NECA NATIONAL EXCHANGE CARRIER ASSOCIATION INC

2120 L Street, NW
Suite 650
Washington, D.C. 20037
Tel. 202-263-1656
Fax. 202-776-0078
e-mail: lmagrud@neca.org

ORIGINAL EX PARTE OR LATE FILED

Lora Magruder
Manager, Government Relations

RECEIVED
MAR 06 2000
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

March 6, 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:

On March 5, 2000, representatives of NECA, NRTA, and NTCA met with members of the Federal-State Joint Board on Separations to discuss an optional categorization freeze for Rate of Return companies (attached). NECA attendees were Bob Anderson, President and COO; Ken Levy, Vice President and General Counsel; and Gina Harrison, Senior Counsel and Director - Washington Office accompanied by Margot Humphrey (representing NRTA) and Marie Guillory, Vice President - Legal and Industry (NTCA). Members of the Federal-State Joint Board were Joan Smith, Commissioner - Oregon PUC; Tom Welch, Chairman - Maine PUC; Diane Munns, Commissioner - Iowa UB; and Joseph Mettner, Commissioner - Wisconsin PSC.

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,

Lora Magruder

Lora Magruder

Attachment

CC: Joan Smith, Oregon
Tom Welch, Maine
Dianne Munns, Iowa
Joseph Mettner, Wisconsin

No. of Copies rec'd 0+1
List A B C D E

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.

    Since 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 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. 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.
- Example: Company implements DSL service in the current year by adding $100,000 investment in each of the following categories: COE Category 4.11 Wideband Exchange Line Circuit Equipment, COE Category 4.22 Interexchange Circuit Equipment, and C&WF Category 3 Interexchange Cable and Wire Facilities. No investment in these categories existed previously.
  - Average investment for the 1995-1997 freeze period for Account 2230, Circuit Equipment, and Account 2410, Cable & Wire Facilities were as follows:

Category	Total Company	Total Interstate	IS Pct
COE Category 4.13	$1,000,000	250,000	25%
COE Category 4.23	$1,000,000	500,000	50%
COE Category 4.3	$500,000	150,000	30%
C&WF Category 1.3	$5,000,000	1,250,000	25%
C&WF Category 3 Msg	$750,000	375,000	50%
C&WF Category 4	$500,000	150,000	30%

  - Additional $200,000 in COE Circuit Equipment investment would be distributed based on the existing COE category relationships and allocated using the frozen interstate allocation percentages shown above, as opposed to 100% assignment to interstate. This results in an underallocation to interstate of 64% for the DSL circuit equipment, and 12% for total COE Circuit Equipment.*
  - Additional $100,000 in C&WF Category 3-Private Line is also distributed based on existing C&WF category relationships and allocated between the state and interstate jurisdiction, resulting in a 72% underassignment to interstate for the DSL C&WF investment and 4% for total C&WF investment.*

* Assumes no additional changes in investment levels and interstate allocation percentages.

Attachment

OPTIONAL CATEGORIZATION FREEZE FOR RATE OF RETURN COMPANIES

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.
- Example: Company adds concentrator equipment and removes host/remote facilities. COE Category 4.13 and C&WF Category 1.3 each increase by $500,000, and COE Category 4.3 and C&WF Category 4 are each reduced by $500,000.
  - Average investment for the 1995-1997 freeze period for Account 2230, Circuit Equipment, and Account 2410, Cable & Wire Facilities were as follows:

Category	Total Company	Total Interstate	IS Pct
COE Category 3	$2,500,000	1,750,000	70%
COE Category 4.13	$1,000,000	250,000	25%
COE Category 4.23	$1,000,000	500,000	50%
COE Category 4.3	$500,000	150,000	30%
C&WF Category 1.3	$5,000,000	1,250,000	25%
C&WF Category 3 Msg	$750,000	375,000	50%
C&WF Category 4	$500,000	150,000	30%

  - Current period investment levels reflecting the shift in investment are as follows:

Category	Total Company	Total Interstate	IS Pct
COE Category 3	$2,000,000	1,400,000	70%
COE Category 4.13	$1,500,000	375,000	25%
COE Category 4.23	$1,000,000	500,000	50%
COE Category 4.3	$0	0	30%
C&WF Category 1.3	$5,500,000	1,375,000	25%
C&WF Category 3 Msg	$750,000	375,000	50%
C&WF Category 4	$0	0	30%

  - Shifts in COE Circuit Equipment and C&WF investment from host/remote to loop-related investment would not be reflected due to freeze in categorization relationships. Since host/remote investment is allocated at 30% and loop-related investment is allocated at 25%, a 17% increase in the allocation to interstate of the related investment occurs, resulting in 3% overallocation for total COE circuit equipment and 1% for total C&WF investment.*
  - $1 million (17%) total increase in loop-related investment would not be included in the Universal Service High Cost Loop formula.

---

* Assumes no additional changes in investment levels and interstate allocation percentages.

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)