

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

In the Matter of

)
)

Jurisdictional Separations Reform and
Referral to the Federal-State Joint Board

)
)

CC Docket No. 80-286

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

Its Attorneys:

Lawrence E. Sarjeant
Linda L. Kent
Keith Townsend
John W. Hunter

1401 H Street, NW
Suite 600
Washington, DC 20005
(202) 326-7375

March 30, 1999

TABLE OF CONTENTS

SUMMARY i

I. INTRODUCTION 2

II. PRINCIPAL ISSUES 3

A. Confiscation Liability 3

B. Effects of New Technologies on the Separations Process..... 4

C. Difficulties in Tracking Usage..... 5

D. Effects of End-user Charges 6

E. Section 254(k)..... 8

F. Competitive Services 9

G. Modified Structure..... 9

H. Transitional Reform..... 10

III. CONCLUSION 11

SUMMARY

The State Members of the Separations Joint Board filed with the Commission a report on comprehensive review of separations that addresses eight specific issues regarding jurisdictional separations (the State Report). While USTA comments on each of those topics, the essence of the State Report is found in three overall issues: the continued legal requirement for the separations process; the effect of new technologies on separations; and the need for and nature of changes to the separations process.

Jurisdictional separations of costs must continue so long as local exchange carriers remain subject to federal and state rate regulation of any kind, regardless of whether that regulation is in the form of price cap or rate of return regulation. The Supreme Court decision in *Smith v. Illinois Bell Tel. Co.* continues to require a determination of which costs are the responsibility of which jurisdiction, regardless of regulatory and market changes.

The local exchange carriers should not be burdened with a costly measurement process that yields little benefit to consumers. Rather, new technologies can and should be accommodated through the existing separations process.

The USTA proposal to freeze separations should be adopted as a transition to eventual elimination of separations. This plan satisfies reporting requirements

and provides a more cost-effective method for the local exchange carriers to perform separations studies than the current procedures. The State Report's alternative transitional proposal, with its three-year rolling average of separations factors, should not be adopted because it would complicate the current process and would significantly increase administrative costs of the carriers. The State Report's proposal also would not result in ultimate regulatory reform of the separations process.

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

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

COMMENTS
OF THE
UNITED STATES TELEPHONE ASSOCIATION

The United State Telephone Association (USTA) hereby files its comments in response to the Commission's Public Notice¹ in the above-referenced proceeding. USTA is the principal trade association of the local exchange carrier (LEC) industry. Its members provide over ninety-five percent (95%) of the incumbent LEC provided access lines in the United States.

In a Notice of Proposed Rulemaking (NPRM),² the Commission invited the state members of the Separations Joint Board to develop a report setting forth their analysis of the parties' comments and identifying issues and subjects to

¹Public Notice DA 99-414, released February 26, 1999.

²*Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, Notice of Proposed Rulemaking, CC Docket No. 80-286, 12 FCC Rcd

address in a Further Notice of Proposed Rulemaking.

On December 21, 1998, the state members of the Separations Joint Board filed with the Commission their report on comprehensive review of separations (the State Report). In its February 26, 1999 Public Notice, the Commission requested comments on the principal issues addressed in the State Report. They are: 1) confiscation liability; 2) effect on new technologies on the separations process; 3) difficulties in tracking usage; 4) effect of end user charges; 5) Section 254 (k); 6) competitive services; 7) modified structure; and 8) transitional reform.

1. INTRODUCTION

USTA=s comments will address these principal issues. However, before the individual issues raised in the State Report are addressed, there are at least two basic questions regarding the overall approach to jurisdictional separations that need to be answered. The first question concerns the idea of separations itself. While most parties agree that separations change need to take place, reform itself is not the goal but should be viewed as a process to achieve other specific goals and/or objectives. In addition, even though there were some criteria identified in the original NPRM, those criteria were not addressed in the State Report. While those criteria at least formed some basis for evaluating separations changes, a more defined objective should be established for separations reform before individual issues are addressed.

22120, 22132 (1997) (NPRM).

The separations freeze proposed by USTA³ is an interim step toward the elimination of separations as a clearly identified goal. If there is to be a different goal, then the goal needs to be clearly and concisely identified so that the industry and the regulators will be able to more easily work toward that goal. If a goal is not clearly defined, then the result is likely to be many efforts in many directions, with much confusion resulting and the process being bogged down.

Another basic question involves the expected longevity of the separations process as a meaningful mechanism. In this age of rapidly evolving technology, competition and alternative regulation, the idea of a jurisdictional separations process becomes more cloudy and less meaningful. Several of the issues raised by the State Report involve trying to predict what new technologies or competition will bring to the telecommunications industry. While this guessing game is an interesting intellectual exercise, it would seem to be more useful to follow the portion of the saying *Lead, follow, or get out of the way* by *getting out of the way*.[≡] Jurisdictional separations has been *following*[≡] since its inception and has not changed in the last few years. *Leading*[≡] the regulatory charge does not seem to be in the future for separations as the many technological and competitive changes take place. It is time for separations to *get out of the way*[≡] and for the USTA separation freeze proposal to be adopted on the path to eventual elimination of the jurisdictional separations

³USTA Comments in CC Docket No. 80-286 filed December 10, 1997.

process.

II. PRINCIPAL ISSUES

1. Confiscation Liability

USTA agrees with the Commission's tentative conclusion that the state and federal jurisdictions are responsible for ensuring that rates are not confiscatory.⁴ The Commission correctly recognizes that there is a legal requirement for some means of defining jurisdictional boundaries for cost and expenses...so long as rates remain regulated.⁵ The Commission notes that it must determine whether regulatory and market changes since [*Smith v. Illinois Bell Tel. Co. (Smith)*⁶] was decided have so eroded the factual predicate of that decision that it is no longer pertinent.⁷ Both the FCC and the states regulate rates for operations that involve joint and common cost used for interstate and intrastate services. *Smith* requires each jurisdiction to allow charges at a level designed to compensate a carrier adequately for services under its authority.⁸ *Smith* forbids a state from relying on total company returns or revenues, which are only partly within its jurisdiction, to conclude that intrastate rates and

⁴NPRM at &35.

⁵*Id.* at &32.

⁶282 U.S. 133 (1930).

⁷NPRM at &32.

⁸*Smith* at 160, 161.

revenues are adequate to compensate intrastate costs.⁹ While there is no requirement to use any particular method of allocating cost, the rights of ratepayers and carriers, as well as the boundaries of state and federal authority, cannot be enforced without a clear answer to the question of which costs are the responsibility of which jurisdiction.

A. Effects of New Technologies on the Separations Process

Technological advances are being developed and deployed in the telecommunications industry at an unprecedented rate. These advances in technology will render any effort to devise a set of rules to accommodate contemporaneous technologies futile if not impossible.

⁹*Id.* at 148.

The separations process is based on categories and jurisdictions and does not lend itself to the unique identification of new technologies and services. For example, the Commission's recent ruling that the Internet Service Providers traffic is interstate in nature reflects the difficulty in applying separations to new technologies and services.¹⁰ Technologies can continue to be processed through the current separations process.

2. Difficulties in Tracking Usage

Relative use is the lynchpin of separations. Historically, separations has been used to establish the underlying costs which regulators in both interstate and intrastate jurisdictions have used as the basis for setting rates in the dual regulatory environment.

In the early 1990's, various LECs adopted interstate incentive regulation known as Price Caps. Price Caps translated interstate costs, using Parts 36 and 69 of the Commission's rules,¹¹ into rates for the last time nearly a decade ago. Price cap regulation has divorced itself from costs as defined by the separations process in favor of the productivity and inflation indexing mechanism. As long as earnings are above costs as defined by the process, then regulators have fulfilled their responsibility by providing adequate recovery. This process should

¹⁰Declaratory Ruling in *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, and Notice of Proposed Rulemaking in *Inter-carrier Compensation for ISP-Bound Traffic*, CC Docket No. 99-68, FCC 99-38, released February 26, 1999.

not be disturbed by artificial changes to the usage rules underlying the separations process.

As forces external to the separations process drive changes, the FCC has determined appropriate cost recovery mechanisms through rule making procedures without tinkering with the separations process. Access reform for price cap companies provided changes to the methods of recovering costs that are not tied to the Part 36 process. For example, line port investment in the local dial switch was non-traffic-sensitive (NTS) before January 1988 and separated with the NTS gross allocator. After January 1988, and before January 1998, the same port was treated as traffic-sensitive and separated with a traffic sensitive factor (Dial Equipment Minutes of Use) and costs were recovered in the local switching element. In January 1998, the Line Port investment in the local dial switch was moved to a flat rate common line recovery mechanism; yet the port is separated based on the DEM, instead of the loop related gross allocator. These interstate tariff changes were accomplished without changes to usage factors and yielded results that were never envisioned but nevertheless worked under the original separations (usage) rules.

The Commission has asserted jurisdiction over internet traffic, although corresponding jurisdictional cost recovery issues have not been resolved. While tracking Internet usage is difficult, certainly the preponderance of the traffic

¹¹⁴⁷ C.F.R. Parts 36 and 69.

destined to the ISPs is interstate in nature. The LEC industry is confident that once the tariff issues are resolved surrounding Internet traffic switched via a Competitive LEC (CLEC) and the ESP exemption in general, an acceptable means of addressing the jurisdictional nature of the traffic will be developed. In any event, LECs should not be burdened with a costly measurement process that provides little benefit to consumers.

D. Effects of End-user Charges

USTA agrees with the State Report that separations has been used to keep basic service rates low by assigning costs to the interstate jurisdiction. Historically, traffic-sensitive costs were assigned to the interstate jurisdiction based on a relative usage measurement and non-traffic-sensitive costs were assigned to the interstate jurisdiction based on political Apolicy compromise.≡ Costs assigned to interstate were recovered through usage-sensitive toll rates.

With the introduction of access charges in 1984, the Commission recognized that interstate usage rates could no longer bear the weight of all the NTS charges. The Commission determined that the end user would have to bear a portion of the NTS charges assigned to the interstate jurisdiction. In the Commission=s Access Charge Order,¹² LECs were ordered to tariff and bill a flat-rate subscriber line charge directly to the end user. After years of delay, subscriber line charges were gradually phased in to the current levels.

¹²12 FCC Rcd 15982 (1997).

USTA agrees with the State Report concerning billing the subscriber line charge directly to the end user. The end user views this as part of the basic service rate. The Commission turned an implicit subsidy buried within the interstate toll rates into an explicit cost to be borne directly by the end user. With the passage of the Telecommunications Act of 1996, Congress went one step further in legislating that recovery of universal service costs should be explicitly funded. Universal service support for NTS costs could be passed on to the end user as a flat rate charge.

USTA disagrees with the State Report that the separations process provided a forum for addressing fundamental rate design. Separations was and still is a method of assigning cost to the jurisdictions. The recovery of the costs assigned to a jurisdiction, whether through flat-rated charges or usage-sensitive charges, was, is and should continue to be purely at the discretion of the jurisdictional regulatory body.

5. Section 254(k)

In its Report and Order in CC Docket No. 86-111, *Separations of Costs of Regulated Telephone Service from Costs of Non-regulated Activities* (Joint Cost Order),¹³ the Commission adopted cost allocation standards for use in apportioning cost between regulated and non-regulated activities.

Section 254(k) of the Act¹⁴ addresses cost allocation rules, accounting safeguards and jurisdiction to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common cost of facilities used to provide those services. Moreover, the Commission is charged with the responsibility at the federal level and the state commissions at the state level.

The Commission already has cost allocation standards and guidelines in place to ensure that no more than a reasonable share of the joint and common cost is assigned to regulated services.

In the Joint Cost Order, the Commission dismissed a recommendation of using a joint board to determine the accounting treatment of common plant.¹⁵

The Commission went on to state, ASuch an approach would prove

¹³2 FCC Rcd 1298 (1987).

¹⁴47 USC § 254 (k).

¹⁵*Id.* at 1340.

tremendously time consuming, would overburden Commission resources, and could result in a wide disparate set of accounting methods that would be difficult to monitor.¹⁶

F. Competitive Services

The State Report indicates that any reform of jurisdictional separations must take into account how costs are allocated between the jurisdictions when certain services are deregulated. In this regard, the state members claim that such reform may require an integration of Parts 36 and 64 of the Commission's rules.

USTA believes that competitive services should be deregulated as soon as possible. While there may be some change in the costs assigned to the jurisdictions as a result of deregulation, it does not mean that there needs to be separations changes. (It should be noted that the State Report states only that there should be a close coordination, not integration, of separations with the removal of services from regulation.) If there are specific concerns that were not identified in the State Report, they need to be identified so they can be addressed by all parties with the same understanding of the concern. Also, changes to Part 64 or to the individual companies' cost allocation manuals are addressed in separate proceedings, which are not subject to review by a joint

¹⁶*Id.*

board and would not be raised in this proceeding.

7. Modified Structure

The State Report recommends that the Separations Joint Board consider proposals that fundamentally alter the basis upon which costs are allocated between jurisdictions. The ultimate goal of any change to the current separations process should be the elimination of unnecessary regulatory costs and burdens....¹⁷ The time is ripe for preparing and planning a transition away from the current separations process. Elimination of separations should be the ultimate goal, but it is recognized that a change of this magnitude cannot be accomplished overnight. There is a great deal of work that needs to be done by state commissions, the FCC and the industry to prepare for any modified structure.

A transitional period needs to be established immediately with an established end date for the elimination of separations in its current form. During the transitional period, which should be from three to five years, the Commission should adopt the USTA freeze proposal. The USTA plan satisfies reporting requirements, provides a more cost-effective method for the LECs to perform separations studies than the current rules, and would allow all parties time to plan and implement a new modified structure.

H. Transitional Reform

¹⁷NPRM at &25.

The State Report recommends the adoption of a "transitional reform" proposal through the implementation of a three-year rolling average of separations factors. The proposal is presented as an interim measure intended to address criticisms of the various freeze proposals, as well as the concerns that gave rise to the freeze concept.

Among the primary objectives of the USTA proposal to freeze separations factors is the reduction of the administrative and regulatory burdens placed upon LECs by the existing separations rules and avoidance of any cost shifts. The practical effect of the State Report's proposal would be to significantly complicate the current jurisdictional separations process while in no way reducing the administrative costs borne by carriers. Where the USTA proposal would simply freeze each company's process at a point in time, development of the three-year average would require additional calculations and procedures over and above those currently in place. This situation would have an even greater impact on those carriers with highly mechanized processes that update separations factors on a monthly rather than annual basis. Also of concern is that once rule changes have been incorporated into historical data, the use of this data in ratemaking could result in retroactive ratemaking, which is prohibited by law.

The State Report's proposal is presented as an interim measure in lieu of comprehensive separations reform. Where USTA presented its freeze proposal

as an interim step toward the eventual elimination of the jurisdictional separations process, the State Report's proposal appears to be based on the belief that some as yet unidentified process will be required in order to maintain the separations process indefinitely. The USTA plan is based on the position that the separations process must be maintained as long as LECs continue to be regulated. However, the competitive and deregulatory goals of the Telecommunications Act are clear. The USTA freeze proposal is consistent with those goals, while the State Report's proposal seems to anticipate a different outcome.

In summary, the State Report's proposal fails to address the concerns that led to the development of the various freeze alternatives and conflicts with the deregulatory goals of the Telecommunications Act. The proposal should be rejected by the Joint Board in favor of the alternatives more consistent with the goals for separations reform such as the USTA freeze proposal.

III. CONCLUSION

For the reasons stated herein, jurisdictional separations remains necessary to the extent that local exchange carriers are subject to federal and state regulation of rates, in any form. As new technologies are introduced, adjustments are made to methods of cost recovery without the need to alter the separations process. New technologies should continue to be processed through the existing separations process, although Internet traffic poses

particular challenges. The incumbent local exchange carriers should not be burdened with costly measurement processes regarding usage for separations determinations.

Separations reform is needed, starting with a transition from the present burdensome separations process and ultimately resulting in the elimination of separations in its current form. The USTA proposal to freeze separations should be adopted by the Commission immediately. This action should be taken instead of the State Report's transitional reform recommendation that involves a three-year rolling average of separations factors.

Respectfully submitted,

UNITED STATES TELEPHONE ASSOCIATION

By _____

Its Attorneys:

Lawrence E. Sarjeant
Linda L. Kent
Keith Townsend
John W. Hunter

Porter E. Childers,
Executive Director
Legal & Regulatory Affairs

1401 H Street, NW
Suite 600
Washington, DC 20005
(202) 326-7375

March 30, 1999

