

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

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

**COMMENTS OF
THE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES,
THE NEW JERSEY DIVISION OF RATE COUNSEL
AND THE MAINE OFFICE OF THE PUBLIC ADVOCATE**

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I. INTRODUCTION

In the Order and Further Notice of Proposed Rulemaking (“Order” and “FNPRM”) released May 16, 2006 in this docket, the Federal Communications Commission (“FCC” or “Commission”) continued the current freeze on the separations process, and asked for comment on separations issues.¹ As the Order describes it, the jurisdictional separations process “is the process by which incumbent [local exchange carriers] LECs apportion regulated costs between the interstate and intrastate jurisdictions.”²

¹ *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Order and Further Notice of Proposed Rulemaking (rel. May 16, 2006) (“Order and FNPRM”).

² Order, ¶ 2.

The National Association of State Utility Consumer Advocates (“NASUCA”) as an organization,³ and its members the New Jersey Division of Rate Counsel (“New Jersey Rate Counsel”)⁴ and the Maine Office of the Public Advocate (“Maine Public Advocate”)⁵ present these comments to address the issues raised by the FNPRM, which are vital to the interests of the consumers represented by NASUCA’s members. The purpose of these comments is to ensure that, in its examination of complex cost accounting systems, the Commission does not lose sight of the interests of consumers, who ultimately bear the cost of outdated cost accounting systems and who literally pay the price for the misallocation and mis-assignment of costs.

These comments are brief, far briefer than the subject requires. But that is possible because the comments fundamentally serve as an introduction to the affidavits of two nationally-recognized experts in telecommunications. The first affidavit (Attachment A hereto) is that of Susan M. Baldwin, who was retained for this purpose by the New Jersey Rate Counsel. The second affidavit (Attachment B hereto) is that of Dr. Robert Loube, who was retained for this purpose by the Maine Public Advocate. Between them,

³ NASUCA is a voluntary association of 45 advocate offices in 42 states and the District of Columbia, incorporated in Florida as a non-profit corporation. NASUCA’s members are designated by laws of their respective jurisdictions to represent the interests of utility consumers before state and federal regulators and in the courts. See, e.g., Ohio Rev. Code Chapter 4911; 71 Pa. Cons. Stat. Ann. § 309-4(a); Md. Pub. Util. Code Ann. § 2-205(b); Minn. Stat. § 8.33; D.C. Code Ann. § 34-804(d). Members operate independently from state utility commissions as advocates primarily for residential ratepayers. Some NASUCA member offices are separately established advocate organizations while others are divisions of larger state agencies (e.g., the state Attorney General’s office). NASUCA’s associate and affiliate members also serve utility consumers but are not created by state law or do not have statewide authority.

⁴ Effective July 1, 2006, the New Jersey Division of Ratepayer Advocate is now the New Jersey Division of Rate Counsel. The Rate Counsel, formerly known as the New Jersey Ratepayer Advocate, is a Division within the Department of the Public Advocate. N.J.S.A. §§ 52:27EE-1 *et seq.*

⁵ The Maine Public Advocate represents all consumers of utility services in Maine, pursuant to 35-A M.R.S.A. Section 1702. The Public Advocate and staff take actions to ensure that Maine's utility customers have affordable, high quality utility services. Under Section 1702(5) of the Maine statutes, the Public Advocate may appear on behalf of utility ratepayers in “proceedings before state and federal agencies... in which the subject matter of the action affects the customers of any utility doing business in the State....”

Ms. Baldwin and Dr. Loube address the gamut of consumers' concerns over the separations process and the need to reform it. They also propose specific actions for the Commission to take in the course of that reform.

The FNPRM focuses on jurisdictional separations, which is only one part of the reform needed for the FCC's accounting regulations. The current jurisdictional separations, like the separation between regulated and non-regulated activities that precedes it in the Commission's accounting system, have become outmoded as a result of seismic changes in the industry.⁶ To the extent that the accounting rules do not recognize these changes, consumers will suffer from rates that are substantially out-of-line with underlying costs.⁷ A fundamental promise of the competitive market into which we have supposedly entered is that prices will be based on marginal costs, **and will not subsidize other areas of the competitive firm's endeavors.**⁸ That is not now the case.

Incumbent LECs ("ILECs") variously and continuously proclaim that they are competitive, and seek to be freed of all regulation, including separations accounting. Ms. Baldwin refutes the ILECs' premise.⁹ The ILEC position misses the fact that most of the current rates were **not** set in a competitive market. Rather, current rates were set under, or derived from, monopoly conditions, based on the outmoded separations and allocations percentages that have been frozen since 2001. In order for consumers to have a fair shake in these new markets, both interstate and intrastate rates need to be re-

⁶ See Baldwin Affidavit, ¶¶ 13, 17, 28, 66-75, 80-88, 105-111, 137-154.

⁷ Id., ¶¶ 9-14, 17, 47-52, 64-80, 89-91, 106-122.

⁸ See 47 U.S.C. § 254(k).

⁹ Baldwin Affidavit, ¶¶ 16-17, 55-60.

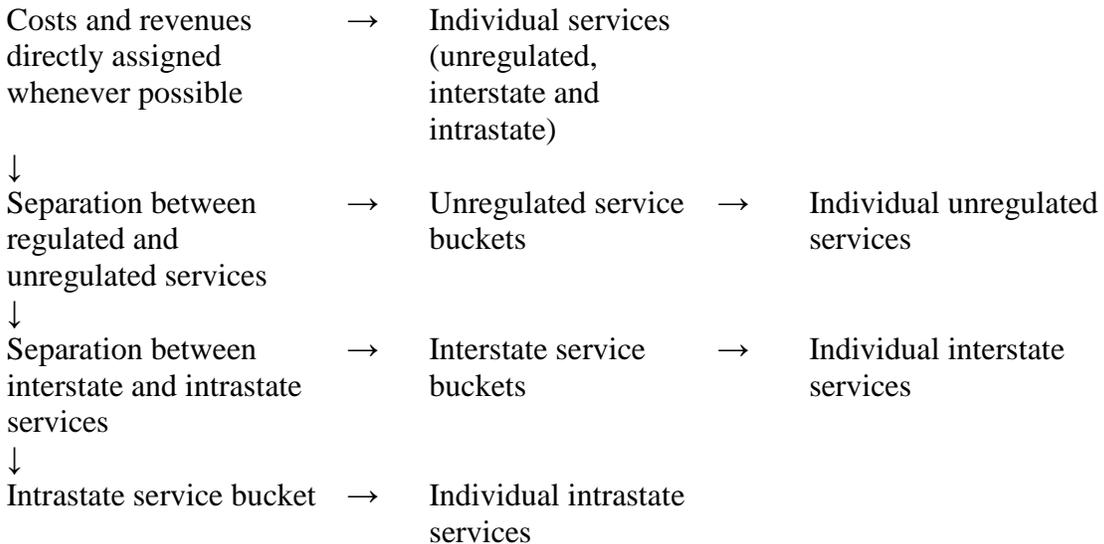
initialized to reflect an up-to-date allocation of costs that reflects the reality of today's markets.

II. CONSUMERS OF INTRASTATE REGULATED SERVICES FOOT THE BILL FOR UNREGULATED SERVICES OR SERVICES THAT ARE JURISDICTIONALLY INTERSTATE.

Consumers of intrastate regulated services are bearing unfairly the cost of billions of dollars of carriers' investment in plant and related expenses that should be assigned and allocated to unregulated lines of business and interstate services. This is shown in detail in Ms. Baldwin's affidavit.¹⁰

The structure of the Commission's rules requires first an allocation of costs between regulated and deregulated services.¹¹ Then there is an allocation of costs between the interstate and the intrastate jurisdiction. Overriding this allocation process is the requirement that costs be directly assigned to services whenever possible.¹²

The process can be simplistically portrayed as follows:



¹⁰ See footnote 6, supra.

¹¹ See FNPRM, ¶ 3.

¹² Loube Affidavit, 9-15; Baldwin Affidavit, ¶ 29.

The cost and revenue combination that should determine each individual service's price or rate is the amount directly assigned plus the allocated or separated portion. It is crucial for the process to be corrected, as explained in the next section.

III. SEISMIC CHANGES WARRANT RE-INITIALIZATION OF INTERSTATE AND INTRASTATE RATES.

Numerous factors -- described in Ms. Baldwin's affidavit¹³ -- create a gross mismatch between the current accounting of revenues and costs, including: the Bells' pursuit of unregulated lines of business;¹⁴ the Bells' increasing sales of long distance and bundled services which mingle intrastate, interstate, regulated, and unregulated products;¹⁵ the Commission's declaration that wireline broadband services are information services;¹⁶ and the increase in VoIP and ISP-bound traffic that the Commission has said is interstate. These seismic changes justify a long overdue close examination of costs and rates by federal and state regulators. As Ms. Baldwin demonstrates, billions of dollars are erroneously allocated to intrastate regulated rates.¹⁷

Those distorted intrastate and interstate costs and their resultant rates demonstrate the compelling need for federal and state regulators to examine those costs and rates (1) to ensure that regulated services are not cross-subsidizing unregulated services¹⁸ and (2) with subsidies removed, to lower intrastate regulated rates based on a proper allocation and assignment of carriers' plant to interstate and unregulated operations that reflects

¹³ See footnote 5, supra.

¹⁴ Baldwin Affidavit, ¶¶ 66-91.

¹⁵ Id., ¶¶ 137-156.

¹⁶ Id., 68.

¹⁷ Id., ¶ 120 and Table 9.

¹⁸ 47 U.S.C. § 254(k).

current conditions. The attached affidavits demonstrate the existence of such misallocations and propose remedies not only for the regulated intrastate jurisdiction, but for the regulated interstate jurisdiction. The intrastate issues can be addressed by the states even before this Commission's interstate analysis is final.

The extreme mismatch between interstate and intrastate costs and rates is easily shown from the Commission's ARMIS reports. Despite the ILECs' claims about the competitiveness of the interstate market, the ARMIS reports, as summarized in Attachment 3 hereto, show the ILECs earning what can charitably be described as supracompetitive¹⁹ profits in the interstate jurisdiction, ranging as high as 58%. Dr. Loube's affidavit highlights what might be described as the "poster child" for the current misallocation, the extreme returns being earned by interstate special access services.²⁰

By contrast, the ARMIS-reported intrastate returns shown in Attachment 3 are substantially lower than the interstate returns.²¹ NASUCA submits that the main causes of this difference are the overallocation of costs to the intrastate regulated side, that should be placed on unregulated services or on the interstate jurisdiction. AT&T and BellSouth, among others, concede the mismatch of costs and revenues.²²

IV. STATES SHOULD NOT AWAIT THE COMMISSION'S RESOLUTION OF THIS COMPLEX PROCEEDING BEFORE REDUCING EXCESSIVE RATES FOR INTRASTATE REGULATED SERVICES.

As a result of the reinitializing of costs and revenues, NASUCA believes that it will be shown that consumers' intrastate regulated rates are excessive. States should,

¹⁹ Others might feel that more extreme terminology was appropriate. See Loube Affidavit, ¶ 22.

²⁰ Loube Affidavit, ¶ 21 and Table 2.

²¹ As in many areas of the industry, there appear to be outliers that perhaps deserve individual examination.

²² See Baldwin Affidavit, ¶ 25.

however, exercise their right to expeditiously remove non-regulated activities from intrastate rates and to direct carriers to directly assign private line investment. As the Commission recognizes, “state jurisdictions have the ability to remove the costs of state non-regulated activities so that those costs will not be recovered in regulated intrastate rates.”²³ The Commission should, consistent with NARUC’s resolution, “clarify that all carriers must continue to directly assign all private lines and special access circuits based on existing line counts,”²⁴ and that states can require their carriers to do so.

Delay in re-initializing excessive state rates harms consumers, and, therefore, states should not await the conclusion of this proceeding before examining carriers’ costs. The Commission should issue an interim order removing any residual uncertainty about states’ rights to remove the costs of non-regulated and interstate activities from intrastate rates.²⁵

V. NASUCA’S PROPOSALS FOR REFORM OF THE PROCESS

As noted above, the first key to the separations and allocation process is direct assignment of costs and revenues. Dr. Loubé demonstrates the current failure to directly assign plant to special access services, which results in a reduction in plant assigned to the interstate jurisdiction.²⁶ Fixing this error actually requires only that the current rules be followed, rather than changing the rules themselves. Dr. Loubé calculates in detail the

²³FNPRM, at footnote 6.

²⁴FNPRM, at para. 92, citing *Resolution Relating to Separations Reform*, NARUC (February 15, 2006).

²⁵ Baldwin Affidavit, ¶¶ 18-27, 62-63.

²⁶ Loubé Affidavit, ¶ 9, 15.

impact of this failure to directly assign to special access on the revenues and returns of the ILECs.²⁷

Once we get to the allocation process, Ms. Baldwin’s affidavit and appendices provide clear evidence of the Bells’ pursuit of new lines of business, and provide three illustrative methodologies that begin to correct the current under-allocation of common plant to unregulated services, such as DSL and video services.²⁸ One methodology estimates a minimum allocation of investment based on consumers’ demand for unregulated services (as measured by the number of DSL connections reported by carriers); a second methodology relies on an estimate of DSL revenues; and a third methodology recognizes that carriers are able to rely on the ubiquitous and invaluable deployment of common loop plant (which enables them to be “ready” to deploy DSL on demand to most consumers), and that, therefore, at least half the common loop plant *regardless of actual demand* should be allocated to unregulated services such as DSL. **In all instances, this Part 64 allocation should occur before the jurisdictional separations process begins.** As presented by Ms. Baldwin, the allocation factor ultimately should be based on all of the carriers’ various unregulated services including not only DSL but also their new entry into video services.

Dr. Loubé’s affidavit also presents a methodology for reallocation that is based on the current use of the loop to provide local service, digital subscriber line (“DSL”) service and video service.²⁹ The allocation there depends on the actual subscription to

²⁷ Id. ¶¶ 16-23.

²⁸ Baldwin Affidavit, ¶¶ 116-120.

²⁹ Loubé Affidavit, ¶¶ 36-41.

the various services. Dr. Loube also proposes that the loop plant allocator based on the use of the plant should also be used to allocate the cost of packet switches.³⁰

Both Ms. Baldwin's and Dr. Loube's affidavits clearly demonstrate that the status quo unfairly burdens customers of regulated intrastate services. The solutions proposed should be considered by the Commission.

VI. INTERSTATE REGULATED RATES ARE ALSO LIKELY EXCESSIVE.

Carriers' forays into unregulated lines of business, which "free-ride" over a common platform (without bearing a commensurate share of common costs), likely yield excessive interstate regulated rates.³¹ Therefore, the Commission should re-initialize interstate rates.

In particular, the most immediate impact on consumers would come from reevaluating the subscriber line charge ("SLC"), which is an interstate rate that customers pay as part of their local service bill. NASUCA submits that if carriers properly allocated and assigned costs to unregulated services, the SLC -- which, for the BOCs and other price cap carriers, is currently based on their CMT revenue requirement³² -- would likely decline, as the cost of regulated services would decline.³³

Most importantly, the Commission should reject the proposal, set forth in the "Missoula Plan" recently filed in CC Docket No. 01-92, to increase SLCs as a means of revenue recovery, unless and until a close examination of carriers' properly-allocated

³⁰ Id., ¶¶ 42-47.

³¹ If costs are removed from the bucket that contains both interstate and intrastate regulated services, it is likely that the total costs allocated to both of those categories will decline.

³² 47 C.F.R. § 69.152.

³³ Baldwin Affidavit, ¶ 10

costs justify such an increase.³⁴ Such an assessment depends critically on the Commission's findings about the Bells' exorbitant overearnings in the pending special access proceeding, and a careful review of the Bells' assignment and allocation of costs to unregulated lines of business.³⁵

VII. THE COMMISSION SHOULD REJECT THE CARRIERS' MYTHS AT THE OUTSET.

Despite carriers' assertions to the contrary, neither existing levels of competition nor the existence of alternative forms of regulation protect consumers adequately from the distorted rates that are based on an outdated and/or insufficiently applied cost accounting system. As explained by Ms. Baldwin, the Bell's remonopolization of the telecommunications markets, along with their increasing sales of bundled offerings, make it even more important for the Commission to assert control over the allocation of costs among services -- regulated and unregulated, intra- and interstate alike.³⁶ This is true regardless of the form of state or federal rate regulation.³⁷

VIII. THE INCREASE IN BUNDLING HAS SERIOUS IMPLICATIONS FOR COST ALLOCATION.

As shown in the affidavit and appendices of Ms. Baldwin, the Bells' phenomenal success in selling bundled services raises significant regulatory concerns and highlights the need to reform the separations rules expeditiously.³⁸ Bundled offerings often combine intrastate and interstate offerings, and regulated and unregulated offerings.

³⁴ See *id.*, ¶ 49.

³⁵ Dr. Loube explains impacts of correcting the accounting process on universal service funds. Loube Affidavit, ¶¶ 48-52.

³⁶ *Id.*, ¶¶ 16-17, 55-60.

³⁷ *Id.*, ¶ 44.

³⁸ *Id.*, ¶¶ 137-148.

Improved cost accounting tools are necessary to detect and to prevent anticompetitive cross-subsidization and errors in jurisdictional allocation of costs and revenues.³⁹

IX. THE BELLSOUTH COST ALLOCATION FORBEARANCE PETITION SHOULD BE DENIED.

In the FNPRM, the Commission asks for comment on the impact of granting or denying a pending BellSouth petition requesting forbearance from the cost allocation rules, based on the purported levels of competition in the market.⁴⁰ For the detailed reasons set forth in Ms. Baldwin's affidavit, the Commission should reject BellSouth's petition, per the comments filed by the New Jersey Rate Counsel in that docket.⁴¹ This will leave the Commission free to pursue the issue in this rulemaking docket, which is where such industry-wide issues of national and local impact are best determined.

X. THE COMMISSION SHOULD CLEAR UP THE JURISDICTIONAL AMBIGUITY REGARDING UNBUNDLED NETWORK ELEMENTS.

As explained in Ms. Baldwin's affidavit,⁴² current accounting for unbundled network elements ("UNEs") appears unclear. Carriers should be required to assign both UNE costs and revenues to the same jurisdiction, whether the UNEs are priced based on total element long run incremental costs or based on negotiated commercial agreements.⁴³ This will ensure proper accounting for these pieces of the network.

³⁹ Id., ¶¶ 149-156.

⁴⁰ FNPRM, ¶ 37, citing *In the Matter of Petition of BellSouth Telecommunications, Inc. for Forbearance Under 47 U.S.C. § 160 from Enforcement of the Commission's Cost Assignment Rules*, WC Docket No. 05-342.

⁴¹ Baldwin Affidavit, ¶¶ 45-46, 50-54;

⁴² Id., ¶ 135-136.

⁴³ Ms. Baldwin refers to "commercially 'negotiated' arrangements" because of doubts over CLECs' ability to effectively negotiate with the increasingly concentrated ILECs. See id., ¶ 135, n.160.

XI. THE COMMISSION SHOULD TAKE IMMEDIATE STEPS TO CORRECT THE CURRENT INFORMATION ASYMMETRY.

The recent changes in the telecommunications industry require that stakeholders -- the FCC, state commissions, state consumer advocates and others -- be able to grasp the reality created by those changes. The five-year freeze on separations means that most stakeholders' information is viewed through the distorting-glass of the market as it existed five years or more ago. For that reason, the Commission should issue a detailed data request in a timely manner, similar to that set forth in the *FNPRM*, with the modifications discussed by Ms. Baldwin and Dr. Loube.⁴⁴ The industry's responses to the request should be made available at least to consumer advocates and state regulators so that they can contribute to a collaborative federal-state approach to revising the outdated cost accounting rules.

XII. CONCLUSION

The issues raised in the affidavits of Ms. Baldwin and Dr. Loube deserve careful scrutiny in order that the Commission can resolve the complex issues involved in separations. Even before that resolution, however, the Commission should make it clear that states are free to enter their own judgments about the proper allocation of costs and revenues in pricing intrastate services.

As Ms. Baldwin states:

Competitive neutrality, administrative simplicity and cost causation continue to be appropriate criteria for evaluating proposals [for reform of the separations rules]. In addition, the Commission should consider whether proposals for reform achieve the objective of ensuring that customers of local services do not

⁴⁴ Id., ¶ 102; Loube Affidavit, 53.

cross-subsidize carriers' entry into new lines of business and do not support services that have been deemed either unregulated or interstate.⁴⁵

NASUCA's proposals meet all of those goals.

Respectfully submitted,

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⁴⁵ Baldwin Affidavit, ¶ 42.

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