's Cost Assignment Rules*, 23 FCC Rcd. 7302, ¶ 44 (2008) ("we conclude that the Cost Assignment Rules pose significant adverse consequences – in terms of competition and financial costs – that outweigh any potential benefits of enforcing the Cost Assignment Rules against AT&T, given the protections afforded to consumers and competition by remaining safeguards and conditions. Thus, we find that the likely savings to AT&T by elimination of the rules, in conjunction with AT&T's compliance with our remaining rules and conditions, including the price cap rules, supports a finding that forbearance from the Cost Assignment Rules at this time is in the public interest.").

could not be reconciled with the 2008 Forbearance Order and would have to be rejected by the Commission.

CONCLUSION

For the foregoing reasons, the Joint Board should not recommend further consideration of the State Members' Interim Proposal.

Respectfully submitted,

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April 29, 2010

CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 2010, I caused true and correct copies of the forgoing Comments of AT&T Inc. to be served the following persons by email.

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