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

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

Reply of Verizon

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Table of Contents

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I. SUMMARY

The communications marketplace has been transformed by robust, intermodal competition, the introduction of powerful new technologies, and consumer demands for the greater efficiency and lower prices associated with bundled service offerings. These changes compel the elimination of regimes that regulate the rates and service of just one among many providers, particularly where such regimes are based on archaic notions of cost and artificial distinctions between interstate and intrastate and regulated and nonregulated services.

The Commission and many states have eliminated archaic price regulation, and in these jurisdictions separations should be preemptively eliminated. Where states still utilize separations, the Commission should maintain the freeze and reemphasize that it is binding on the states. Letting the states adopt their own jurisdictional cost allocation requirements is not only unnecessary, but would create great uncertainty in the industry and undermine investment. Likewise, parties advocating modifications to the separations

[1] The Verizon companies participating in this filing are the regulated, wholly-owned subsidiaries of Verizon Communications Inc.

rules ignore both the efficacy of competition in constraining local telephone rates and the highly burdensome and counter-productive nature of their proposals.

Proceeding in this manner will preserve the stability that the freeze has brought to the industry, promote continued investment in next-generation networks and services, and enable ILECs to compete more effectively with the multitude of rivals that are not subject to onerous cost allocation requirements.

II. <u>THE RECORD SUPPORTS ADOPTION OF A PROCESS FOR PREEMPTIVELY ELIMINATING SEPARATIONS WHERE REGULATION NO LONGER RELIES ON SEPARATED COSTS.</u>

A. <u>Separations Should Be Discontinued in States That No Longer Rely on Separated Costs.</u>

There is robust competition in the communications marketplace. *See* Verizon at 4-8. Moreover, developments since the opening comments were filed confirm that this competition continues to expand and intensify. For example, Cox, which in July 2006 stated that it would be offering voice service in all of its markets by year-end, announced on October 30, 2006 that it had already met this goal.[2] Concomitantly, Verizon has continued to lose access lines, reporting a loss of 7.5 percent of total access lines between the third quarter of 2005 and the third quarter of 2006 and a loss of 9.8 percent of residential access lines in the same period.[3]

This competition prevents any carrier from pricing its services unreasonably. Not surprisingly, therefore, the record shows that many states have followed the

[2] Cox News Release, *Cox Digital Telephone Now Offered in All Cox Markets* (Oct. 30, 2006) http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=923325&.

[3] *Verizon Investor Quarterly, Q3 2006* at 14, http://investor.verizon.com/financial/quarterly/vz/3Q2006/3Q06Bulletin.pdf (Oct. 30, 2006).

Commission's lead and moved away from cost-based regulation. For example, state commissions observe that "[m]any states have now passed laws that permanently remove carriers from classical rate of return regulation." Vermont/Nebraska PSC at 6; *see also* Idaho PUC at 5; Iowa Utilities Board at 1-2. Likewise, a recent study released by the National Regulatory Research Institute (which is affiliated with NARUC) found that, "incumbent local exchange carriers (ILECs) continue transitioning from rate-of-return regulation (ROR) to alternative forms of regulation, including price caps, flexible regulation, and particularly towards deregulation of competitive and non-basic services." NRRI, *State Retail Rate Regulation of Local Exchange Providers as of September 2005*, at 2 (April 2006).

In light of these marketplace and regulatory changes, carriers and state commissions uniformly urge that separations requirements be removed where a state no longer relies on separated costs in regulating rates. For example, several state commissions recommend that "[i]f separations results are not relevant for any regulatory purpose, no carrier should bear the cost of conducting separations studies and reporting separations data." Idaho PUC at 6; *see also* Iowa Utilities Board at 2; Vermont/Nebraska PSC at 6; Wisconsin PSC at 5 ("the industry is nearing a point where the separations process could be eliminated for some companies, especially larger companies….").[4]

Verizon has proposed that the Commission establish a streamlined glide path for removing separations on a carrier- and state-specific basis. Under such an approach, any

[4] Similarly, AT&T, BellSouth, Qwest, Verizon, and the United States Telecom Association all showed that the separations process is burdensome and unnecessary, creates a competitive imbalance, and thus should not be applied in jurisdictions that no longer rely on separated costs. AT&T at 4-8; BellSouth at 4-6; Qwest at 11-16; Verizon at 11-13; United States Telecom Association at 3.

carrier no longer subject to cost-based regulation can petition the Commission to eliminate separations requirements for that carrier in that state. Removal of separations requirements would be automatic within a set time period if the state does not demonstrate that separations-derived costs actually are used in rate regulation. This process would put a minimal burden on regulators and carriers and would benefit consumers by discontinuing unnecessary and costly regulation.

Several state commissions propose an "exit ramp" option for incumbent carriers to terminate their separations obligations,[5] which is consistent in principle with the mechanism suggested by Verizon. However, certain aspects of the states' proposals are unnecessary. For example, there is no basis for freezing a company's universal service receipts on the date separations requirements are removed. Iowa Utilities Board at 4; Idaho PUC at 8. The states' implicit point is correct. Where competition assures reasonable rates in the absence of high-cost support, then such support is no longer necessary. There is a critical need to reform high cost support, but the issue of whether to eliminate the separations rules can and should be resolved independently from changes to the USF rules. Nor should the removal of separations requirements be conditioned on elimination of the subscriber line charge ("SLC"). *See* Wisconsin PSC at 6. If the Commission decides to adopt a means of cost recovery other than the SLC in the interstate jurisdiction, that is its prerogative. However, the elimination of separations rules where they are no longer used in ratemaking is not logically dependent on doing away with the SLC.

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[5] *See, e.g.*, Vermont/Nebraska at 9; Iowa Utilities Board at 4; Idaho PUC at 8; *see also* Wisconsin PSC at 5

B. <u>The Elimination of Separations by the Commission Is Binding on the States.</u>

The Commission's separations decisions (including a determination that no separation of costs is required) are binding on the states and preempt any inconsistent state requirements. *See* 47 U.S.C. §§ 221(c), 410(c); *Crockett Tel. Co. v. FCC*, 963 F.2d 1564, 1567 (D.C. Cir. 1992) ("Although each state has great freedom to regulate intrastate rates, once the FCC has applied its jurisdictional separation, that part of the cost base deemed to be interstate is outside the jurisdictional reach of the state regulatory agency."), *id.* at 1573 ("when the Commission has prescribed an applicable separation methodology, states are not free to ignore it"); *see also Hawaiian Tel. Co. v. Public Utilities Commission of Hawaii*, 827 F.2d 1264, 1275-76 (9th Cir. 1987), *cert. denied*, 487 U.S. 1218 (1988) (finding a state ratemaking methodology to be inconsistent with and thus "necessarily preempted" by federal separations methodology).

Once the Commission eliminates separations requirements, states are not free to impose their own jurisdictional cost allocation rules. *See Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 348 (2001) (finding preemption where "somewhat delicate balance of statutory objectives" could "be skewed by allowing" state-law claims). A decision that separations requirements are no longer necessary is no less an assertion of federal authority than the imposition of separations rules. For example, the Commission's determination in *Computer II* to deregulate customer premise equipment on a preemptive basis was upheld on appeal,[6] as was the Commission's action in *Computer III* to preemptively eliminate structural separation requirements for enhanced

[6] Amendment of Section 64.702 of the Commission's Rules and Regulations, 77 F.C.C.2d 384 (1980), *aff'd*, *CCIA v. FCC*, 693 F.2d 198 (D.C. Cir. 1982).

services.[7] Accordingly, once the Commission finds that separations rules are no longer necessary, that determination forecloses the states from adopting their own requirements.

III. PENDING THE ELIMINATION OF SEPARATIONS, THE COMMISSION SHOULD MAINTAIN THE CURRENT FREEZE AND REEMPHASIZE THAT STATES CANNOT IMPOSE THEIR OWN JURISDICTIONAL COST ALLOCATION REQUIREMENTS.

A. The Freeze Has Promoted Stability and Has Been Consistent with the Interests of Consumers, and the Proponents of New Separations Rules Have Failed To Justify Such Requirements.

In adopting the initial separations freeze in 2001, the Commission sought to "reduce regulatory burdens" in light of growing competition and changing technology. *Separations Freeze Order*, ¶¶ 12, 13. Likewise, in deciding to extend the freeze for another three years, the Commission noted that its action "will provide stability" in a rapidly changing marketplace. *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Order and Further Notice of Proposed Rulemaking, FCC 06-70, CC Docket No. 80-286 (rel. May 16, 2006), ¶ 1. The record confirms that the separations freeze has achieved its pro-competitive goals, promoted stability, and served the interests of consumers. For example, the Wisconsin PSC (at 1) stated that the original freeze and its extension "have been useful for the industry and have produced no evident, significant harms to the market or to consumers." *See also* Idaho PUC at 13-14.

The separations freeze, in short, has been a deregulatory success story, and the Commission should resist requests to adopt new separations rules in the pursuit of an assertedly more "accurate" jurisdictional cost allocation. Cost allocation in a multi-product, multi-jurisdictional firm is inherently arbitrary, and pursuing "accuracy" is

[7] *Amendment of Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) (*Computer III Phase I Order*), *subsequent history omitted.*

tantamount to tilting at windmills. Indeed, as the Commission recently explained, the rise of new services and service bundles renders cost allocations even "more arbitrary." *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶ 142 n.434 (2005) ("*Wireline Broadband Order*").

The Commission's conclusion is unassailable. As Dr. William Taylor has emphasized, it is "impossib[le] – not just in practice but in principle – [to assign] fixed common costs and network investment in any economically meaningful way to particular services in particular jurisdictions." *See* Declaration of William Taylor, ¶ 94, Attachment C to Comments of Verizon, WC Docket No. 05-25, filed June 13, 2005. Similarly, the Commission has noted the futility of trying to devise "cost causality and usage measures" applicable to nonregulated broadband Internet access services: "These measures … would have to reflect the evolution of the incumbent LECs' networks from traditional circuit-switched networks into IP-based networks. The proceedings to set these measures would be both resource-intensive and, given the changes in network technology from the time when the part 64 cost allocation rules were developed, likely to lead to arbitrary cost allocation results." *Wireline Broadband Order,* ¶ 134. The same holds true in the separations context. New separations rules consequently would not produce more "accurate" cost allocations than the freeze does. They would, however, be unduly burdensome, restrain competition, and disserve consumers.

In today's competitive environment, the only effect of detailed separations rules is to handicap one set of competitors (incumbent LECs), to the detriment of those companies and of consumers. No matter how "simplified," separations rules are inherently burdensome. As articulated even by the proponents of purportedly "streamlined" separations reform, any new separations rules would require legions of economists, accountants, and engineers to analyze the use (actual and prospective) of facilities, make predictions as to the future course of the technology and the market, and keep meticulous records (subject, of course, to audits). None of that activity, however, would produce any economic benefit: There would be no resulting increase in output or innovation, and no enhanced responsiveness to consumer demands. To the contrary, the resources of the regulated firm would be diverted to a pointless paper chase.

Notwithstanding the clear consumer benefits of the freeze and the arbitrary nature of any jurisdictional cost allocation rules, NASUCA and certain state regulators contend that new separations rules must be imposed in order to fix supposed flaws resulting from market changes since the current freeze was instituted. In particular, these parties point to growth in DSL and private line services, robust expansion of VoIP, increased use of the local loop for unregulated services, and the obligation to provide unbundled network elements. *See, e.g.*, Pennsylvania PUC at 2; Idaho PUC at 15; NASUCA, Baldwin Aff. at ¶ 12. The Commission should not accept any of these many and varied "reforms." All are premised on the mistaken notion that consumers of intrastate phone services are unfairly bearing billions of dollars of investment and expenses that purportedly should be reallocated to interstate services and unregulated lines of business. NASUCA, Baldwin Aff. at ¶ 12.

First, as explained in detail in Verizon's opening comments, robust competition assures that local phone rates are reasonable. Neither NASUCA nor any other proponent of detailed separations rules even tries to introduce contrary evidence. Indeed, NASUCA even acknowledges that Bell Company-served access lines have declined precipitously, *see* NASUCA, Baldwin Aff. at Table 5. Yet it nonetheless pronounces, without support, that "competition does not constrain market power." NASUCA, Baldwin Aff. at ¶ 56. Clearly, these lines are going somewhere – to cable telephony providers, wireless carriers, and VoIP providers – but NASUCA refuses to concede that this competition constrains prices.

NASUCA also is wrong in implying that basic phone subscribers are subsidizing rates for bundled services.[8] NASUCA, Baldwin Aff. at ¶ 140. As the Commission has long recognized, bundles are pro-consumer. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace*, Report and Order, 16 FCC Rcd 7418 ¶ 14 (2001) ("[A]llowing all carriers to bundle products and services is generally procompetitive and beneficial to consumers."); *Bundling of Cellular Customer Premises Equipment and Cellular Service*, Report and Order, 7 FCC Rcd 4028, 4030-31, ¶ 19 (1992) ("[B]undling is an efficient promotional device which reduces barriers to new customers and which can provide new customers with … service more economically than if it were prohibited."). Indeed, NASUCA itself provides evidence of the consumer benefits of bundles, conceding that more than half of all former Bell company customers subscribe to bundles. NASUCA, Baldwin Aff. at ¶ 136. Clearly, where most telephone company subscribers already purchase bundles, and with that proportion growing, it makes no sense to suggest that the remaining minority of standalone local voice customers are

[8] NASUCA (at 5) goes so far as to suggest that pricing should be based on a service-by-service cost allocation. Yet no firm in a competitive market prices in this manner, and neither the FCC nor state commissions have ever sought to do so.

subsidizing bundled service rates, particularly where basic phone rates has been constrained by competition and by state regulation.[9]

B. The Specific Proposals Advanced by NASUCA and Some States Would Be Highly Burdensome and Would Deter Investment in Broadband Networks.

Not only are modified separations rules unnecessary and counter-productive, but the specific proposals put forth by NASUCA and others likely would harm consumers. It would be highly burdensome and inimical to local competition and continued investment in next-generation networks to implement the proposed changes.

First, adopting new separations reform with the goal of cutting local phone rates would be unlikely to yield appreciable consumer savings. As NASUCA acknowledges, most consumers purchase bundles of services, so forcing providers to recover more of their costs from jurisdictionally interstate or unregulated services would not produce an overall reduction in the price of the bundle. *See Wireline Broadband Order*, ¶ 143 (reallocating costs to particular services using the loop "would seem to produce only a shifting of charges from one part of the customer's bill to another"). And even the minority of customers who purchase local and long distance services on a standalone basis would see any decrease in local rates offset by an increase in long distance rates.

Second, the proposed rule changes would be highly burdensome, raising costs for both carriers and consumers. These proposals would require companies to perform

[9] NASUCA (Loube, ¶¶ 34-35) incorrectly asserts that Verizon has not been keeping its records in accordance with Part 64. Verizon's Part 64 compliance has been confirmed through periodic audits. Although Loube asserts that Verizon's reported results for Pennsylvania evidence non-compliance, in reality, the nonregulated investment reported in 2004 was related to FTTP broadband data service, which Verizon at that point treated as nonregulated pursuant to its Petition for Declaratory Ruling, which subsequently was mooted by the *Wireline Broadband Order*. Following that *Order*, FTTP broadband data service was reclassified as a regulated service for Part 64 purposes, so there was no shared investment to report.

complex allocation studies and predict future demand,[10] randomly reallocate a major portion of loop investment to unregulated services,[11] impute UNE revenues and expenses as a means of reducing common line costs,[12] and reinstate DEM studies for circuit switches,[13] among other things. As the Commission recognizes, however, incumbent LECs no longer retain the personnel and computer systems necessary to perform separations studies. *Notice*, ¶ 23. To accommodate these changes, Verizon and other carriers "would have to hire or reassign and train employees and redevelop systems for collecting and analyzing the data necessary to perform separations," which would be "unduly burdensome … when there is a significant likelihood that there would be no lasting benefit to doing so." *Id.* While the Commission made this observation in the context of extending the freeze, the point is even more valid in the context of the post-extension marketplace, which will be even more competitive.

Third, the proposed rule changes would be antithetical to the Commission's and Congress's core goals of promoting local competition and fostering broadband deployment. Cutting local rates by fiat, which already are market-driven (or are set artificially low pursuant to regulatory mandate), would deter competitive entry by establishing an uneconomically low price ceiling. Competitors will not enter the market

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[10] *See, e.g.*, Wisconsin PSC at 6-9 (adopt company-specific fixed factors based on the relative contribution that each group of services makes to the peak design capacity at the time of the purchase of a major investment in equipment; proposes multiple service groups and categories of equipment); Vermont/Nebraska at 18; Idaho PUC at 15.

[11] *See, e.g.*, NASUCA, Baldwin Aff. at 62-71; Loube Aff. at 17-19 (use current 25 percent interstate gross allocator for customers purchasing only telephone service, change allocator to 50 percent for customers purchasing ADSL and to 75 percent for customers purchasing ADSL and video)

[12] Wisconsin PSC, Appendix at 3-7.

[13] NASUCA, Loube Aff. at 22-23; Baldwin Aff. at 77; Vermont/Nebraska at 18.

or expand their existing offerings if they cannot earn a reasonable return on their investment.

Moreover, deterring competition in the provision of local voice service would undercut broadband investment by both competitors and incumbent LECs. Competitors such as cable companies market high-speed Internet access in conjunction with telephone service. If they cannot compete effectively in providing phone service because artificially low rates limit the potential return on capital, they will have fewer incentives to build out their high-speed networks, particularly in areas where the economic case for doing so already is marginal. And penalizing incumbent LECs for providing broadband services (by compelling them to reallocate even more investment and expenses away from local telephone service) would deter investments in next-generation networks – again, with economically marginal areas being hardest hit – which would deprive consumers of competition in the provision of high-speed Internet access and video services.

The detrimental impact on the provision of competitive video services is particularly anti-consumer. Local phone rates have declined in real terms,[14] while cable rates have increased markedly.[15] Thus, not only is there no need to cut phone rates further, but doing so could sacrifice the potential for much greater savings in the video

[14] Between December 2002 and December 2005, local phone rates declined by 1.4 percent in real terms. *See* FCC Industry Analysis and Technology Division, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service 2006*, at Table 3.1 ("FCC Reference Book").

[15] Between January 2002 and January 2004 (data for 2005 are not yet available), cable rates increased by 13.6 percent, while inflation during this period was only 5.1 percent. *See Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, Report on Cable Industry Prices, 20 FCC Rcd 2718, Attachment 2 (2005); FCC Reference Book, Table 3.1.

market, where wireline entry has triggered dramatic price reductions. *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Twelfth Annual Report, 21 FCC Rcd 2503, 2519, ¶ 41(2005) ("[C]ompetition to an incumbent cable operator from a wireline provider resulted in cable rates that were 'substantially lower (by 15 percent)' than in markets without this competition.") (citations omitted); Robert W. Crandall, J. Gregory Sidak, and Hal J. Singer, *Does Video Delivered Over a Telephone Network Require a Cable Franchise?* at 27, forthcoming at 59 Fed. Comm. L.J. (2007) (telephone entry into the video market can be expected to trigger a $7.15 decrease in the monthly price of cable television service) (available at http://papers.ssrn.com/so13/papers.cfm?abstract_id=932980).

IV. STATES MAY NOT TAKE ACTIONS THAT ARE INCONSISTENT WITH THE SEPARATIONS FREEZE.

As explained in Section II.B above, states have no authority to establish their own jurisdictional cost allocation rules. Perhaps recognizing the states' lack of latitude in this area, NASUCA claims that state regulators can compel incumbent LECs to directly assign private line investment notwithstanding the freeze. Some states also assert that they can preclude recovery of wireline broadband costs that are assigned to the intrastate jurisdiction through the separations process. Neither contention is correct.

A. States Cannot Compel "Direct Assignment" of Private Line Investment.

"Direct assignment" refers to the assignment of a particular cost category directly to the intrastate or interstate jurisdiction without employing a relative use factor or a fixed allocator. *See Notice*, ¶ 4. The *Separations Freeze Order* (at ¶ 23) makes it plain that *only* those facilities that are "readily identifiable" as being either exclusively intrastate or exclusively interstate would continue to be directly assigned following the freeze. That is not the case for private lines. To the contrary, determining directly assigned amounts prior to the freeze required carriers to conduct the same investment studies as were used for any other category of cable and wire facilities or central office equipment investment. For example, in the case of cable and wire facilities, the carrier had to perform a detailed examination of engineering records to obtain mileages, circuit types, and materials used and their relative costs. Carriers also had to determine average book cost per mile and develop average loop costs in order to calculate the directly assigned amounts. Similarly, carriers had to undertake a detailed examination of engineering records to determine which pieces of circuit equipment (and their relative costs) were put on each circuit and what type of circuit was involved. Consequently, carriers cannot be forced to directly assign private line investment under the separations freeze.

Without acknowledging the "readily identifiable" language noted above, NASUCA nonetheless alleges that the *Separations Freeze Order* requires carriers to perform annual separations studies in order to update direct assignments. NASUCA, Loube Aff. at ¶¶ 9, 14; Baldwin Aff. at ¶¶ 20-26. NASUCA is wrong. The *Separations Freeze Order* provides precisely the opposite, stating that price cap carriers "will not have to perform the analyses necessary to categorize annual investment changes for interstate purposes." *Separations Freeze Order*, ¶ 14. The *Order* further explains that, "[b]ecause a goal of the freeze is to reduce administrative burdens on carriers . . . any Part 36 requirement to segregate costs recorded in Part 32 accounts into categories, subcategories, or further sub-classifications shall be frozen at their percentage relationship for the calendar year 2000." *Separations Freeze Order*, ¶¶ 22.

Moreover, shortly after the freeze was instituted, Commission staff instructed carriers *not* to perform studies to determine directly assigned amounts, and the staff subsequently told Verizon to "comply with the Commission's mandatory categories and factors freeze and not make any adjustments until the freeze expires" and to allocate "investment … to the appropriate Part 36 separations categories and subcategories consistent with the percentage relationship for Verizon's calendar year 2000 results." IATD Letter 2004-14. *See* Verizon at 21 n.33 (discussing the 2001 meeting with the staff and the events leading up to the 2004 IATD letter). Accordingly, there is no merit to NASUCA's claim that separations studies are required.

For this reason, NASUCA (Loube Aff., ¶ 9; Baldwin Aff. ¶¶ 121-128) also is wrong in contending that Section 36.3(a) of the Commission's Rules compels carriers to perform updated investment studies for private line services each year. First, that Rule, which states that "[d]irect assignment of private line service costs between jurisdictions shall be updated annually," must be read in light of the language in the *Separations Freeze Order* limiting direct assignment only to those investments that are "readily identifiable" without the use of separations studies. Second, Section 36.3(b) of the Rules contains specific language governing carriers subject to federal price cap regulation (which must take precedence over the general language in subsection (a)), and that subsection states that price cap carriers *must* assign costs "based on the percentage relationships of the categorized/sub-categorized costs to their associated part 32 accounts for the twelve month period ending December 31, 2000." As Qwest (at 25-26) points out, it "is impossible both to annually update direct cost assignments and to use frozen factors." Updating direct assignments would change the amounts in the different separations categories and thereby alter the percentages assigned to the interstate and intrastate jurisdictions.[16]

Finally, even aside from the fact that separations studies to revise direct assignments are not permitted under the freeze, NASUCA is wrong in claiming that such studies would not be burdensome. NASUCA, Loube Aff. ¶ 24. Under the pre-freeze separations process, carriers had to perform more than 475 separate studies. Verizon alone devoted at least 60 employees and 11 major computer systems to maintaining the separations databases and performing separations calculations. Compelling incumbent local exchange carriers once again to expend significant resources in this manner – when no competing provider is subject to such a burdensome obligation – would be inimical to fair competition and would serve no purpose. Accordingly, the Commission should reaffirm the broad scope of the freeze in order to prevent states from demanding the reclassification of investment from intrastate to interstate.

B. States Cannot Use the Part 64 Rules To Remove Wireline Broadband Costs from the Intrastate Rate Base.

A few state commissions (and NASUCA) contend that the Commission has afforded them flexibility, through the Part 64 process of allocating costs between regulated and non-regulated activities, to remove wireline broadband investment from the intrastate rate base. *See* Iowa Utilities Board at 7; Idaho PUC at 12; Vermont/Nebraska at 14; NASUCA at 7. They are wrong. States have authority to remove from the rate base *only* those costs that (1) have been allocated to the intrastate jurisdiction through the separations process, but (2) are associated with intrastate services that have been

[16] That is, revising a single category percentage results in changes to all category percentages in order to balance to 100 percent.

deregulated. States may not preclude recovery of jurisdictionally intrastate costs that they believe should have been assigned to the interstate jurisdiction but were not because of purported shortcomings in the separations process. Yet that is precisely what some seek to do here.

Under the Commission's rules, costs are first allocated between regulated and non-regulated services pursuant to the Part 64 rules. Costs associated with regulated services are then subject to the Part 36 jurisdictional separations process; costs associated with non-regulated services do not go through the separations process. In the *Wireline Broadband Order*, the Commission declared that wireline broadband Internet access should be treated as regulated under Part 64. *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, ¶¶ 129-130 (2005) ("*Wireline Broadband Order*"). Indeed, in declining to reclassify these services as non-regulated for Part 64 purposes, the Commission noted that doing so would "impose significant burdens" while generating "at most marginal benefits." *Id.* ¶¶ 133-134.

Once costs have been assigned to the intrastate jurisdiction pursuant to the separations process, "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 service rates." *Separations Freeze Order*, footnote 6 (emphasis added). This is so because, once costs that are considered regulated for Part 64 purposes have been through the separations process, "states can reallocate costs between the intrastate regulated and non-regulated spheres in order to reflect the scope of regulation in a particular state." *Joint Cost Order*, 2 FCC Rcd 1298, ¶ 91 (1987); *see also Wireline Broadband Order*, ¶ 129 & n.406.

However, they must "refrain from asserting any jurisdiction over activities that are identified as *interstate* regulated activities through the interaction of these [Part 64] rules and the Part [36] jurisdictional separations rules." *Joint Cost Order* at 1310 n.179 (emphasis added). That is precisely what some states seek to do here – essentially, to reallocate certain intrastate costs as interstate – and it is therefore prohibited.

V. THE COMMISSION SHOULD NOT ISSUE A DATA REQUEST.

The record demonstrates that any data collection would be burdensome and pointless. *See, e.g.*, US Telecom at 9; JSI at 9-10; ITTA *et al.* at 12-14; Qwest at 16-23. The information that the draft data request seeks unreasonably presumes that the extent to which a particular portion of the network is used by a particular service is relevant to the ratemaking process. Likewise, the draft data request assumes that there is some economically meaningful way to divide revenues in service bundles between federal and state jurisdictions and between regulated and non-regulated services, which is not the case. And the draft further presumes that carriers retain the systems, personnel, and processes that would be needed to provide the requested information, much of which relates to the pre-freeze separations rules. Again, this is not the case. Consequently, the Commission should not issue the draft request attached to the *Notice*, let alone the even more detailed and burdensome version proposed by NASUCA. *See* NASUCA, Baldwin Aff. ¶¶ 98-100; Loube Aff. ¶ 53.[17]

[17] Finally, imposing a data collection requirement now would be premature in any event. In light of ongoing, dramatic changes in network usage and technology, any data collected in the next 12-18 months likely would be stale by the time regulators finalize a post-freeze separations process.

VI. CONCLUSION

The Commission should establish a glide path toward the ultimate elimination of jurisdictional separations, retain the current freeze in the interim, and preempt the states from imposing any separations requirements that are inconsistent with the federal framework.

Respectfully submitted,

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