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

Tariff Filing by	)	
800 Service Management System Transmittal No. 22 (SMS/800) Functions	)	Transmittal No. 22
Tariff F.C.C. No. 1	)	

PETITION OF AT&T CORP.

Pursuant to Section 1.773 of the Commission's rules, 47 C.F.R. § 1.773, AT&T Corp. ("AT&T") submits this petition requesting the Commission to reject or suspend and investigate the above-referenced tariff filed by BellSouth Telecommunications, Inc., SBC Communications, Inc., Qwest Corporation, and Verizon communications, Inc. (collectively the "Bell Operating Companies" or "BOCs") on November 15, 2002 in their role as administrators of the distribution of toll-free numbers.

The transmittals filed by these BOCs on November 15, 2002 propose to substantially increase the monthly charge paid by carriers to recover the costs of administrating the distribution of toll-free telephone numbers (*e.g.,* 800, 888, 877, and 866 numbers). The primary explanation offered by the BOCs for this substantial rate increase is that demand for toll-free numbers will fall, and that the costs of administrating those numbers must therefore be spread over fewer records.[1] This claim does not withstand scrutiny.

[1] D&J at 1, 4.

As demonstrated by the BOCs' own data, there has been a long-term *upward* trend in demand for toll-free numbers. To be sure, there was a slight decline in demand for toll-free numbers a few months ago, but that drop appears to have been influenced heavily by adjustments made by a single carrier (WorldCom) and, in light of gross domestic product ("GDP") and other forecasts that the current recessionary phase is ending, there is no reason to expect any sustained or long-term decline in the demand for toll free numbers. In fact, the demand for toll-free numbers in more recent months – which, oddly, are not reflected in the data used by the BOCs to estimate future demand – shows that demand for toll free numbers has, indeed, resumed its upward trend.

Notwithstanding the fact that demand for toll-free numbers is continuing its upward trend, the BOCs purport to have conducted a statistical study showing that demand for toll-free numbers will decline. That analysis contains many methodological and application flaws. But the Commission need not resolve methodological disagreements to recognize that this tariff must be rejected or suspended. Real world data confirms that the BOC study cannot rationally be relied upon as a valid predictor of future demand, because recent data shows that the demand forecasts produced by the BOC's statistical study are not accurate. As noted, the BOC's statistical study was based on historical data ending in August 2002, and contains monthly demand forecasts from September 2002 through December 2004. The actual data for September 2002 through October 2002 (and part of November 2002) are now available and show that the BOCs' demand estimates for these months grossly misstate actual demand. Thus, there is no question that the BOCs' demand forecasts are erroneous and cannot reasonably be relied upon to implement the proposed massive rate increases.

The other principal reason cited for the rate increase is an "anticipated increase in operating expenses (bad debt) for services provided to bankrupt Responsible organization."[2] The BOCs provide no evidence or other basis to justify this bad debt-related increase, and instead rely solely on two sentences claiming that "bankrupt" Responsible Organizations ("RespOrgs") have increased the BOCs' actual bad debt. These two sentences fall far short of the showing required under the Commission's rules to justify such an increase. In fact, like their access operations, the BOCs' are already protected in providing their SMS services from any serious risk of non-payment by RespOrgs through existing tariff provisions that allow the BOCs to collect security deposits from carriers that present unusual risks of non-payment (*i.e.,* those with a proven history of nonpayment or with no established credit).

Moreover, the BOCs' transmittal is expressly designed to recover its rate increase from *all* customers. This would be patently unreasonable even if the BOCs had shown an increased risk of non-payment from certain carriers, because it would require carriers that pose little or no financial risk to pay inflated rates for the risks posed by other carriers. Of course, the generalized harm to customers – and, ultimately, consumers – is even greater considering that non-payment risks have certainly been exaggerated.

Finally, the BOCs' claims that rate increases are necessary are not substantiated by any evidence that the BOCs' returns on the provisioning of toll-free numbers are declining or would become inadequate if the demand decreases and bad debt increases they assume had some basis

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[2] D&J at 1; *see also* D&J at 2.

in reality. On this record, the BOCs' transmittal should be rejected or, at a minimum, suspended for five months and investigated.[3]

I. THE BOCs HAVE NOT DEMONSTRATED THAT THE DEMAND FOR TOLL-FREE TELEPHONE NUMBERS WILL DECLINE MATERIALLY DURING THE NEXT TWO YEARS.

The BOCs' primary justification for raising the monthly charge for administering toll-free numbers is that projected demand declines require the BOCs to recover the costs of administering toll-free numbers over fewer records.[4] According to the BOCs, the demand analyses they filed last May – on which their current rates are based – are unreliable because those analyses are based on the long-term trend in demand for toll-free numbers.[5] Instead, the BOCs contend, rates should be set based only on very recent trends. The BOCs concede, however, that short term trends may be temporary[6] – much like previous temporary dips in demands for toll free numbers, which were followed by continued and substantial growth in demand.[7] And the BOCs have failed to demonstrate that the recent few month "blip" in toll-free number demand is anything but temporary.

In this case, examination of the underlying data confirms that the recent dip in demand for toll-free numbers was indeed a one-time phenomenon that should have no impact on future demand for toll-free numbers. In particular, those data show that the recent dip in demand was caused almost entirely by a single carrier – WorldCom – that apparently was making very large

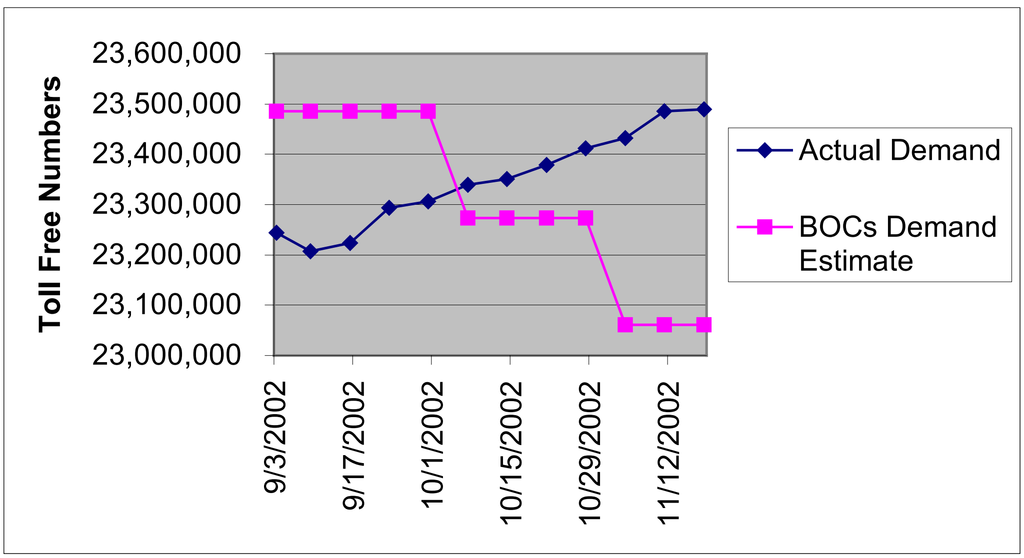
[3] A tariff is subject to rejection when it is *prima facie* unlawful, in that it demonstrably conflicts with the Communications Act or a Commission rule, regulation or order. *See*, *e.g.*, *American Broadcasting Companies, Inc. v. AT&T*, 663 F.2d 133, 138 (D.C. Cir. 1980); *MCI v. AT&T*, 94 F.C.C.2d 332, 340-41 (1983). Suspension and investigation are appropriate where a tariff raises substantial issues of lawfulness. *See Suspension Order* at 2.

[4] D&J at 1, 4.

[5] D&J, Attachment A at 2.

[6] D&J at 4.

and uncharacteristic adjustments in the wake of its accounting-related reorganization. Last March (2002), WorldCom's demand for toll-free numbers began to decline – between February and March, WorldCom's demand for toll-free numbers declined by about 1 million numbers. Since then, the dip in WorldCom's demand for toll-free numbers has been offset by large increases in demand by other carriers. Indeed, as of October, WorldCom's demand reductions had been almost completely offset by increases in demand by other carriers, and the trend in demand for toll-free numbers has resumed its upward trend. The chart below demonstrates that the weekly demand for toll free numbers from September through the third week in November has resumed its upward trend.



It is not surprising therefore that the BOCs' demand predictions, which predict future demand based on limited data that is heavily influenced by one-time events, produces demonstrably wrong results. As the Chart demonstrates, the BOCs' demand projections

[7] D&J at 3.

significantly understate demand for October and November. Given that it is now known with certainty that the BOCs' statistical analyses do not produce accurate results, those analyses cannot be used as a basis for the massive rate increases contained in the BOCs transmittal.

Even if existing data did not already conclusively show that the BOCs' predictions of future demand are wrong, the Commission still would have to reject the BOCs' predictions because they are based on flawed and largely undocumented statistical analyses. As a preliminary matter, the BOCs' description of how they ultimately chose the statistical model on which they rely strongly indicates a "results oriented" approach. The BOCs first assert that they tried to predict demand for toll-free numbers using a structural model. The benefit of a structural model is that it uses independent (or "explanatory") variables to explain changes in the dependent variable, which in this case is demand for toll-free numbers. Once an appropriate set of explanatory variables is identified, future predictions of the explanatory variables can be used to predict future trends in the dependent variable.

The BOCs rejected the use of a structural model, because, according to the BOCs, the only explanatory variable they could identify that produces statistically significant results was Gross Domestic Product ("GDP").[8] However, the BOCs contend, after correcting for a statistical characteristic of GDP (called autocorrelation), GDP could not predict demand for toll-free numbers in a statically significant fashion.[9]

The BOCs' explanation for rejecting a structural approach does not withstand scrutiny. Many economic statistics – like demand for toll-free numbers – cannot be explained in any

[8] D&J at 7-8.

[9] D&J at 9.

statistically significant way using only *one* explanatory variable. Accordingly, it is common practice for statisticians and econometricians to use multi-variable structural models to make predictions about economic statistics. In other words, although there may be no *single* statistically significant variable that can be used to model demand for toll-free numbers, there may be a combination of variables that can provide statistically significant estimates of demand for toll-free numbers.[10] In this regard, it appears that the BOCs set up their tests to ensure that no structural model they examined would produce statistically significant results.

There are also other indications that the BOCs intended for the structural approach to fail. For example, although the BOCs had access to monthly demand data, they chose to use only quarterly demand data to estimate their structural model. In other words, even though the BOCs had access to 36 data points for the three year period, they used only 12 of those data points to assess whether a structural model produced statistically significant results. The BOCs attempt to justify disregarding 24 data points by asserting that "[b]ecause data typically contain random elements, projections tend to become less reliable with the umber of periods forecasts."[11] But the BOCs provide *no evidence* that this is a real constraint here.

There also is evidence that the BOCs had a strong incentive to set up the analysis in such a way that would ensure the rejection of a structural model approach. The BOCs concede that demand for toll-free numbers should be highly correlated with general economic factors. Many general economic statistics have shown significant improvements during the past several months, and many of those variables are predicted to improve significantly in the next few years. For

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[10] The BOCs did not even consider a multi-variable structural model, rather they relied exclusively on an "Ordinary Least Squares" methodology, which uses only a single explanatory variable. Moreover, the problems identified by the BOCs that allowed them to reject the use of GDP as an explanatory variable are consistent with a model that wrongly excludes important other explanatory variables.

example, government projections estimate that gross domestic product likely will continue its upward trend at least through the end of 2003.[12] A properly designed structural model would therefore very likely support a prediction that the demand for toll-free services also will continue to rise.

After rejecting the use of all structural models based on analyses of only a few single variable structural models, the BOCs endorse a time series model. Time series models are designed to detect trends in a variable's history and use those trends to predict the future levels of those variables. A pure time series approach is most reliable when applied to a sample of data drawn from a period where the underlying process governing the relevant variables operates consistently. If this criteria does not hold, the model forecasts may be extremely unreliable. In particular, because time series models rely primarily on past values of the variable being estimated, the results of those models can be very sensitive to the time periods used in the model. And that appears to be why the BOCs ultimately chose to rely on a time series model.

The BOCs' time series model relies on three years of data, from August 1999 through August 2002. Tellingly, the BOCs do not inform the Commission as to what the results of their time series analyses would have been if they had chosen different historical data. And AT&T's preliminary analyses confirm that the model forecasts are enormously sensitive to the chosen time period and may vary by 50 percent or more depending upon the length of the past period used in the series.

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[11] D&J at 6.

[12] *See, e.g.,* <http://www.eia.doe.gov/emeu/steo/pub/1tab.html>.

The BOCs' own discussion confirms that there was no legitimate reason to rely on three years of data rather than some other time period. Because time series techniques predict current and future values on the strength of the dynamics of past values, any change in the underlying mechanism controlling the variables in question renders the prediction unreliable. The BOCs invoke this principle when they explain their choice of a three year sample period by appealing to the business cycle.[13] They suggest that the dynamics of demand for toll free numbers will be different in a recessionary phase of the cycle than in a growth phase. But this does not explain why they chose a sample that extends from the fourth quarter of 1999 through the third quarter of 2002, which includes both the recessionary phase and the growth phase. In fact, the BOCs sample is divided exactly evenly between six quarters of growth and six quarters of recession. Moreover, the BOCs provide no justification for predicting recession through the fourth quarter of 2004; leading indicators and forecasts suggest otherwise. And they fail to make any adjustment at all for the anomalous WorldCom influences on data points.[14]

In this regard, it is notable that conspicuously absent from the BOCs' transmittal is a summary of all of the underlying assumptions used in the time series analysis. Because the results of a time series analysis are very sensitive to the underlying assumptions used to compute those analyses, it is critical that the Commission and third parties have access to those assumptions to further assess whether the BOCs' time series analysis was properly performed, and not designed to produce a desired result.

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[13] D&J, Attachment A at 6.

[14] The BOCs also provide no explanation for relying only a total toll free numbers rather than on *working* toll free numbers. Total toll free numbers reflect numbers that have been disconnected, but not yet returned to the pool. Therefore, working numbers may be a better predictor of actual demand for toll free numbers.

In all events, as noted, there is no question that the BOCs' time series analyses does not accurately predict future demand for toll-free numbers, because recent data shows that the BOCs' predictions are not remotely accurate. On this basis alone, the Commission should reject the BOCs transmittal, or at least suspend the tariff and open and investigation seeking appropriate new forward-looking demand estimates.

II. THE BOCs' INCREASE IN BAD EXPENSE IS ENTIRELY UNJUSTIFIED.

Just a few months ago, on May 31, 2002, the BOCs filed their annual tariff filing for SMS, and at that time, they did not appear to claim that *any* significant increase for an uncollectible reserve was necessary. The BOCs never explain what has happened since that filing only a few months ago that led them to reevaluate uncollectibles requirements and to request a *$5 million* rate increase due to an "anticipated increase in . . . bad debt."[15] Indeed, even though the BOCs are well aware that the Commission's Pricing Division is conducting an ongoing investigation of individual tariffs filed by three of the BOCs (and other incumbent LECs) that seek broad and virtually unlimited discretion to impose security deposits and other unfavorable credit terms on access customers, out of an alleged fear of increased bad debt, the BOCs provide none of the categories of data that the Pricing Division has requested in those proceedings. In fact, the BOCs offer almost no explanation at all for why they anticipate such a massive increase in bad debt expense. The entirety of their justification for their new $5 million bad debt revenue requirement is that it includes "an *estimated* monthly expense of $455,000 for services provided to bankrupt RespOrgs (bad debt) during the prospective period of November 30, 2002 through June 14, 2003. Actual bad debt expense during the first nine months of 2002

[15] D&J at 1.

averaged $671,500."[16] This is patently insufficient under the Commission's tariff rules (*see* 47 C.F.R. § 61.83) – and is all the more troubling because the BOCs retain strong incentives to increase these rates, and, unless the tariff is suspended, the ability to act on those incentives to harm interLATA competition.

The BOCs fail to provide any evidence to back up their claims about their bad debt expense for 2002 (or to compare it with prior levels of bad debt). Thus, nothing shows how the BOCs calculated the alleged $600,000 in monthly bad debt for the first seven months of 2002. The term "bad debt" has no standardized meaning, and the BOCs fail to specify what categories of non-payments were included in that figure. In particular, although the BOCs state that the estimated prospective amount is for "bankrupt" RespOrgs, the BOCs do not say whether their past bad debt figure for 2002 includes only bankrupt entities, or any entity that the BOCs claim has not paid. And with respect to claims against bankrupt RespOrgs, the BOCs do not state whether their figures include both pre-petition and post-petition debts. Moreover, since many bankruptcy proceedings for RespOrgs remain open, it is not clear how much the BOCs expect to collect (or have collected) from any bankrupt RespOrgs. And the BOCs never explain why they were not aware of any alleged increases in bad debt sooner. To be sure, the telecommunications industry has experienced a downturn, but that fact has been evident for quite some time. A number of the RespOrgs that are in bankruptcy – such as Global Crossing, McLeod, and Netlink 2000 – filed well before the BOCs' May 31, 2002 tariff filing. Nothing in recent events could possibly provide a valid basis for the BOCs' reassessment, after just a few months, of their revenue requirement to increase it by $5 million.

[16] D&J at 2.

In addition, and regardless of the timing of the BOCs' request, their rate increase must be denied because the BOCs provide no explanation for how they "estimated" the "prospective" bad debt for the next 7 months, and no evidence that their uncollectibles will, in fact, increase. As AT&T and others have demonstrated in objecting to prior incumbent LEC tariff transmittals relating to uncollectibles expense, there simply is no BOC bad debt "crisis." Although WorldCom and Global Crossing have filed large bankruptcies, those companies' difficulties apparently resulted from massive – and unprecedented – accounting fraud that masked their financial problems long after they would otherwise have been evident. The BOCs' other customers can hardly be painted with WorldCom's and Global Crossing's unusual circumstances.[17]

The BOCs provide *no* information to support claims that they will be unable to collect in late 2002 and through June 2003 from remaining RespOrgs. Indeed, it seems likely that, as with the BOCs' access operations, the BOCs generally enjoy low levels of bad debt for their SMS.[18] And, in fact, the BOCs *already* receive sufficient protection from the risks of nonpayment by customers, because their existing tariff has long permitted them to demand security deposits from customers that have filed for bankruptcy, that have a proven history of late payments, or that have no established credit. *See* SMS Tariff FCC No. 1, § 2.4.1(B). With regard to the BOCs' access operations, that tariff language has been sufficient for years to protect the BOCs from non-payment risks, even in prior unfavorable economic circumstances. Under these circumstances, any assertion that the BOCs face increased risk of bad debt is purely speculative.

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[17] And, in all events, the BOCs can and are pursuing their Bankruptcy Code rights to adequate assurance of payment from WorldCom and other bankrupt customers.

[18] As AT&T has shown, the BOCs and incumbent LECs generally experience bad debt levels of less than one percent for their access customers.

The BOCs' transmittal is also unreasonable because, although the BOCs purport to justify it by pointing to problems posed by bankrupt entities and customers that in the future may be unable to pay, their tariff revisions at issue here are not directed at bankrupts or even at deadbeats, but at *all* ratepaying customers, even those with impeccable credit. Even if the BOCs could show truly increased levels of bad debt expense, this transmittal does not represent a limited, specified, and reasonable measure to recover the costs of bad debt caused by customers that can be demonstrated, by objective criteria, to present actual and unusual risks of nonpayment. Rather, the Transmittal openly seeks to require *all* customers to pay increased rates. That result would be unreasonable even if the non-payment risks faced by the BOCs' carriers were substantial. But because the BOCs have provided no evidence of any actual bad debt crisis, this transmittal will simply result in increased rates for customers, and higher rates of return for the BOCs.

Given the complete lack of evidence to support the $5 million increase – particularly when just months ago the BOCs did not seek any increase in their revenue requirement for bad debt expense – the Transmittal must be rejected.

CONCLUSION

For the foregoing reasons, the Commission should reject or suspend and investigate the BOCs' tariff filing.

Respectfully Submitted,

AT&T CORP.

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November 22, 2002.

CERTIFICATE OF SERVICE

I, Peter Andros, do hereby certify that on this 22nd day of November, 2002, a copy of the foregoing "Petition of AT&T Corp." was served by facsimile and U.S. first class mail, postage prepaid, on the parties named below.

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November 22, 2002