PUBLIC NOTICE

Federal Communications Commission
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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

Comment Date: April 29, 2010
Reply Comment Date: June 1, 2010

In the *2001 Separations Freeze Order,* the Commission imposed an interim freeze on jurisdictional separations category relationships and cost allocation factors in Part 36 of the Commission's rules for a five-year period beginning July 1, 2001, or until the Commission completed comprehensive separations reform, whichever came first.[1] The Commission extended the freeze in 2006 and in 2009, and the freeze is currently scheduled to expire on June 30, 2010.[2] In the *2009 Separations Freeze Extension Order*, the Commission also referred to the Federal-State Joint Board on Jurisdictional Separations (the Joint Board) specific issues regarding comprehensive and interim reform of the separations process.[3]

[1] Jurisdictional separations is the process by which incumbent local exchange carriers apportion regulated costs between the intrastate and interstate jurisdictions. 47 C.F.R. §§ 64.901-04; *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, 16 FCC Rcd 11382, 11387-88, para. 9 (2001) (*2001 Separations Freeze Order*). Rate-of-return carriers were only required to freeze their allocation factors, but had the option to freeze their category relationships at the outset of the freeze. *2001 Separations Freeze Order*, 16 FCC Rcd at 11388-89, para. 11.

[2] *Jurisdictional Separations and Referral to the Federal-State Joint Board,* CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking, 21 FCC Rcd 5516 (2006); *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board,* CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6162, 6165, para. 12 (2009) (*2009 Separations Freeze Extension Order*).

[3] *2009 Separations Freeze Extension Order*, 24 FCC Rcd at 6167-69, paras. 15-20. The Commission referred a number of issues to the Joint Board and asked it to prepare a recommended decision. The Commission asked the Joint Board to consider: 1) whether, in lieu of Part 36 usage studies, there should be a limited number of fixed jurisdictional cost allocation factors, or a single fixed factor; 2) the circumstances under which carriers should no longer be subject to jurisdictional separations; 3) whether deferral of separations reform pending comprehensive reform of intercarrier compensation and universal service would be in the public interest; 4) whether, pending comprehensive separations reform, a modification of the existing freeze, under which carriers could, for example, be required to modify category relationships and/or jurisdictional cost allocation factors, which would then be refrozen pending the outcome of the other proceedings, would be in the public interest; 4) what criteria would be used for the recalculation of category relationships and jurisdictional cot allocation factors; and 5) whether allowing carriers a

On March 5, 2010, the state members of the Joint Board submitted a proposal for an interim adjustment of separations allocation factors and category relationships pending comprehensive separations reform.[4] The State Members' Interim Proposal is included in the appendix to this public notice. The Joint Board seeks comment on the State Members' Interim Proposal. In addition to general comments regarding the State Members' Interim Proposal, the Joint Board seeks specific comment regarding:

1. whether and to what extent the State Members' Interim Proposal would improve the accuracy of the apportionment of regulated costs between the intrastate and interstate jurisdictions;
2. whether and to what extent any refinements to the State Members' Interim Proposal or alternatives to the State Member proposal should be made in light of the recently released recommendations in the National Broadband Plan;[5]
3. whether the procedures set forth in the State Members' Interim Proposal raise implementation or operational issues that would have a significant adverse impact on carriers;
4. the time-frame in which companies could reasonably be expected to comply with the procedures in the State Members' Interim Proposal;
5. the impact on the universal service fund and other federal programs expected to result from the potential changes in the ratio of intrastate to interstate costs; and
6. what changes in rules, regulations, or policies affecting jurisdictional separations, rate regulation, intercarrier compensation, or universal service would be necessary to implement the State Members' Interim Proposal. Please be as specific as possible.

Further, the Joint Board seeks comment on issues related to comprehensive permanent separations reform referred to the Joint Board by the Commission in the *2009 Separations Extension Freeze Order*.[6] Commenters are encouraged to submit reform proposals as part of their comments and to address whether and how separations reform should be coordinated with potential reforms in broadband policy. Commenters are also instructed to clearly delineate whether their comments refer to the State Member Interim Proposal, long-term reform, or both.

Interested parties may file **comments on or before April 29, 2010**, and **reply comments on or before June 1, 2010**. All pleadings are to reference **CC Docket No. 80-286**. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.[7]

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one-time opportunity to freeze or unfreeze category relationships would be warranted pending comprehensive separations reform. *Id.*

[4] Letter from Steve Kolbeck, State Chairman, Federal-State Joint Board on Jurisdictional Separations, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 80-286 (Mar. 5, 2010) (State Members' Interim Proposal).

[5] *See, e.g.*, Recommendations in Chapter 8 of *Connecting America: The National Broadband Plan*, *available at* http://download.broadband.gov/plan/national-broadband-plan-chapter-8-availability.pdf (last visited Mar. 24, 2010) (recommending comprehensive reforms to universal service and intercarrier compensation over a ten-year period).

[6] *2009 Separations Freeze Extension Order*, 24 FCC Rcd at 6167-69, paras. 15-20.

[7] *See Electronic Filing of Documents in Rulemaking Proceedings*, GC Docket No. 97-113, Report and Order, 13 FCC Rcd 11322 (1998).

- Electronic Filers: Comments may be filed electronically using the Internet by accessing the ECFS: http://fjallfoss.fcc.gov/ecfs2/.

- Paper Filers: Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, filers must submit two additional copies for each additional docket or rulemaking number.

Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail. All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

All hand-delivered or messenger-delivered paper filings for the Commission's Secretary must be delivered to FCC Headquarters at 445 12th St., SW, Room TW-A325, Washington, D.C. 20554. All hand deliveries must be held together with rubber bands or fasteners. Any envelopes must be disposed of before entering the building. The filing hours are 8:00 a.m. to 7:00 p.m. Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743. U.S. Postal Service first-class, Express, and Priority mail must be addressed to 445 12th Street, S.W., Washington D.C. 20554.

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In addition, one copy of each pleading must be sent to each of the following:

(1) The Commission's duplicating contractor, Best Copy and Printing, Inc., 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, www.bcpiweb.com; phone: (202) 488-5300 fax: (202) 488-5563;

(2) Dan Ball, Pricing Policy Division, Wireline Competition Bureau, 445 12th Street, S.W., Room 5-A133, Washington, D.C. 20554; e-mail: Daniel.Ball@fcc.gov**;**

(3) Lori Kenyon, Regulatory Commission of Alaska, 701 West Eighth Ave., Suite 300, Anchorage, AK 99501; e-mail: lorraine.kenyon@alaska.gov; and

(4) Charles Tyler, Telecommunications Access Policy Division, Wireline Competition Bureau, 445 12th Street, S.W., Room 5-A452, Washington, D.C. 20554; e-mail: Charles.Tyler@fcc.gov.

Filings and comments are also available for public inspection and copying during regular business hours at the Commission's Reference Information Center, Portals II, 445 12th Street, S.W., Room CY-A257, Washington, D.C. 20554. They may also be purchased from the Commission's duplicating contractor, Best Copy and Printing, Inc., Portals II, 445 12th Street, S.W., Room CY-B402, Washington, D.C. 20554, telephone: (202) 488-5300, fax: (202) 488-5563, or via e-mail www.bcpiweb.com.

For further information, please contact Dan Ball, Pricing Policy Division, Wireline Competition Bureau at (202) 418-7400 or TTY (202) 418-0484, or Lori Kenyon, Federal-State Joint Board Staff (Alaska Commission) at (907) 276-6222.

APPENDIX

State Members' Interim Proposal

STATE MEMBERS
of the
FEDERAL STATE JOINT BOARD ON SEPARATIONS
1101 VERMONT AVENUE, N.W. SUITE 200
WASHINGTON, D.C. 20005

March 5, 2010

The Honorable Commissioner Mignon Clyburn
Chair, Federal State Joint Board on Separations
Commissioner, Federal Communications Commission
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: Privileged Intra-Board Proposal for a Recommended Decision in the proceeding captioned: *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board,* CC Docket No. 80-286

Dear Commissioner Clyburn:

On October 9, 2008, the State Members of the Separations Joint Board sent a letter to Commissioner Tate of the Federal Communications Commission ("Commission" or "FCC") outlining our concern that 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 between the jurisdictions. The distortions in the current separations process are so extreme that reform should occur expeditiously and not be deferred pending universal service and intercarrier compensation reform. In light of our concern, our October letter proposed interim changes to the separations process that we felt were essential if the freeze were to continue past its then expiration date of June 30, 2009.

More than a year has passed and we again face the situation where we must either work towards jurisdictional separations reform before the freeze expires or observe yet another extension to the freeze. While we look forward to meeting with the FCC to discuss potential long term reforms, the likelihood of completing such a process by the termination of the freeze on June 30, 2010 is grim. However, opportunity still exists to make interim changes to the frozen separations factors to reduce market distortions and improve cost assignment, consistent with directives provided in the *2009 Separations Freeze Order*.[1]

We renew our request that the FCC consider interim adjustments to the jurisdictional separations factors prior to extending the freeze beyond June 30, 2010. To support this proposal, we have included a brief history of past events and the reasoning that led us to conclude that changes are critical prior to continuation of the freeze. We have also reviewed our October 2008

1 *2009 Separations Freeze Order* at 14: "We also ask the Joint Board to examine the possibility of modifying the frozen category relationships and jurisdictional cost allocation factors if a . . . freeze is to continue beyond June 30, 2010."

interim reform proposal and updated it where appropriate in light of recent events. We request your expeditious consideration of this matter so that meaningful action can occur prior to June 30, 2010.

Past Events

On May 22, 2001, the FCC imposed an *interim* freeze of the Part 36 category relationships and jurisdictional cost allocation factors for price cap carriers and of the allocation factors for rate-of-return carriers.[2] As a result, since 2001, carriers have applied separations allocation factors and, for some carriers, category relationship factors based on data from calendar-year 2000 separations studies.[3] The freeze was originally intended to remain in place from July 1, 2001 to June 30, 2006,[4] but was later extended twice by the Commission for a total of four years.[5] These extensions were necessary as federal separation reform had not occurred, notwithstanding repeated efforts by the State Members of the Separations Joint Board to engage their federal counterparts in productive discussions. When the FCC extended the freeze in 2006, it specified that it (1) would be of limited duration and (2) would be extended "no longer than three years . . . or until such comprehensive [separations] reform can be completed, whichever is sooner."6 Similarly when the FCC extended the freeze in 2009, the FCC stated it was "committed to working with the Joint Board to develop an efficient system for the jurisdictional separation of regulated costs in light of the dynamic nature of the telecommunications market place and the dramatic changes to the telecommunications industry since the separations freeze was first adopted in 2001."[7] Currently, the freeze will expire on June 30, 2010.

While the Commission expected the freeze to provide an opportunity for "comprehensive, permanent reform"[8] of the jurisdictional separations process, reform has not occurred. As a result, the current allocation of costs between the state and interstate jurisdictions is governed by separations studies that are nine years old. Based on their age alone, these studies are unlikely to reflect current conditions. Moreover, any age-related inaccuracies are amplified by advances in technology and several key FCC jurisdictional determinations during the last nine years. The increased use of packet-based networks; the increased sale of DSL and other broadband services; the extraordinary increase of bandwidth use caused by the uploading, transmission, and downloading of digital photos and video files; the FCC's decision to alter the jurisdictional nature of various services; and a wide variety of other factors unquestionably requires the adjustment of the current process. The planned expansion in broadband services under newly created stimulus programs will further widen the gap between separations procedures and network realities.

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2 *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order, FCC 01-162, (2001) (*2001 Separations Freeze Order*), released May 22, 2001, at 2, 9, available online at: http://www.fcc.gov/Bureaus/Common_Carrier/Orders/2001/fcc01162.doc.

3 *2001 Separations Freeze Order* at 9.

4 Id.

5 *Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking, FCC 06-70, (2006) *(2006 Separations Freeze Order*), released May 16, 2006, at 16, available online at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-06-70A1.pdf.

6 Id. at 16.

7 *2009 Separations Freeze Order* at 15.

8 *2006 Separations Freeze Order* at 1.

The current separations allocation factors and categorizations no longer have any basis in fact. While some inaccuracy of the separations process is permissible, currently the actual use to which the property is put is almost completely ignored. This is contrary to the Supreme Court's instructions in *Smith v. Illinois*.[9] Under these circumstances, it is unreasonable to continue the freeze past July 1, 2010 without key adjustments to ensure existing allocation factors better reflect actual use of property. Once these changes are made, the freeze could be reimposed and continued while further reform options are considered. Our proposal for such key adjustments is provided with this letter.

We stress that our proposal here is not a recommendation on long term separations reforms. We have yet to conclude that policy review. Instead, our efforts here are intended to provide an interim adjustment to existing cost allocation factors and to allow continuation of the freeze while policy reforms are evaluated. We believe state commissions could implement such interim adjustments on their own motion in state proceedings concerning Verizon, AT&T, and Qwest in light of the FCC's forbearance from its Cost Assignment Rules.[10] In particular, the FCC directed these companies to work with state commissions to "develop methods to separate costs, satisfying any remaining need states have for jurisdictional separations information."[11] However, we believe an adjustment to the national separations process could be more administratively efficient and would potentially allow for more consistent treatment across states affected by the FCC's forbearance decision. Further, the separations process continues to play an important role in the regulation of many rate-of-return companies, in universal service programs, in setting the consumer rates of price cap carriers and in other areas.

Notwithstanding past assertions that separations is not relevant to price cap companies, the FCC and certain states allow exogenous changes to price cap company rates in recognition of separations changes.[12] For those companies and states in which rate-of-return regulation is still applicable, changes in the jurisdictional separations rules have a direct effect on end user rates. In other states and service areas, separations often impacts state universal service and intercarrier

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9 *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930). The Supreme Court concluded: "The separation of the intrastate and interstate property, revenues and expenses of the company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation . . . . [T]he validity of the order of the [Illinois] state commission can be suitably tested only by an appropriate determination of the value of the property employed in the intrastate business and of the compensation receivable for the intrastate service under the rates prescribed. While the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being *essential it is quite another matter to ignore altogether the actual uses to which the property is put*. It is obvious that, unless an apportionment is made, the intrastate service to which the exchange property is allocated will bear an undue burden to what extent is a matter of controversy." {emphasis added}

10 WC Docket Nos. 07-21, 05-342, *Memorandum Opinion and Order,* FCC 08-120, released April 24, 2008 (*AT&T Forbearance Order),* available at: http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-08-120A1.doc; WC Docket Nos. 08-190, 07-139, 07-204, 07-273, 07-21, *Memorandum Opinion and Order and Notice of Proposed Rulemaking*, FCC 08-203, released September 6, 2008.

11 *AT&T Forbearance Order* at 25.

12 The FCC has itself recognized that separations changes could lead to exogenous changes that may affect Price Cap companies. *2001 Separations Freeze Order* at 54. The FCC also acknowledged a potential need for separated accounting data to evaluate the existing price cap regime or for use in consideration of reforms moving forward. *AT&T Forbearance Order* at 19.

compensation policies.[13] The state members want to work with the FCC to ensure that any freeze moving forward provides a meaningful allocation of costs between the jurisdictions.

As noted earlier, the basis for the freeze, and each of the subsequent extensions, was to give this Joint Board and the FCC time to complete work on a comprehensive reform proposal. ***Since there is a very short window for FCC action before the current freeze extension ends*, *we respectfully request that our federal colleagues work closely with us to refine or revise the attached proposal and quickly release it for comment.*** The undersigned State Commissioners believe this document with little modification -- provides a good basis for a full Joint Board recommendation. ***It is obvious, for there to be a realistic chance for FCC final action on any Joint Board recommendation before the freeze extension expires this July, the FCC needs to get comment on this – or any other recommendations – as soon as possible.***

Sincerely,

/s/ Steve Kolbeck

The Honorable Steve Kolbeck
State Chairman
Federal State Joint Board on Separations
South Dakota Public Utilities Commission
State Capitol - 500 East Capitol Avenue
Pierre, SD 57501-5070

/s/ John D. Burke

The Honorable John D. Burke
Commissioner
Federal State Joint Board on Separations
Vermont Public Service Board
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/s/ Anthony Palermino

The Honorable Anthony Palermino
Commissioner
Federal State Joint Board on Separations
Connecticut Department of Public Utility Control
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/s/ Thomas W. Pugh

The Honorable Thomas W. Pugh
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cc: *C. Crowell, Senior Counselor to the Chairman*
B. Gottleib, Chief Counsel and Senior Legal Advisor to the Chairman
P. Aiyar, Legal Advisor to the Chairman for Wireline Competition & International Issues
A. Kronenberg, Wireline Legal Advisor to Commissioner Clyburn
D. Johnson, Deputy Chief of Staff to Commissioner Clyburn
J. Schneider, Broadband, Wireline & Universal Service Legal Advisor to Cmr. Copps
C. Shewman, Legal Advisor for Wireline and Universal Service to Commissioner Baker
S. Gillett, Wireline Competition Bureau Chief

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13 By pointing out the linkages between separations and other issues, we are not suggesting that reform of the separations rules be postponed again in order to resolve those other issues. On the contrary, we are attempting to point out that the jurisdictional separations rules are more important and, therefore, reform of those rules is more critical and more urgent, than some may have suggested.

Separations Proposal of the State Joint Board Members

The state members of the Separations Joint Board offer this proposal as an interim adjustment to reduce the most glaring imbalances in cost assignment that have arisen during the nine years of the separations freeze. The proposal is in two parts. The first part addresses the cost-revenue mismatch caused by some carriers that have not directly assigned their interstate special access investment during the freeze. The second part addresses: change in the jurisdictional definition of services; the impact of customers purchasing interstate and non-regulated services; and the impact of competitive carriers purchasing UNEs. Overall, these two proposed adjustments to the separations process will more accurately reflect direct cost assignments and assignment of costs related to special access, DSL, video, broadband, data, and UNE services.

Part I – Directly assign special access investment

A. The problem

Under the freeze, large price cap carriers have frozen the relationships among their categories and subcategories of investment. Based on direction provided through correspondence with FCC Staff,[14] some if not all of these carriers have also ceased applying direct assignment rules to special access facilities.[15] The same may be true of rate-of-return companies that have chosen to voluntarily freeze their category relationships. We believe that these carriers do record whether their new investments are in Cable and Wire Facilities (C&WF), Central Office Equipment (COE), or General Support Facilities (GSF). Each of the three investment categories is then split through the separations process into categories and subcategories which govern how costs are ultimately assigned to the state and federal jurisdictions. Companies' 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.

We believe that the freeze and the FCC staff directive to ignore direct assignment rules have led to a mis-assignment of special access costs. This mis-assignment is created by the growth in interstate special access lines and revenues over time without a commensurate growth in interstate assignment of costs. This mis-assignment is accentuated by the fact that much of the revenue benefit due to the growth in the number of special access circuits would have been allocated to the interstate jurisdiction given the FCC's assertion of jurisdiction over certain exchange special access lines with even minimal levels of interstate traffic.[16] In contrast the

14 Letter from Ms. Fatina K. Franklin, Assistant Division Chief, Industry Analysis and Technology Division, Wireline Competition Bureau, to Ms. Ann D. Berkowitz, Associate Director – Federal Regulatory, Verizon Communications, Item # 1 (final paragraph), IATD 2004-14B (June 4, 2004).

15 While we do not necessarily agree with this interpretation of the *2001 Separations Freeze Order*, we acknowledge that a member of the FCC Staff provided guidance on this issue and that many carriers have been following it.

16 Under 47 C.F.R. 36.154(a), Cable and Wire Facility Category 1 private line and similar circuits are treated as interstate if the interstate portion of the traffic on the circuit is more than 10%. For example, a Category 1 special access circuit with 89% state traffic is deemed interstate under the separations rules. This policy has been termed the "contamination doctrine". As a result, a large portion of all Category 1 exchange private line and special access

associated special access costs under the freeze would in large part have been allocated to the state jurisdiction at the same relative level as before the freeze.

At the national level this mis-assignment has contributed to ever-growing losses to intrastate revenues, while keeping intrastate costs largely the same. When companies no longer directly assign their investment in new special access lines to the appropriate jurisdiction, that investment is absorbed in other categories. C&WF is the largest group of assets held by the large companies,[17] and it provides the most financially significant example of the direct assignment problem. Based on ARMIS data for the large companies, 89% of C&WF is "Category 1" plant used for voice-grade ("narrowband") exchange circuits, commonly called "loops." Of this Category 1 investment, 95% is categorized as "joint use" loop used for both interstate and intrastate traffic.[18] Under separations rules, 75% of that joint use loop investment is assigned to the state jurisdiction. In sum, when the average large price cap carrier invests $1 in C&WF, under the freeze, its intrastate joint use loop investment in Category 1 increases by $0.63 regardless of the use of the plant.[19]

Other categories of C&WF investment, including broadband circuits (Category 2) and interexchange trunks (Category 3) are affected in the same way, if by smaller amounts. These other categories increase the effect. Overall, a $1.00 increase in C&WF investment produces a $0.72 increase in the price cap carrier's intrastate investment.[20] Once the cost has been separated in this way – and regardless of the actual purpose of the investment – the carrier has a constitutional right to charge intrastate rates that will allow it an opportunity to earn a reasonable return on that extra $0.72 of "intrastate-separated" investment. This impact on intrastate costs is unwarranted if the $1 investment in C&WF provides only interstate service and produces only interstate revenue.

Central Office Equipment (COE) comprises the second largest portion of plant assets.[21] Circuit equipment (Category 4) is COE equipment used to control transmission signals over loops and trunks. Performing a similar calculation to that described above, when a price cap carrier invests $1.00 in COE, the carrier increases its Category 4 COE intrastate investment by $0.37,[22] regardless of the actual purpose of the investment. Once again, this impact on intrastate costs is unwarranted if the $1 investment in COE provides only interstate service and produces only interstate revenue.

The separations factors applied to C&WF or COE flow through several layers of subsequent separations calculations, including the separation of General Support Facilities and the separation

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circuit revenues are charged for under interstate tariffs or interstate contracts, with the revenue treated as interstate. This is at odds with how costs are treated under the freeze and the FCC Staff interpretation letter.

17 C&WF accounts for 46% of Telecommunications Plant in Service for the reporting ARMIS companies. The estimates provided in this proposal are based on ARMIS data as reported in 2008.

18 Only 1% of Category 1 investment is "directly assigned" to the interstate jurisdiction.

19 $0.63 = $1.00 * 89% * 95% * 75%

20 This calculation is based on a review of ARMIS data.

21 COE comprises 42% of Telecommunications Plant in Service.

22 62% of COE is Category 4. Approximately 59% of Category 4 is separated to state. Therefore $1.00 of investment in COE increases Category 4 intrastate investment by $0.37 = $1.00 * 62% * 59%.

of expenses.[23] Therefore, any error in separating C&WF or COE is magnified by the separations rules, further increasing the effect on the carrier's intrastate revenue requirement. While our analysis is based primarily on price cap company data available from ARMIS, we believe the same general conclusions would apply to other carriers, including rate-of-return companies that have elected to freeze their categories and that under guidance from the FCC staff, are not directly assigning special access investment.

Under the freeze, investment and expense ratios have been frozen, but revenue ratios have not. Since 2000, the number of switched lines has declined, but the number of special access circuits, especially interstate special access circuits, has grown enormously. During the freeze, as shown in the table, state revenues have declined by 29%, while interstate revenues have grown by 10%. The separation of investment shows a quite different pattern, with both jurisdictions experiencing increased gross investment.

Percent change – 2000-2007	Investment	Revenue
State	15%	-29%
Interstate	25%	10%

These data show a cost-revenue mismatch that unfairly disadvantages the states, is of significant size, and is increasing over time. We have no evidence that this pattern has reversed itself or even slowed down after 2007. Therefore, any further continuation of the freeze is likely to greatly disadvantage those states that refer to separations results when they set intrastate rates or develop state universal service funding for their carriers that have frozen separations categories.

Once separations of costs are modified to reflect current usage and proper assignment of costs, then federal and state regulators would have the opportunity to further assure just and reasonable rates. The state members of the Joint Board believe the issues related to the direct assignment process must be addressed before we could support further continuation of the freeze.

B. The proposal

Before the freeze, special access costs were directly assigned each year to one jurisdiction or the other. Each carrier had to conduct a periodic study of how its plant was used, and directly assign the portion for which a single jurisdictional use could be identified. For C&WF, for example, this required analysis of the usage of cables and wires. 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.

Nevertheless, the state members of the Joint Board do propose a one time adjustment to modify the direct assignment of both C&WF and COE investment of those carriers who have frozen

23 Under the separations rules, investment factors flow through into expense factors. For example, C&WF investment affects the separation of Cable and Wire Facilities Expense (Account 6410), as well as several other expense accounts. The affected accounts include Other Property, Plant and Equipment (6510), Network Operations (6530), Depreciation and Amortization (6560), and Corporate Operations (6720).

their plant categories.[24] Instead of usage studies, we propose a simpler adjustment based on the carrier's revenue stream, a readily available source of information. We are offering this proposal as an alternative to requiring the detailed studies contained in the separations rules. We consider this an acceptable way of collecting a minimum amount of necessary data. We would apply this method once to change the interstate separations ratios, and we would then re-freeze the category and subcategory ratios for an additional period of three years, effective July 1, 2010.

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 assignment through rate adjustments. Instead, we view this proposal as a short-term means to better assign costs pending long term reform. Our proposal assumes, in this limited instance and in the absence of better data and the reform we have been promised since 2001, that allocation based on revenues provides a reasonable surrogate to directly assigning costs. This proposal better matches plant usage to costs than the current freeze. Its simplicity allows this proposal to be implemented prior to July 2010, an important factor in light of the FCC's intent to limit the most recent freeze extension to one year. The following is a more detailed explanation of how this proposal would work. The new method would be based upon each carrier's 2008 revenues, on the assumption that 2009 data is not yet available.

The first step is for each carrier to calculate the ratio of its 2008 interstate special access revenue[25] to its 2008 total revenue.[26] Specifically, we define the Interstate Revenue Factor (IRF), as follows:

IRF = (2008 Interstate Special Access Revenue / 2008 Total Regulated Revenue)

The second step is to shift investment so that total investment assigned to interstate special access is scaled up so that it is equal to IRF times the total plant in service subject to separations. This is achieved by adjusting the investment within each relevant category[27] of C&WF and COE so that the percentage directly assigned to interstate is equal to IRF.[28] Once the investment in the relevant category is determined the adjustment to investment is further allocated to the subcategories of C&WF and COE. The third step is to adjust joint use or common investment so as to keep total investment constant. The effect of this adjustment is to reduce the investment that is joint and common and increase the investment that is directly assigned.

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24 The proposals identified in this letter are based in large part on the work of Dr. Robert Loube and Susan Baldwin. See CC Docket No. 80-286, Comments of the National Association of State Utility Consumer Advocates, the New Jersey Division of Rate Counsel and the Maine Office of the Public Advocate, filed on August 22, 2006. We also would like to thank long time Separations Joint Board staff member Peter Bluhm for his past assistance to the State Members.

25 DSL loop revenue would be excluded here because DSL loops are considered separately in Part II below.

26 For large carriers taken as a whole, IRF is approximately 21%.

27 Investment directly assigned to the intrastate jurisdiction would not change.

28 Within C&WF, the step 2 calculation would be applied separately to the directly assigned portions of: Category 1 (Exchange Line); Category 2 (Exchange Trunk and Wideband Line); Category 3 (Interexchange). Within COE, this equation would be applied separately to Category 4 (circuit equipment) by applying it separately to: Subcategory 4.11 (wideband exchange line); Subcategory 4.12 (basic exchange trunk circuit and wideband exchange trunk circuit); Subcategory 4.13 (basic exchange circuit equipment and special exchange circuit equipment); Subcategory 4.22 (wideband interexchange circuit equipment); and Subcategory 4.23 (basic and special interexchange circuit equipment).

The following formulas use the C&WF adjustments as illustration ("D/A" means directly assigned). In step 2, the directly assigned amount of investment is calculated for each affected category and subcategory of investment:

*2010 C&WF Interstate D/A = 2010 C&WF Subject to Seps. * IRF*

Then in step 3, the common investment is reduced to maintain a constant total within each category of investment:

2010 C&WF Common = 2010 C&WF Subject to Seps. – C&WF Interstate D/A – C&WF State D/A

Similar calculations would be performed, separately, for Central Office Equipment.

The final step is to recalculate all downstream separations factors, including General Support Facilities and Expenses. For the average large carrier, we anticipate that this procedure would directly assign approximately 21 percent of total regulated investment to the interstate jurisdiction, rather than the current 10 percent. Similar results may occur for other carriers.

This proposal would create a "safe harbor." Carriers that dispute the results of this approach would be allowed 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.

We further clarify that our proposal here is not intended to address all areas where special access related separations reform is needed, it is only intended to provide an adjustment to the process so as to allow the freeze to continue while our reform review continues. We recognize that our interim proposal does not address a variety of issues on this point, including treatment of costs associated with services of an unusual jurisdictional nature such as broadband internet access service.[29] As state members of the Federal-State Joint Board on Jurisdiction Separations, we are willing to work with the federal members and with the FCC to more broadly determine whether it is necessary to make additional changes to the Separations Rules for costs, expenses, and revenues associated with broadband and video transport.

We would welcome constructive suggestions to refine or improve this proposal; however we believe that a reasonable approach should not be delayed by efforts to find a perfect approach. The existing freeze has led to inequities in the assignment of costs between the jurisdictions and should not be preserved, absent short-term adjustment.

29 For example, see the FCC's treatment of Broadband Internet Access Transmission service ("BIAT") in which the service can be offered on either a common carrier or a non-common carrier basis, but the costs would be treated as regulated and flow through the separations process, even if a carrier chooses the non-common carrier option for offering the service. CC Docket No. 02-33, CC Docket No. 01-337, CC Docket No. 95-20, 98-10, WC Docket No. 04-242, WC Docket No. 05-271, *Report and Order and Notice of Proposed Rulemaking*, paras. 5, 130 (FCC 05-150, rel. Sept. 23, 2005. *See, also*, paras. 137, 139.

Part II – Treatment of Cable & Wire Facility Loops

A. The Problem

The problems that arise from the freeze are not limited to the fact that separations allocators are based on outdated studies. Separations procedures themselves are dated, and they contain fixed factors that were set decades ago under far different circumstances. The major factor affecting overall cost assignment is the 25% basic allocator for local loop facilities assigned to C&WF Subcategory 1.3.[30] This 25% allocator was adopted in 1986 and now applies to all joint use Category 1 plant regardless of its nature.

Since the 1980's there have been significant changes in the nature of local exchange carrier plant, including the proliferation of investment to support broadband applications. In addition, after the freeze began in 2001, the FCC substantially expanded its jurisdiction. Notably, it declared that wireline broadband Internet services, including DSL, are interstate information services. At the same time, the FCC has allowed carriers to retain associated interstate information investments in regulated accounts that are substantially allocated to the state jurisdiction.[31] The FCC made both of these decisions without referrals to this Joint Board. In some states, carriers have proposed or effectuated intrastate rate increases, based at least in part on the effects of these decisions.[32]

Further unbundled network elements (UNEs) provide a related separations issue. There are no standardized separations rules for UNE costs or UNE revenues.[33] Varying carrier practices can produce a number of jurisdictional mismatches between costs and revenues. With the significant percentage of loops sold on an unbundled basis, standardized practices for UNEs are needed.

In addition, the invention of multi-jurisdictional service packages has raised new separations issues. Traditionally, revenues have been assigned to the jurisdiction in which the service was tariffed, but that is not easily done for multi-jurisdictional packages. Multi-jurisdictional packages are popular with customers, and separations rules have not explicitly addressed how to separate the associated revenue or costs.

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30 47 C.F.R. § 36.152(a)(1): "Exchange Line C&WF *Excluding Wideband*-Category 1-This category includes C&W facilities between local central offices and subscriber premises ...;" 47 C.F.R. § 36.154(a) Subcategory 1.3- "Subscriber or common lines that are jointly used for local exchange service and exchange access service for state and interstate interexchange services;" 47 C.F.R. § 36.154(c): "Effective January 1, 1986, 25 percent of the costs assigned to subcategory 1.3 shall be allocated to the interstate jurisdiction;"

31 CC Docket No. 02-33, CC Docket No. 01-337, CC Docket No. 95-20, 98-10, WC Docket No. 04-242, WC Docket No. 05-271, *Report and Order and Notice of Proposed Rulemaking*, (FCC 05-150, rel. September 23, 2005), at 133.

32 The FCC has recognized that states are free under 37 C.F.R. Part 64 to exclude such plant for intrastate ratemaking purposes.

33 NECA has provided members of the NECA pools with an advisory regarding the assignment of revenues and costs for UNEs. For all other carriers, UNE revenues have been assigned to a particular part 32 account. However, allocation of that account is not standardized, and each carrier performs its own analysis or special study to allocate revenues. There has been no direction from the FCC for the allocation of investment or expenses related to UNEs. This non-standardized treatment of UNE allocations requires investigation in all state proceedings involving rates in order to assure proper allocation and matching of UNE revenues, investments, and expenses. The lack of standardization may also result in overstated costs associated with interstate rate elements including the Subscriber Line Charge (SLC).

B. The Proposal

The state members of the Joint Board propose to create additional subcategories within C&WF category 1. The new subcategories would reflect the jurisdictional assignments of, and revenues produced by, advanced and other services that have become prevalent. Unlike the current rules, this proposal does not assume that a local loop is used primarily for voice telecommunications or that DSL usage is insignificant.

It may no longer be reasonable to assume that loop costs are insensitive to traffic capacity.[34] Nevertheless, we do not propose a traffic-sensitive formula for allocating loop costs. To do so would exacerbate the importance of legacy measures of network usage that have become less applicable in the Internet age. Rather, we propose to retain fixed allocators for non-traffic-sensitive costs at this time.

Second, to the extent that a loop is actually used for DSL, broadband or video purposes, we also propose new allocators. The new assignments are intended to align the jurisdiction of loop investment more closely with the jurisdiction of the principal services provided on the loop and in which the associated revenues are generated.

In sum, we propose to categorize loops according to the services provided over them, and then to apply distinct fixed separations factors to each category. In this way, if a loop is actually used to deliver advanced services, its subcategory would change. More costs would be assigned to the interstate jurisdiction or to non-regulated costs, an assignment that is consistent with the FCC's assertion of jurisdiction over those services. The proposal standardizes that allocation of costs associated with loops used to provide UNEs. We also propose a method for allocating revenues from multi-jurisdictional bundled services.

Because the method 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.

1. First Step: create new C&WF subcategories.

Subcategories within Cable and Wire Facility Category 1 would be modified and expanded. Subcategory 1.3 would be reserved for lines that provide only voice service. A new subcategory 1.4 would consist of lines that provide both voice and data. New subcategory 1.5 lines would consist of lines that provide voice and video. New subcategory 1.6 would consist of lines that provide voice, data and video. New subcategory 1.7 lines would consist of lines that do not provide voice but that do provide data or video. New subcategory 1.8 would consist of lines that are sold as unbundled network elements.

34 Separations factors have been set using fixed factors because regulators in the past believed that increased usage did not increase the cost of providing those loops. Today, carriers incur many costs in conditioning local loops for broadband service, and they invest in remote terminals and additional fiber so as to shorten copper loop lengths and provide DSL. These costs are directly associated with increasing the throughput capacity of those loops.

2. Second step: assign lines

Carriers would assign Cable and Wire Facility Category 1 lines among subcategories 1.1 to 1.8 based on a study of billing records. The regulated carrier would review its own records and the records of its affiliates. For example, when a customer subscribes to both voice and DSL, that customer's line would be assigned to subcategory 1.4.[35] A line would be considered to have a "data" component if the customer ordered and was billed for any kind of data service (e.g., DSL), regardless of speed, and even though the consumer was able to use the data line to download video applications. Similarly, a line would be considered to have a "video" component if the customer ordered and was billed for video services. Lines sold to other carriers as UNEs would be assigned to subcategory 1.8.

By using actual loop counts, this method responds to the services that customers are currently purchasing. A single billing study would be required each year to assign lines to subcategories based on the current combined carrier and affiliate billing records in the study area. In effect, the carrier would determine the line allocations by imputing the affiliate line sales as its own. We believe this imputation is necessary to prevent corporate structural and affiliated interest transactions from affecting the accuracy of how lines are ultimately assigned. Lines assigned to subcategories would change each year as billing data change, even if the freeze were to continue.

Our approach relies on billing records, not detailed engineering studies. While this approach is less precise, it is preferable to the existing situation. We are certain the current categorization of C&WF Category 1 under the freeze is no longer consistent with the actual usage of property or with the revenues it generates. However, we recognize 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.

As with Part I, 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.

We note that AT&T, Verizon and others filed a joint proposal on August 6, 2008, urging the FCC to assert exclusive jurisdiction over all IP-based voice services "that touch" the public switched telephone network.[36] If adopted, that proposal could dramatically change the jurisdictional nature of many traditionally intrastate services and lines. At this time, we are not taking a position on the proper separations treatment of Voice over Internet Protocal (VoIP) loops nor where such lines may be properly assigned between subcategories 1.3 through 1.7. While we believe that changes to the separations procedures may be needed in recognition of VoIP, this is an extremely complicated issue for which we do not have a specific proposal at this

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35 If the customer subscribed to two voice and one DSL line, one line would be assigned to subcategory 1.3 and one line would be assigned to subcategory 1.4.

36 While we do not support this proposal, if it were adopted it would make further continuation of the freeze even more untenable and further increase the need to make adjustments to separations factors and procedures.

time. The complexity is partly due to the fact that different "types" of VoIP services may be subject to different jurisdictional treatments and different service categorizations. However, to the extent the FCC preempts VoIP services and declares that such revenues are interstate or informational in nature, then the costs should be similarly treated.

3. Third step: assign Cat.1 investment to subcategories

Carriers would annually assign their category 1 investment to the subcategories. Each subcategory would be assigned an equal pro-rata share of the carrier's total Cat.1 investment equal to the line share from step 2.[37]

4. Fourth step: assign Cat.1 investment to jurisdictions

We propose that separations factors be assigned, by subcategory, using fixed allocation factors shown in the following table:

Table 1: C&WF Category 1 Subcategories and Fixed Factors

C&WF Category 1 - Subcategory	**Services provided**	**State Allocation Factor**	**Interstate Jurisdiction and/or Information Service Allocation Factor**
1.1	State private lines and state WATS lines	100%	0%
1.2	Interstate private lines and interstate WATS lines	0%	100%
1.3	Subscriber or common lines[38] jointly used for state and interstate services- voice only	75%	25%
1.4	Voice and data- jointly used for state, interstate, and information services	50%	50%
1.5	Voice and video- jointly used for state, interstate, and information services	30%	70%
1.6	Voice, data and video- jointly used for state, interstate, and information services	10%	90%

37 This rule may somewhat understate the actual cost of DSL and video lines and thereby understate the interstate cost allocation. However, extreme nicety is not required for separations. The new method will better reflect the current cost of providing service than the method in use today.

38 The title "Subscriber or common lines" comes from 47 C.F.R. § 36.154(a) that defines Sub-category 1.3.

1.7	Data and/or video but not voice jointly used for interstate, and information services	0%	100%
1.8	Unbundled network elements and similar sales[39]	Not applicable	Unallocated

The table heading includes "information services" in the interstate column. This is in recognition that the FCC allows DSL and possibly other investments to be included in interstate plant even though the investment may be related to an interstate information service or a preemptively unregulated service.

The new separations factors for subcategories 1.4 through 1.7 reflect our estimates both of the added costs imposed by broadband uses and of the revenue potential of multipurpose loops. Based on our experience as state regulators, we believe that a loop used for both voice and data will be more expensive, on average, than a loop capable of supporting only voice. Moreover, that loop should be able to produce at least as much interstate revenue (between DSL and interstate toll) as it produces intrastate revenue. We therefore conclude that allocating 50% of the loop cost to interstate would be appropriate, and it may even understate the costs actually generated by the interstate jurisdiction.

Video services typically add significantly to per-loop cost because video services typically require higher data speeds and require that fiber feeders be extended farther into the neighborhood. Similarly, video services have higher revenue potential than data services. We have accordingly recommended a 70% interstate separations factor, substantially higher than for category 1.4. When a loop is used for "triple play" service, providing voice, data and video, nearly all of the income potential is on the interstate side, and so we recommend a 90% factor because it approaches 100% but still reflects some potential for intrastate revenue. When no voice is provided at all, only interstate revenue can be generated, and we recommend a factor that is 100% interstate. While we propose these allocation factors as reasonable, we welcome comment and debate in efforts to make any necessary improvements.

Under 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 advanced services made possible by the new investment. A carrier might, for example, build a DSL-capable network; but its separations factor will not change until customers begin to buy DSL in some numbers. In that sense our proposal is a step in the right direction, but it only partially addresses state costs generated by interstate investments. Nevertheless, we propose this solution believing it administratively simple. It also does not deter investment in advanced networks.

This proposal would not justify any increase to the Subscriber Line Charge (SLC). Category 1.3 customer costs should be decreasing as a result of more appropriate assignment of data and video costs to Categories 1.4 through 1.7. Category 1.4 to 1.7 interstate cost increases would be

39 This sub-category would include loops sold pursuant to contract, including loops sold under so-called "UNE-P replacement" contracts.

matched by associated revenue for video and data, which should be sufficient to recover the additional assigned interstate costs for these customers.

The allocation factors we have proposed here are conservative. For example, while we do not at this time advocate a capacity-based approach, if allocations between the jurisdictions were made based on line capacity, even greater percentages of costs would likely be assigned to the interstate jurisdiction.[40]

5. Fifth step: unbundled element costs left unseparated

The fifth step specifically leaves costs in sub-category 1.8 unseparated. Sub-category 1.8 is for loop facilities sold as unbundled network elements or sold in similar ways, such as those sold under so-called "UNE-P replacement" contracts or agreements. As a result of the Telecommunications Act of 1996, incumbent local exchange carriers (ILECs) are obligated to provide access to UNEs to any requesting competing telecommunications carrier.[41] In general, the carrier purchasing UNEs obtains network elements (e.g., loops) *in their entirety*, with the opportunity to use the network elements for the provision of both intrastate and interstate services. As such, UNEs are different from other purchases: the carrier does not buy a service that is within one jurisdiction or the other. Accordingly, this proposal does not include any jurisdictional allocation percentages for UNE revenues or costs. Rather, this proposal leaves those revenues and costs un-separated and sets those revenues and costs aside, making them irrelevant to determining state rates and interstate rates. We also note that 47 U.S.C. 252(d)(1) requires the prices for UNEs to be "determined without reference to a rate-of-return or other rate-based proceeding." Removal of UNE costs from both the federal and state jurisdictions is a reasonable approach that is consistent with this statute.

6. Sixth step: calculate downstream factors

The sixth step is to recalculate all downstream separations factors, including General Support Facilities and Expenses.

7. Seventh step: separate revenues

Carriers offering mixed-jurisdiction services packages that include voice and also include data, video or both, would separate the revenues from such services in accordance with the investment allocators listed in the table above. For example, if a customer subscribed to a voice and data package where the individual revenues for services were not readily identifiable, revenues would be divided equally between the jurisdictions based on the allocation factors for Subcategory 1.4.

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40 Based on an estimated "voice" capacity of 64 kbps and "data" and "video" capacity of greater than 200 kbps in both directions.

41 Per 47 U.S.C. §251(c), unless the ILEC holds an exemption or its obligation has been suspended or modified per 47 U.S.C. §251(f).