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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

March 31, 1998

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
1919 M Street, N.W. -- Room 222
Washington, DC 20554

Re: Ex Parte CC Docket No. 80-286 – Jurisdictional Separations Reform and Referral to the Federal-State Joint Board
CC Docket No. 96-45 – Federal-State Joint Board on Universal Service

Dear Mr. Caton:

On March 24, 1998 Mark Lemler of AT&T presented the attached material before the staff of the Federal-State Joint Board in CC Docket 80-286. Mr. Lemler was invited by the Joint Board staff to participate as a panelist to discuss AT&T's positions of record in CC Docket 80-286.

Two copies of this Notice are being submitted to the Secretary of the FCC in accordance with Section 1.1206(a)(1) of the Commission's Rules.

Very truly yours,

Brian W Masterson

Enclosure

cc: CC Docket No. 80-286 Joint Board Staff

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AT&T Presentation
Joint Board Staff Docket CC. 80-286
Separations Reform
March 24, 1998

Good morning. It is a pleasure to be here this morning to discuss the issues involved in the Separations Notice of Proposed Rulemaking. In passing the Telecommunications Act of 1996, Congress took the first significant steps toward creating local telecommunications competition. Subsequent initiatives by the FCC and many state commissions held out the promise of eventually supplanting federal and state telecommunications rate regulation with competition, thereby rendering superfluous such regulatory mechanisms as the separations process that is the subject of the NPRM. Unfortunately, two years after passage of the 1996 Act, local competition sufficient to constrain incumbent LECs' prices has not emerged and, under current conditions, is unlikely to do so in the foreseeable future. This is so for a litany of reasons, where time prohibits my delving into now.

Rather, for these reasons, effective state and federal telecommunications rate regulation of incumbent LECs' regulated services must continue in order to protect consumers and permit the development of local competition. And, as long as current market conditions and rate regulation of incumbent LECs' regulated services remain in place at both the federal and state levels, the jurisdictional separations process clearly must remain in place.

Without separations and proper cost allocations, ILECs would have the ability to shift intrastate costs into the interstate jurisdiction, thereby raising IXCs' costs and facilitating

anticompetitive pricing strategies once an ILEC is permitted to offer long distance services. Moreover, the advent of price cap regulation has not done away with the need for a separations process, and that many specific features of both state and federal regulation still depend on the separations process. For example,
the FCC's price cap regulation of interstate services retains a lower formula adjustment and the possibility of exogenous adjustments, both of which can only be determined by reference to separated interstate costs. Moreover, the states' adoption of price cap regulation is spotty at best, and even where it has been adopted it also retains features of rate of return regulation.

A separations procedure is also necessary to ensure appropriate divisions of costs between federal and state jurisdictions. As long as both federal and state agencies continue to regulate the rates of the ILECs, and as long as the ILECs' services depend on joint and common costs that cut across the two jurisdictions, Smith vs Illinois requires a separations process to confine the two regulatory authorities to their proper spheres of regulation.

That is not to say that the current process should not be improved. It can and should be reformed in several ways so as to promote greater competition and more efficient investment decisions. Moreover, the respective rolès of the FCC and the states in implementing the prerogatives of the Act has not been without controversy; witness the current debate over the FCC's plan to limit federal high cost support to 25 percent of the difference between forward-looking economic costs and a revenue benchmark. AT&T believes that a well founded separations procedure that is based on the underlying principles of cost causation and allocation of joint and common costs based on relative use will go a long way towards sizing the jurisdictional rate bases on economic terms, rather than political terms. This should then help the states and the FCC reach an accommodation on the politically sensitive issue of universal service. It is in this spirit that AT&T offers the following adjustments to the separations procedures:

THE COMMISSION SHOULD ALLOCATE LOOP COSTS TO THE INTERSTATE JURISDICTION ACCORDING TO RELATIVE INTERSTATE MINUTES OF USE.

Economic principles do not support the allocation of any loop costs to the interstate jurisdiction. Absent immediate Commission action to transfer the total recovery of loop costs to end users, the pro-competitive goals of the 1996 Act and consumers will be best served by allocating a frozen proportion of loop costs that does not exceed the relative interstate minutes of use on an incumbent LEC's loop network. Indeed, the current industry-wide interstate subscriber line usage factor is approximately 15%, not 25%. The Commission should use the discretion to promote the pro-competitive intent of the Act by ensuring that IXCs and local entrants are not unfairly and inefficiently handicapped through an over-allocation of loop costs to interstate access services.

The Marketing Expense Misallocation Needs To Be Corrected

The ILECs do not actively market their access services to the IXCs, therefore marketing expenses should not be allocated to interstate carrier access. The ILECs' essential argument is that marketing benefits all services and cannot be isolated to a single service or jurisdiction. But this argument simply ignores the issue of cost-causation. The ILECs have submitted no evidence that offers any functional analysis or quantification to demonstrate that marketing expenses are in fact incurred in the provision of access services to IXCs. Moreover, the ILECs' contention that generic marketing of their services adds common lines and therefore stimulates interexchange traffic is based on a fallacy. Costs that are associated with common lines should be recovered directly from the end user, not from interexchange carriers through access charges.

Remove Costs Associated With Interconnection And UNEs From The Separations Process

AT&T believes that the costs associated with UNEs and interconnection should be removed from the separations process altogether. In addition, it is the historical, booked costs associated with interconnection and UNE that should be removed from the process, not the forward-looking costs. If only the forward-looking costs were removed, the result would be to leave the residual of embedded costs included with the regulated costs subject to separations. The failure to remove these embedded costs from the separations process would have the unintended effect of creating a keep-whole mechanism that would insulate the ILEC from the effects of the very competition that interconnection and UNEs are intended to generate.

Retain The Expense Adjustment

On the other hand, the Commission should retain the "expense adjustment" for federal high cost support, rather than eliminating it for non-rural carriers as of January 1, 1999, as the Commission currently intends to do. However, it should be capped at 1998 levels to limit the growth of the expense. To be sure, the commission is obligated by Section 254 of the 1996 Act to remove all implicit, universal service-related subsidies from access charges, so that all universal service support becomes explicit. Today, however, the existing high cost mechanism in reality functions as an explicit subsidy system, because it consists of identifiable carrier charges that are in turn disbursed as direct payments to the LECs. Therefore, the first $217 million of the new federal universal service fund (the amount currently received by non-rurals in 1998) will represent the replacement of one explicit subsidy with another. Because the $217 million is in reality explicit support, it should not be treated as if it were implicit support for purposes of access charge reductions. The

most appropriate course, therefore, would be to retain the expense adjustment – albeit capped at 1998 levels ($217 million for non-rurals) – and to reduce access charges by an amount equal to the remainder of federal USF support, not by the full amount. This can readily be accommodated by reversing the elimination of the high cost expense adjustment for non-rural carriers as of January 1, 1999, but capping the expense adjustment at 1998 levels. However, this does not imply that the full amount of the high cost expense adjustment should be distributed to all incumbent LECs. As AT&T indicated at the recent en banc meeting on universal service, the $114 million of high cost support targeted to RBOCs, GTE, and SNET should be withheld until robust competition exists in their territories.

Thank you and I look forward to answering your questions.