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

In the Matter of	)	
	)	CC Docket No. 80-286
Jurisdictional Separations Reform and	)	
Referral to the Federal-State Joint Board	)	

COMMENTS OF BELL ATLANTIC ON REPORT FILED BY STATE MEMBERS OF THE JOINT BOARD[1]

Changes in the landscape of regulation and the marketplace rapidly are moving to a point where there no longer will be any need to track or separate costs between state and interstate jurisdictions. While the state members of the Joint Board conclude that we have not yet arrived at that destination, they agree that we are moving in that direction and explain why. For the present, their paper provides further support for the concept of an interim freeze of separations factors that would avoid unnecessary disruptions and still provide a basis to calculate jurisdiction-specific costs.

The specific type of freeze considered by the state members, however, should be rejected. A so-called "rolling average" freeze is no freeze at all. It would simply add new regulatory requirements to the existing separations rules and thereby move regulation in precisely the wrong direction. Moreover, use of a rolling average freeze would in fact

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[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, D.C., Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company; and New England Telephone and Telegraph Company.

cause the very type of disruptions (i.e. jurisdictional cost shifts) that the freeze is intended to avoid.

I. Trends in regulation and the market support a freeze of separations factors.

The state members identify several trends that demonstrate the diminishing importance of calculating costs separated by interstate and intrastate jurisdictions. They recognize the "increasing role of competition." State Members' Report at 12. In particular, they recognize that while competition is growing for all services, some sectors, such as services for business customers, already are "quite competitive." *Id.* To the extent that pricing for such services is deregulated, this reduces the services subject to pricing regulation by any jurisdiction, and as a result, diminishes the reliance of separations factors in setting prices.

More fundamentally, the state members recognize that the move to price cap regulation, which cuts the link between costs and price setting, has reduced (if not eliminated) the reliance on separated cost, even for services still under regulation. *See* State Members' Report at 5. Because not all jurisdictions have made that move, however, some form of separations is still necessary.

The state members also recognize that separated costs would be used to protect incumbent local exchange carriers from confiscation should regulators attempt to reduce prices based on a forward looking cost measure that ignores actual costs.[2] State Members' Report at 4. The only way to evaluate a confiscation claim is to examine a carrier's actual costs on a jurisdictionally separated basis.

This combination of reduced reliance on separations for day to day regulatory purposes and a continued need for a safety net based on separated costs leads the state members to two logical conclusions. First, that "for at least the next few years" there may be a continued need for "some form of separations," but that this need "does not compel the conclusion that any particular form of separations is required." State Report at 6 (emphasis in original). Second, they conclude, that the Joint Board should adopt an "interim measure" that "minimizes the anomalies while still providing state and federal regulators with the vital 'confiscation liability' information they require." State Members' Report at 15.

A freeze of separations factors would accomplish the state members' goals of preserving the ability to separate costs without impacting prices and thereby creating new separations-based anomalies. A frozen factor would still provide a reasoned basis for separating costs to the extent there is any remaining need for such information. Like any separation of joint use plant, the current factors are economically arbitrary.[3] Nonetheless, they reflect settled regulatory policy and have varied little over the past decade.[4] At the same time, freezing the current factors would minimize separations-caused anomalies by

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[2] The FCC has also retained the lower formula adjustment, which, while rarely invoked, does rely on separated costs as a basis for price adjustments. *See* Separations Reform Comments of Bell Atlantic at 3 (filed Dec. 10, 1997).

[3] *See* Affidavit of William E. Taylor at && 7-10 [Exhibit 1 of Separations Reform Comments of Bell Atlantic].

[4] As Bell Atlantic previously demonstrated, the standard deviation for changes in the separations factors has averaged less than one one-hundredth over the years of federal price cap regulation. Separations Reform Comments of Bell Atlantic at 5.

not allowing separations changes to impact day to day prices for those services subject to price cap regulation.[5]

While the State Members' Report supports the idea of a freeze, it proffers a modified version of what it calls a freeze using a multiyear average of separation factors. This variation of a "freeze," however, obviously is no freeze at all, since the separations factors will still vary over time and the averaging merely complicates the concept with no real policy benefit. Using a three-year average would, by definition, necessitate an adjustment from the current factors. Such change would have no economic or policy basis and would be backward looking. Moreover, the modified freeze would actually require continued calculation of new separations factors each year (to be averaged in with factors from the prior two years). As a result, the proposed solution would actually *increase* the administrative burden of the separations process.[6]

II. Changes in regulation or technology do not invalidate the current factors.

While the State Members' Report endorses the concept of a freeze, they also identify changes in the market that some parties have suggested could require changes to

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[5] Under FCC rules, a change in separation factors may be considered an exogenous event that could result in an adjustment to allowable prices. *See* 47 C.F.R. э 61.45(d)(1).

[6] An alternative interpretation of the modified freeze assumes that no new factors are calculated, but then the three-year rolling average is pointless. The changes in subsequent years would be an automatic and gradual movement toward a complete freeze, with each new data point reflecting no new information, but rather a simple average of the impact of the freeze formula on prior years' results. In the end, the result would mimic a complete freeze, but would require continued annual calculations that serve no purpose.

the current factors. In fact, these changes do not impact current separations, and do not create the need for separations adjustments.

Specifically, the State Members' Report highlights growth in the use of packet switched technology, particularly through the Internet. But this growth does not create a separations "problem". The State Members' Report predates the Commission's ruling clarifying the jurisdictional nature of Internet traffic. The Commission reconfirmed that Internet traffic is interstate, and this issue cannot be considered "unresolved" as suggested in the Report (p. 8). *See Implementation of the Local Competition Provisions*, CC Dkt. Nos. 96-98, 99-68, Declaratory Ruling (rel. Feb. 26, 1999). In reconfirming the interstate nature of the traffic, the Commission nevertheless reiterated that because Internet providers procure their connections to the local exchange carriers through intrastate services, the associated costs should continue to be treated as intrastate for separations purposes.[7] *Id.* at & 36.

The path toward comprehensive separations reform should not be blocked by attempting to manipulate the impact of new technologies on the current jurisdictional separations process. Adapting separations processes in today's rapidly changing technological and competitive landscape will only impede separations reform and force constant reevaluation to reflect the latest change in direction. The state members acknowledge that the separations rules reflect "a policy compromise between the federal

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[7] In contrast, the expense and revenues attributed to reciprocal compensation payment associated with Internet service (to the extent such costs and revenues exist subsequent to the Commission's declaratory ruling) relate to interstate usage and have no corresponding intrastate revenue to create a matching problem. As a result, these expenses and revenues must be treated as interstate for separations purposes. But this

and state jurisdictions." State Members' Report at 7. Current initiatives to reform separations will be no exception. Adopting a freeze is a policy compromise that will not be overtaken by events and that will create a smooth glide path toward eventual elimination of the need for artificial separation of costs by jurisdiction.

The State Members' Report also suggests the current treatment of costs for competitive services is inadequate because after Part 64 cost allocations, the remaining costs that are separated through Part 36 include both competitive and more regulated less competitive services. But this is exactly how the cost allocation process is intended to work. Despite the simple shorthand that Part 64 removes "nonregulated" costs, in fact, Part 64 cost allocations are not intended to remove costs associated with all services that face competition.

If the FCC were to expand the role of Part 64 to capture all fully competitive services, such a change would limit the ability of state regulators to adapt regulation of intrastate services to local competitive conditions. Part 64 allocations occur prior to the split of costs between jurisdictions through Part 36. As a result, only the federal regulator has the authority to determine what non-regulated costs should be excluded through Part 64. Thus, increasing the role of Part 64 in the treatment of all fully competitive services would take away the ability of local regulators to determine the level of competition of local services. Given the localized nature of competition for many of these services, that would not be a sound policy choice and, in fact, would be inconsistent with the intent of

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change can be booked to accounts that allow the expense and revenue assignment to interstate without affecting allocations of other costs and expenses.

Part 64 cost allocation.[8] Part 64 is only intended to capture carrier costs associated with services that "are not classified as common carrier communications services for Title II purposes." *Separation of Costs of Regulated Telephone Service From Costs of Non Regulated Activities*, 2 FCC Rcd 1298 at & 70 (1987) ("Separation of Costs"). More than a decade ago the Commission recognized that there would be services that were sufficiently competitive to be subject to regulatory forbearance, but nonetheless these services "would still be classified as regulated activities for purposes of our accounting rules." *Id.* at & 71. Under this system, the states retain the ability to classify intrastate services as competitive.[9] The costs for these services are treated as common carrier services under Part 64, and are assigned to the intrastate jurisdiction under Part 36. Once a state finds a service to be competitive, various cost allocation mechanisms have been developed to segment intrastate costs among the service classifications (e.g. competitive, discretionary, non-competitive, etc). States have implemented these types of allocations under both rate-of-return and price caps forms of regulation. In many cases, state regulators require carriers to continue these allocations even where there is little or no link between cost and price. The results of these allocations enable the commissions to monitor the interrelationship of costs between "competitive" and "non-competitive"

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[8] To the extent such an arrangement would require the federal regulator to control the regulatory treatment of purely intrastate services, such an arrangement would violate legal limitations on federal authority. *See Smith v. Illinois*, 282 U.S. 133 (1930).

[9] While at least in theory, the states could retain control of regulatory treatment of intrastate services if the FCC were required to accept state determinations in formulating Part 64 allocations, as the Commission recognized, such a mix and match system of cost allocation would create "an administrative nightmare." *Separation of Costs* at & 74.

services. Such a monitoring process facilitates the state's effort to ensure compliance with Section 254(k) of the 1996 Act. Implementing a "one size fits all" approach could not possibly consider the varying levels of competition and may inhibit state authority in regulating intrastate services.

Conclusion

Consistent with the recommendations of the State Members' Report, the Joint Board should adopt a true freeze of the current separations factors until such time as separations of cost by jurisdiction is no longer necessary.

Respectfully submitted,

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