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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

February 18, 2000

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Ex Parte Notice, CC Docket No. 80-286, In the Matter Of Jurisdictional Separations Reform and Referral to the Federal-State Joint Board.

Dear Ms. Salas:

The attached letters were sent today, via e-mail to Andy Firth of the Common Carrier Bureau in connection with the above-referenced proceeding. In accordance with Commission rules, I am submitting two copies of this notice. Kindly stamp the additional return copy provided. Please direct any questions to me.

Sincerely,

Robert Falkner
Robert Falkner
Attachments

CC: Andy Firth

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List A B C D E

CALCULATION OF NECA INTERNET REVENUE REQUIREMENT IMPACT

- NECA requested 1998 dial-up Internet traffic levels from cost companies in its Traffic Sensitive (TS) Pool. NECA also requested estimated Internet traffic growth percentages.

- Responses to the data request were as follows:
  - Data was provided for a total of 409 study areas (approximately 75% of the NECA TS pool study areas).
  - Based on data provided, 1998 Internet traffic as a percent of local/state DEM was **17.7%**.
  - Average estimated one-year growth of dial-up Internet traffic provided by companies was 39%.
  - Average 1998 relative interstate DEM factor with Internet as local/state was 0.1818.
  - The average relative interstate DEM factor recalculated to reflect Internet as interstate, with growth, was 0.4099.

- Revenue requirement estimate of Internet traffic was calculated as follows:
  - For cost companies providing data, the 1998 Internet DEM usage was removed from their reported local/state DEM, increased by the reported growth percentages, and added to the interstate DEM. For companies not providing data to NECA, an average proportion of Internet DEM traffic and growth rate was used.
  - Study area relative interstate DEM factor was then recalculated, and the COE Category 3 factor was calculated pursuant to section 36.125(f) of the Commission's rules.
  - The new COE Category 3 factor was used in the allocation of the 1999/2000 forecasted test period total company data, resulting in revised local switching revenue requirement amounts.
  - For average schedule companies, a comparable increase in local switching settlements reflecting the cost company Internet impact was applied.

- The difference between the test period local switching revenue requirement reflecting Internet as interstate ($716.3 million) and the local switching revenue requirement without reflecting the shift in Internet traffic ($545.6 million) is an Internet impact of **$170.7 million**.

02/16/00

OPTIONAL CATEGORIZATION FREEZE
FOR RATE OF RETURN COMPANIES

- It is critical that an interim freeze of separations factors be put into effect immediately for rate of return companies due to increasing levels of Internet traffic.

- The interim freeze of separations factors should be based on the 1995-1997 three-year average which results in minimal cost shifts. It is also centered on 1996, the year DEM was frozen. Using three years, instead of just one, addresses anomalous situations which some companies may have experienced in one year.

- Freeze should be applied prospectively.

- An ***optional*** freeze of categorization relationships in addition to the factor freeze is proposed.

- There are valid reasons for a categorization freeze being ***optional*** for rate of return companies:

  - Not all rate of return companies are alike. In addition to differences between price cap and rate of return companies, there are substantial *differences among rate of return companies.* Rate of return companies are at different stages of network deployment, and plan to implement new technologies (*e.g.,* DSL, ATM switching) and changes in network configurations at different times and in different proportions.

  - Rate of return companies are much smaller than price cap companies and therefore tend to be more volatile, with changes in investment potentially resulting in large shifts in categorization relationships.

  - A mandatory categorization freeze could cause disincentives for companies to deploy new technologies due to insufficient cost recovery (see attachment for examples)

Attachment

OPTIONAL CATEGORIZATION FREEZE FOR RATE OF RETURN COMPANIES

Categorization Freeze Concerns:

Scenario 1: *Company deploys Digital Subscriber Line (DSL) service where previously it did not have any DSL service.*

- Investment would be added to Account 2230, Circuit Equipment, for the Digital Subscriber Line Access Multiplexer (DSLAM) and Account 2410, Cable & Wire Facilities, for the interoffice transport.
- Cost recovery effects:
  - Without a categorization freeze, the DSLAM is categorized as Central Office Equipment (COE) Category 4.11, Wideband Exchange Line Circuit Equipment, and the interoffice facilities are categorized as COE Category 4.22, Interexchange Circuit Equipment, and C&WF Category 3, Interexchange Cable and Wire Facilities.

    As ordered by the FCC, if all DSL services provided by the company are interstate (*e.g.,* provided for connections to the Internet), costs related to DSL are directly assigned to the interstate jurisdiction, and recovered via special access.
  - With a freeze of categorization, investment would be allocated predominantly to COE Categories 4.13 and 4.23 (as well as Category 4.3 if host/remote facilities are in place) for the circuit equipment investment and to C&WF Categories 1.3 and 3 (and Category 4 for host/remote).

    These costs would be allocated between to the interstate jurisdiction on the basis of the gross allocator (*i.e.,* 25%) for COE Category 4.13 and C&WF Category 1.3, and an average of 50% for interexchange investment and 30% for host/remote facilities. In addition, the amounts that are categorized to COE Category 4.13 and C&WF Category 1.3 would be included in the Universal Service High Cost Loop formula.
- If a mandatory categorization freeze was implemented, companies would not fully recover DSL costs from the interstate jurisdiction as directed by the FCC. Instead, costs would be allocated between jurisdictions, with a significant proportion (possibly as high as 75%) being distributed to the intrastate jurisdiction for recovery. Companies cannot be assured of recovery of these costs from intrastate rates.

Scenario 2*: Company replaces remote switching offices with concentrator devices*

- Investment would be added to Account 2230, Circuit Equipment, for the concentrator equipment and removed from Account 2210, Central Office-Switching. The level of C&WF investment in Account 2410 may also be affected.
- Cost recovery effects:
  - Without a categorization freeze, C&WF investment would be allocated to category 1.3 to connect the concentrator unit to the central office, and C&WF investment in category 4, Host/Remote message C&WF, would be removed. Circuit equipment would be added to COE Category 4.13, and removed from COE Category 4.3.
  - With a categorization freeze, C&WF investment would continue to be allocated to C&WF Category 4 and circuit equipment investment would continue to be allocated to COE Category 4.3, even though these investment categories have been greatly reduced (or possibly eliminated). The additional proportion of investment in COE Category 4.13 compared to the other categories of circuit equipment investment would not be reflected.
- If a mandatory categorization freeze was implemented, investment in interoffice host/remote facilities would be overallocated and loop-related investment would be underallocated. The loop-related amounts would not be properly included in the Universal Service High Cost Loop formula.