Several sources of evidence confirm the finding of a large depreciation shortfall. Other (more-lightly regulated) telecommunications firms with similar types of plant depreciate that plant much more rapidly than LECs. The Hatfield Model and the FCC's proxy costs both imply that regulatory capital recovery has been wholly inadequate.

When interveners or regulators draw sharp distinctions between forward-looking and embedded capital costs, they implicitly acknowledge the seriousness of the capital-recovery problem.

More generally, we have adduced a variety of evidence to demonstrate that the capital-recovery problem is serious. Regulators urgently need to address the depreciation shortfall.

ATTACHMENT 16

USTA
A QUANTIFICATION OF THE EFFECTS OF CERTAIN SPECIFIC PART 36 SEPARATIONS RULES DECISIONS

USTA COMMENTS
CC DOCKET NO. 96-262
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A QUANTIFICATION OF THE EFFECTS OF CERTAIN SPECIFIC PART 36 SEPARATIONS RULES DECISIONS

As described by USTA elsewhere in these comments and supported by expert testimony of past FCC and state commission regulators, the history of separations rules has resulted in deliberate allocations of cost to the interstate jurisdiction. This attachment was prepared by separations experts from the USTA member LECs to quantify the amount of costs (defined as interstate revenue requirements pursuant to the FCC's rules and procedures) allocated to the interstate jurisdiction by several of the major Part 36 separations rules. This quantification focuses specifically on: (1) the allocation of loop costs based on the 25% Gross Allocator; (2) the use of weighted dial equipment minutes (DEM) for study areas with less than 50,000 access lines; and (3) the allocation of marketing expense based on revenues.

To quantify the effects of these specific separations policy decisions, USTA examined alternatives compared to the current Part 36 separations rules. The difference(s) between interstate revenue requirements under current rules and under one or more alternatives was calculated. These differences illustrate the quantitative effects of the Commission's separations rules decisions.

These quantifications were performed individually for each LEC study area identified in NECA's 1995 annual data submission filed with the Commission. Individual study area results were then summed to obtain an ILEC total for: (1) all price cap LECs; and (2) all ILECs.

In presenting these quantifications, USTA is not recommending that the Commission adopt any of the specific alternatives utilized for quantification purposes. For example, several alternatives examined the effects of allocating zero percent of certain costs to the interstate jurisdiction. A table of results presenting these differences is attached.

The calculation of the 1995 revenue requirements amounts utilized in the quantifications are explained below.

Revenue requirement amounts were calculated individually for each individual study area identified by NECA in their 1995 data filing with the FCC. The individual study area results were then summed to obtain the nationwide totals. The procedure followed was:

I. Obtain or derive each study area's investment and expense components
II. Obtain or derive each study area's interstate separations factors
III. Utilize the results of the application of the FCC's Part 36 Separations Rules in applying separations factors to investment and expense components to obtain interstate separated results
IV. Varied the separations factors to estimate the change resulting from alternative separations rules

Each of these steps is described further.

I. Investment and Expense Components

Investment and expense components were obtained, or derived, from the following sources:

a. 1995 ARMIS 43-01 and 43-03 reports
b. 1995 USF data filing
c. USTA 1995 financial data compilation
d. 1994 REA financial reports
e. 1993 Joint Board data request

In those cases where necessary data could not be obtained, it was estimated based on known data from similar companies.

II. Interstate Separations Factors

Interstate separations factors were obtained, or derived, from the following sources:

a. 1995 ARMIS 43-01 Reports
b. FCC Monitoring Report
c. 1993 Joint Board Data Request

III. Interstate Separated Results

Interstate separated results were obtained by:

1. Grouping individual investment and expense amounts into the following functional categories:
   a. message loop
   b. IOT (information originating terminating)
   c. operator systems
   d. tandem switch
   e. local switching
   f. transport
   g. marketing
   h. customer services other than marketing
   i. private line

2. Applying the appropriate overhead and loading amounts to each functional category in accordance with Commission's Part 36 Separations Rules.

3. Applying an 11.25% return to the net investment amounts and a 35% FIT and 5% SIT factor to the amounts subject to income tax. (USTA recognizes that individual state and local income tax rates are not uniform. Use of a common SIT rate is a simplifying assumption used here that does not materially affect the quantification of separations rules effects.)

IV. Estimate Difference from Current Part 36 Rules

The effect of different separations rules was estimated by developing new separations factors for each functional category based on an alternative and comparing the new revenue requirement amount with the revenue requirement amount based on the current rules.

The following tables display these differences.

Quantification of Effects of Specific Part 36 Separations Rules Decisions

(Using 1995 Revenue Requirements Data and Part 36 Rules)

	$ Billions	
	Price Cap LECs	All ILECs
Message Loop (Included In Common Line)		
Current -- Part 36 Allocation to IS (25% Gross Allocator)	9.3	10.3
Alternative -- Allocated to IS based on SLU (DEM)	5.5	6.2
Alternative -- No Loop Costs Allocated to IS	0.0	0.0
Differences from Current Part 36 Rules		
If Allocated to IS based on SLU (DEM)	(3.8)	(4.1)
If No Loop Costs Allocated to IS	(9.3)	(10.3)
Note: Payphone costs and other IOT are not included in Message Loop.		
Local Switching		
Current -- Part 36 Allocation to Interstate (DEM)	2.5	3.1
Alternative -- Allocated to IS based on Unweighted DEM	2.5	2.8
Alternative -- 25% of Local Switching defined as NTS and 0% of NTS Portion Allocated to IS, TS Portion Allocated Based on Unweighted DEM	1.9	2.1
Differences from Current Part 36 Rules		
If Allocated based on Unweighted DEM	(0.0)	(0.3)
If 25% of Local Switching defined as NTS, and 0% of NTS Portion Allocated to IS, TS Portion Allocated Based on Unweighted DEM	(0.6)	(1.0)
Marketing Expense		
Current -- Part 36 Allocation to Interstate (Billed Revenue)	2.2	2.4
Alternative -- Allocated to IS excluding all Access Revenue (both Interstate and Intrastate)	0.2	0.3
Alternative -- 0% Allocated to Interstate	0	0
Differences from Current Part 36 Rules		
If Allocated to IS excluding all Access Revenue (both Interstate and Intrastate)	(2.0)	(2.1)
If 0% Allocated to Interstate	(2.2)	(2.4)

Prepared by SWBT for USTA using 1995 data. Data were gathered for each study area for each LEC. Data are from ARMIS, other sources filed with the FCC or other industry sources. Results for individual study areas for each LEC were then summed to the totals shown above.

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Allocation of Marketing Costs to Categories
(Using 1995 Revenue Requirements Data and Part 36 Rules)

	$ Billions	
	Price Cap LECs	All ILECs
Current Part 36 Rules -- Allocation of Marketing Cost to Interstate	2.2	2.4
Approximate Amounts by Category:		
Common Line	1.1	1.2
TIC	0.2	0.2
Other Interstate	1.3	1.4

Prepared by SWBT for USTA using 1995 data. Data were gathered for each study area for each LEC. Data are from ARMIS, other sources filed with the FCC or other industry sources. Results for individual study areas for each LEC were then summed to the totals shown above.

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