SIDLEY AUSTIN BROWN & WOOD LLP

CHICAGO
DALLAS
LOS ANGELES
NEW YORK
SAN FRANCISCO

1501 K STREET, N.W.
WASHINGTON, D.C. 20005
TELEPHONE 202 736 8000
FACSIMILE 202 736 8711
www.sidley.com

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BEIJING
GENEVA
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LONDON
SHANGHAI
SINGAPORE
TOKYO

WRITER'S DIRECT NUMBER
(202) 736-8689

WRITER'S E-MAIL ADDRESS
cshenk@sidley.com

April 10, 2003

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 Twelfth Street, S.W.
12th Street Lobby, TW-A325
Washington, D.C. 20554

Re: Iowa Telecommunications Services, Inc., ATS Rate Revision, F.C.C. No. 1, Transmittal No. 31

Dear Ms. Dortch:

It has come to AT&T Corp.'s ("AT&T") attention that AT&T, in its opposition to the above captioned tariff, inadvertently included one number in its public filing that Iowa Telecommunications Services Inc. designated as "Confidential." AT&T has requested, and the Commission Staff has agreed, to remove AT&T's prior filing from the public record. At the Commission Staff's request, AT&T hereby files the attached "Redacted For Public Inspection" version of its opposition to the above captioned tariff.

Respectfully submitted,

/s/ Christopher T. Shenk
Christopher T. Shenk

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Iowa Telecommunications Services, Inc. ATS Rate Revision	)	Transmittal No. 31
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 addressed to the annual interstate access tariff filed March 25, 2003 by Iowa Telecommunications Services ("Iowa Telecom").

Iowa Telecom seeks a fifty-six percent increase in its traffic-sensitive interstate access charges. Although Iowa Telecom claims that such an increase is necessary to bring its rates in line with forward-looking economic cost ("FLEC"), as demonstrated below, even a cursory glance at its supporting materials reveals significant omissions as well as numerous assumptions and errors that would be inconsistent with any reasonable measure of Iowa Telecom's FLEC-based rates. Accordingly, the Commission should reject or, in the alternative, suspend Iowa Telecom's tariff and set it for investigation.[1]

[1] A tariff is subject to rejection when it is *prima facia* 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 AT&T* (Transmittal No. 148), Memorandum Opinion and Order, 56 RR2d 1503 (1984); *ITT* (Transmittal No. 2191), 73 F.C.C.2d 709, 716 n.5 (1979) (citing *AT&T*, 46 F.C.C.2d 81, 86 (1974)).

This tariff is filed pursuant to the Commission's order granting Iowa Telecom forbearance from the $0.0095 rate for traffic-sensitive interstate access services that would otherwise apply to Iowa Telecom under the *CALLS Order*.[2] In the *CALLS Order*, the Commission gave price cap carriers a choice of two regulatory regimes. The first was the CALLS Plan itself, in which an X-Factor of 6.5 percent is applied and targeted to traffic-sensitive rates until a pre-determined target average traffic-sensitive (ATS) rate is reached, at which point the X-Factor is set equal to GDP-PI. *See CALLS Order* ¶ 161. Under the second, alternative regime, a carrier would "submit a cost study based on forward-looking economic costs," which would result in "the LEC's rates being reinitialized to the appropriate level as indicated by the study and then made subject to a price cap plan and X-Factor that we would determine." *CALLS Order* ¶ 59.

In forbearing from enforcing the $0.0095 rate, the Commission in effect permitted Iowa Telecom to opt for the other alternative offered to carriers under the *CALLS Order* – to establish a new rate for traffic-sensitive services based on forward-looking economic cost ("FLEC").[3] As the Commission explained, "[u]pon filing of a tariff, supported by a forward-looking cost study, we will undertake a tariff investigation to determine Iowa Telecom's forward-looking ATS target rate for the remainder of the CALLS plan's five

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[2] *See Petition for Forbearance of Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom Pursuant to 47 U.S.C. § 160(c) from the Deadline for Price Cap Carriers to Elect Interstate Access Rates Based on the CALLS Order or a Forward Looking Cost Study*, Order, CC Docket No. 01-131, FCC 02-323 (rel. Nov. 26, 2002) ("*Iowa Forbearance Order*"); *Access Charge Reform*, CC Docket Nos. 96-262, Sixth Report and Order, 15 FCC Rcd. 12962 (2000) ("*CALLS Order*"); 47 C.F.R. § 61.3(qq)(2) (establishing $0.0095 rate for carriers such as Iowa Telecom).

[3] The Commission's forbearance order differs from the CALLS alternative, however, in that the Commission decided not to impose an X-Factor on Iowa Telecom. *See Iowa Forbearance Order* ¶ 22. AT&T has filed a petition for reconsideration on that aspect of the Order, which is still pending.

year term."[4] The Commission also emphasized that "Iowa Telecom's decision to set its ATS rate based on forward-looking costs is binding regardless of the outcome of the tariff investigation." *Id.*

The need to investigate Iowa Telecom's new ATS tariff is further confirmed by the numerous deficiencies in that filing. Foremost, the tariff filing contains insufficient documentation to assess fully the extent to which it violates fundamental forward-looking economic cost principles. The tariff filing contains only a high-level discussion of the methodologies used to develop the cost studies, and provides little (and often none) of the underlying data to allow the Commission or third parties to verify Iowa Telecom's cost estimates. These omissions are especially relevant here, where nearly every methodology and model relied upon by Iowa Telecom is new, and has never been reviewed by the Commission or third parties. But even with the scant amount of support provided by the Iowa Telecom, it is clear that the study violates many fundamental forward-looking principles. The following discussion will focus only on the few topics in the filing that contain adequate detail to at least begin to assess whether the Iowa Telecom study complies with fundamental forward-looking principles.

Depreciation. The asset depreciation lives assumed in Iowa Telecom's cost study reflect multiple fundamental forward-looking cost modeling violations. Iowa Telecom has chosen to not rely on the Commission's prescribed depreciation rates in its cost study, but has instead adopted GAAP depreciation lives, which generally are well outside the Commission's prescribed ranges (47 C.F.R. § 32). *NERA Study* at 11. This omission by itself confirms that the Iowa study is not a forward-looking study. The Commission's list

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[4] *Iowa Forbearance Order* ¶ 23.

of "Criteria for Forward-Looking Cost Determinations" explicitly states that "[e]conomic lives and future salvage percentages used in calculating depreciation expense must be within the FCC-authorized range." Report and Order, *Federal-State Joint Board On Universal Service*, CC Docket No. 96-45, ¶ 250 (rel. May 8, 1997) ("*Universal Service Order*"). By using GAAP depreciation lives rather than the Commission prescribed depreciation lives, the Iowa Model departs from forward-looking cost principles.

Because depreciation lives that fall outside the Commission's prescribed ranges are highly suspect, the Commission's access rules require LECs to first obtain a waiver if they choose to compute access rates based on asset depreciation lives that are different from the ranges prescribed by the Commission's Part 32 rules. *Depreciation Prescription Order* ¶ 25.[5] Iowa Telecom has not obtained such a waiver. Nor could it. Iowa Telecom has provided *no evidence* that its cost study complies with any of the pre-conditions that the Commission has deemed necessary to approving such a waiver. In particular, Iowa Telecom has not demonstrated that it "(1) adjusts the net book costs on its regulatory books to the level currently reflected in its financial books by a below-the-line write-off; (2) uses the same depreciation factors and rates for both regulatory and financial accounting purposes; (3) forgoes the opportunity to seek recovery of the write-off amounts through a low-end adjustment, an exogenous adjustment, or an above-cap filing; and (4) agrees to submit information concerning its depreciation accounts, including forecast additions and retirements for major network accounts and replacement

[5] Report and Order in CC Docket No. 98-137; Memorandum Opinion And Order In ASD 98-91, *1998 Biennial Regulatory Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers; United State Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers*, ¶ 48 (rel. Dec. 30, 1999) ("*Depreciation Prescription Order*").

plans for digital central offices." *Id.* (summarizing conditions that must be satisfied to depart from the Commission's prescribed depreciation lives). Having failed to satisfy these waiver conditions, the GAAP depreciation lives relied upon by Iowa Telecom must be rejected as forward-looking estimates.

Indeed, the Commission has been highly and rightfully suspicious of the use of GAAP depreciation lives as a substitute for depreciation lives that fall within the FCC's prescribed range:

> GAAP is guided by the conservatism principle which holds, for example, that, when alternative expense amounts are acceptable, the alternative having the least favorable effect on net income should be used. . . . [A]lthough conservatism is effective in protecting the interest of investors, it may not always serve the interests of ratepayers, and did not offer adequate protection for ratepayers in the case of depreciation accounting. . . . We believe that giving LECs the right to select, for regulatory purposes, any depreciation rate allowed by GAAP is inappropriate.

Depreciation Prescription Order ¶ 48. GAAP lives therefore are conservatively short and overstate the annual amount of depreciation costs incurred by Iowa Telecom, which in turn inflates Iowa Telecom's ATS cost estimates.

Iowa Telecom then compounds the rate-inflation caused by using unrealistically short GAAP depreciation lives by coupling those short depreciation lives with Commission prescribed net salvage percentages. *NERA Study* at 11. The net salvage percentage is the fraction of the initial value of the asset that remains at the end of its depreciation life. To the extent that Iowa Telecom is using asset depreciation lives that are substantially shorter than those prescribed by the Commission, Iowa Telecom should be using net salvage percentages that are substantially higher than those prescribed by the

Commission (because the asset should be worth more at the end of a shorter economic life (GAAP) than at the end of a longer lives prescribed by the Commission). 47 C.F.R. § 32. By assuming net salvage percentages that are lower than are consistent with the corresponding economic life assumptions, Iowa Telecom further inflates its costs, and hence overstates its proposed ATS rates.[6]

Switch Costs. Iowa Telecom's ATS rates are not based on actual switch prices, *i.e.,* switch prices contained in vendor contracts. Rather, Iowa Telecom developed its switching rates based on switch "cost *quotes* from" Nortel. *IT Cost Study* at 2 (emphasis added). The problem with that approach is that vendor pricing quotes for switches generally overstate the actual prices paid by the local exchange carrier. As explained by the Commission Staff in assessing switching inputs for use in the universal service cost model, "switch vendors typically grant carriers substantial discounts when selling switching, and require carriers to sign nondisclosure covenants that require carriers to keep actual prices for which switches are sold confidential." Opinion, *The Use of Computer Models for Estimating Forward-Looking Economic Costs; A Staff Analysis*, 1997 FCC LEXIS 160, ¶ 49 (1997) ("*Staff Opinion*"). As a result of these industry practices, vendor cost quotes do not generally reflect these substantial discounts. The Commission Staff therefore recommended, and the Commission adopted, switching costs that are based on "the actual level of switch discounts." *Staff Opinion* ¶ 40; *Inputs Order*

[6] In addition, the Iowa Telcom study appears to repudiate even its GAAP lives as representing the economic life of its assets by adducing a capital recovery schedule that bases its depreciation recovery rates on front-end non-levelized costs (*i.e.,* it sets rates based only on presumed disproportionately high depreciation experienced in the first three years than on average over the life of the equipment). *NERA Study* at 12. This assumption ensures that Iowa Telecom's rate design will over-collect the present value of its capital stock.

¶¶ 298-303.[7] Moreover, Iowa Telecom's use of inflated switch costs is made even worse by the fact that the Iowa Telecom further inflated costs by 10 percent. *See NERA Study* at 6.

Non-Traffic Sensitive Portion Of Switching. Another indication that Iowa Telecom's cost study is badly flawed is that it assumes that non-traffic-sensitive ("NTS") costs account for only *15 percent* of the total switching-related costs. Forward-looking switching cost studies, in contrast, derive fractions of the switch that are line port-related (NTS) that range from 30% to 100%. In this regard, it appears that the Iowa Telecom study has shifted costs from the NTS to the traffic-sensitive category, and because ATS rates reflect traffic-sensitive costs, the impact of this shift is an inflated ATS cost estimate.

This 15 percent allocation fraction raises serious concerns as to whether Iowa Telecom is double-recovering switching costs. As noted, Iowa Telecom's tariff allocates 15% of switching costs to the NTS portion of switching and 85% of switching costs to the traffic sensitive portion of switching. That means that Iowa Telecom's common line charges – which recover the NTS switching costs – should reflect only 15% of switching costs. But according to the common line tariffs under which Iowa Telecom is operating, its common line charges already reflect 30 percent of switching costs.[8] Thus, it appears that Iowa Telecom is recovering 85% of its switching costs through traffic sensitive rates

[7] Iowa Telecom's cost study also appears to vastly overstate costs for switching-related overhead costs. ***

***. *Inputs Order* ¶ 292.

[8] *See* Transmittal no. 1127 GTE – IOWA (Iowa Telecom operates exchanges purchased from GTE-Iowa).

and 30% of its switching costs through its common line charge – that is, Iowa Telecom is seeking to unlawfully recover 115% of its switching costs.[9]

This obvious and critical flaw in Iowa Telecom's tariff illustrates an even more fundamental problem with Iowa Telecom's tariff. The costs of the elements in Iowa Telecom's network are highly interrelated, and cannot reasonably be computed separately. Therefore, the costs of any particular rate element must be computed in a manner that reflects those interrelationships. Iowa Telecom has not done that. Instead, Iowa Telecom has attempted to compute ATS rates with a standalone cost model that does not reflect the impact of the various assumptions used in that cost model on the cost of other rate elements. To address this problem, Iowa Telcom should be required to submit a comprehensive cost study that reflects costs for all interrelated network and rate elements.

Outside Plant Costs. Iowa Telecom's study also provides no underlying support for its cost of outside plant assumptions. Outside plant costs reflect the costs of plant located outside of central offices, which includes, among other things, interoffice transport and loop feeder plant. Without access to the underlying support for the outside plant assumptions, it is impossible to determine, for example, whether the Iowa Telecom study reflects appropriate structure sharing levels between loop feeder and interoffice transport. To the extent that structure is appropriately being shared between interoffice transport facilities (which are ATS-related) and feeder facilities (loop-related), the costs

[9] This missallocation of costs inflates Iowa Telecom's rates in other ways as well. For example, the NTS allocation percentage is used to allocate all ancillary and overhead costs to the NTS and usage-sensitive rate elements. By underallocating costs to NTS elements, Iowa Telecom is substantially overallocating costs to the usage-sensitive elements, thereby inflating Iowa Telecom's ATS estimates.

for interoffice facilities (and hence ATS costs) would be lower, resulting in lower ATS rates. There is no question that these effects can be quite large. The Commission's Synthesis Model, for instance, assumes that 75% of interoffice structures are shared with feeder structures. Thus, Iowa Telecom's failure to provide its underlying outside plant sharing assumptions makes it impossible to evaluate whether those assumptions are forward-looking outside plant cost assumptions.

Excess Capacity. Iowa Telecom's cost study engineers OC48 and OC3 transmission systems that have far more service capacity than is needed for the several uses identified in Iowa Telecom's cost study (local, interstate switched and special access, and intrastate switched and special access). The study appears to assume that this substantial overcapacity is to be paid for entirely from the above services and is not shared with any other Iowa Telecom services (*e.g.,* DSL, packet services such as ATM or frame relay, local private line, UNE interconnection, CATV). This assumption appears not to be credible given that Iowa Telecom also acts as a CLEC, an ISP and a DSL provider to customers within its network footprint. Thus, it is likely that substantial portions of its costed network will be used to provide these services as well. But to the extent that these activities share use of Iowa Telecom's expansive network, the portion of its cost that should be borne by access services should be reduced. Because Iowa Telecom's cost study does not account for all of the uses of its network, it violates forward-looking principles. *See, e.g.,* 47 C.F.R. § 69.101-731.

CONCLUSION

For the reasons stated above, the Commission should reject Iowa's revised tariff, or, in the alternative, the Commission should, consistent with its statement in the *Iowa Forbearance Order* (¶ 23), suspend and investigate the tariff revisions,[10] or impose an accounting order.

Respectfully submitted,

AT&T Corp.

By /s/ Judy Sello

David L. Lawson
James P. Young
Christopher T. Shenk
SIDLEY AUSTIN BROWN & WOOD, L.L.P.
1501 K St., N.W.
Washington, D.C. 20005
(202) 736-8000

Mark C. Rosenblum
Lawrence J. Lafaro
Judy Sello
AT&T Corp.
Room 3A229
One AT&T Way
Bedminster, NJ 07921
(908) 532-1846

Attorneys for AT&T Corp.

Please Fax Replies To:

Safir Rammah
Fax: (703) 691-6057

April 1, 2003

[10] In the *Iowa Forbearance Order* (¶ 23), the Commission stated that "[u]pon filing of a tariff, supported by a forward-looking cost study, we will undertake a tariff investigation to determine Iowa Telecom's forward-looking ATS target rate for the remainder of the CALLS plan's five year term."

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of June, 2003, I caused true and correct copies of the forgoing Petition of AT&T Corp. to be served on all parties by telecopier and mailing, postage prepaid to their addresses listed on the attached service list.

Dated: April 1, 2003
Washington, D.C.

/s/ Christopher T. Shenk
Christopher T. Shenk

SERVICE LIST

Ms. Barbara Bouley[*]
Mngr., Regulatory Affairs, IA Telecom
P.O. Box 330
11 Eleventh Ave.
Grinnell, IA 50112
Phone: (641) 269-7577
Fax: (641) 269-7376

Gregory J. Vogt
Counsel for Iowa Telecommunications
Wiley Rein & Fielding, L.L.P.
1776 K St., Washington, D.C. 20006
Phone: (202) 719-7000
Fax: (202) 719-7049

Ms. Marlene H. Dortch, Secretary[**]
Federal Communications Commission
445 Twelfth Street, S.W.
12th Street Lobby, TW-A325
Washington, D.C. 20554

Tamara Preiss
Pricing Policy Division Chief
445 12th St., N.W.
Washington, D.C. 20554

William Maher
Chief of Wireline Competition Bureau
445 12th St., N.W.
Washington, D.C. 20554

Judith Nitsche
Asst. Division Chief, Pricing Policy Division
445 12th St., N.W.
Washington, D.C. 2055

[*] By First Class U.S. Mail and by facsimile.

[**] By electronic filing via ETFS.