

State Issues Regarding The Separations Freeze

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State Uses of Separations

- Setting rates for intrastate services.
- Rate design (EAS v. local rates)
- State universal service calculations

Federal Uses of Separations

- Set interstate rates
- Calculate Universal Service (that affects intrastate rates)
 - High Cost Loop
 - (uses categorized accounts)
 - Local Switching Support
 - (uses categorized accounts)

The Freeze

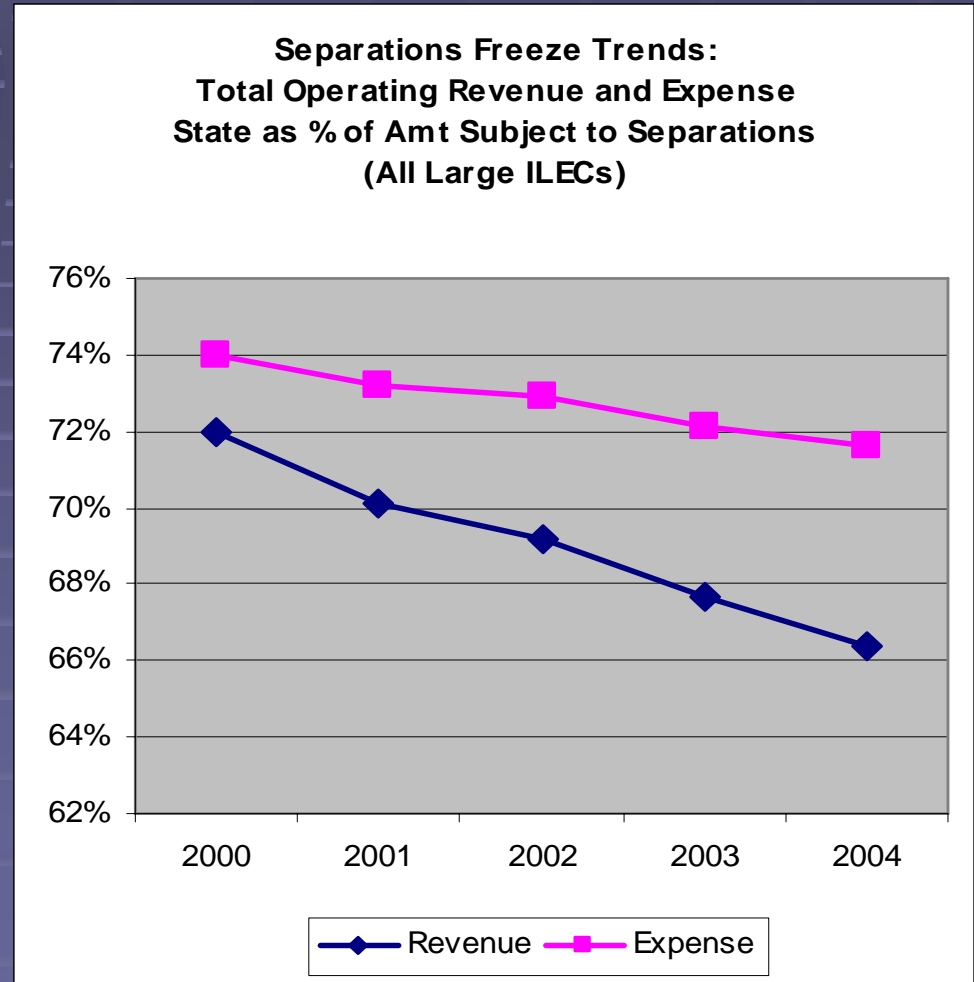
- July 1, 2001 to June 30, 2006
- “Category” Freeze
 - Applies to categorization of accounts
 - E.g.: Which part of outside plant is “loop?”
 - Only price cap carriers
 - Some others elected a freeze of categories.
- “Factor” Freeze
 - E.g. What portion of “loop” is assigned to states?
 - Applies to all carriers

Types of Separations Problems

- Jurisdictional Mismatch
 - Jurisdiction is in one place, costs and revenues in the other.
 - No immediate effect on rates
 - Incremental costs can be a problem
- Revenue-Cost Mismatch
 - Costs are in one place, revenues in the other.
 - Direct effect on rates.

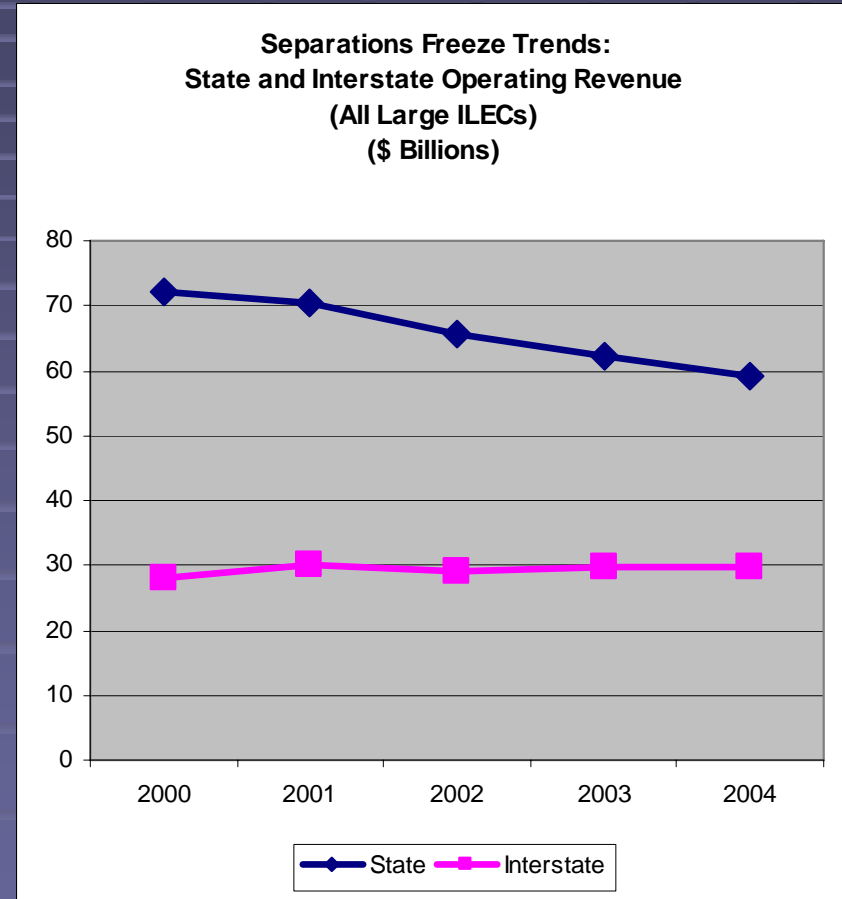
Separations Freeze Trends: Operating Revenue and Expense

- State % of Expenses is higher than % of Revenues
- Revenues are declining more rapidly than expense



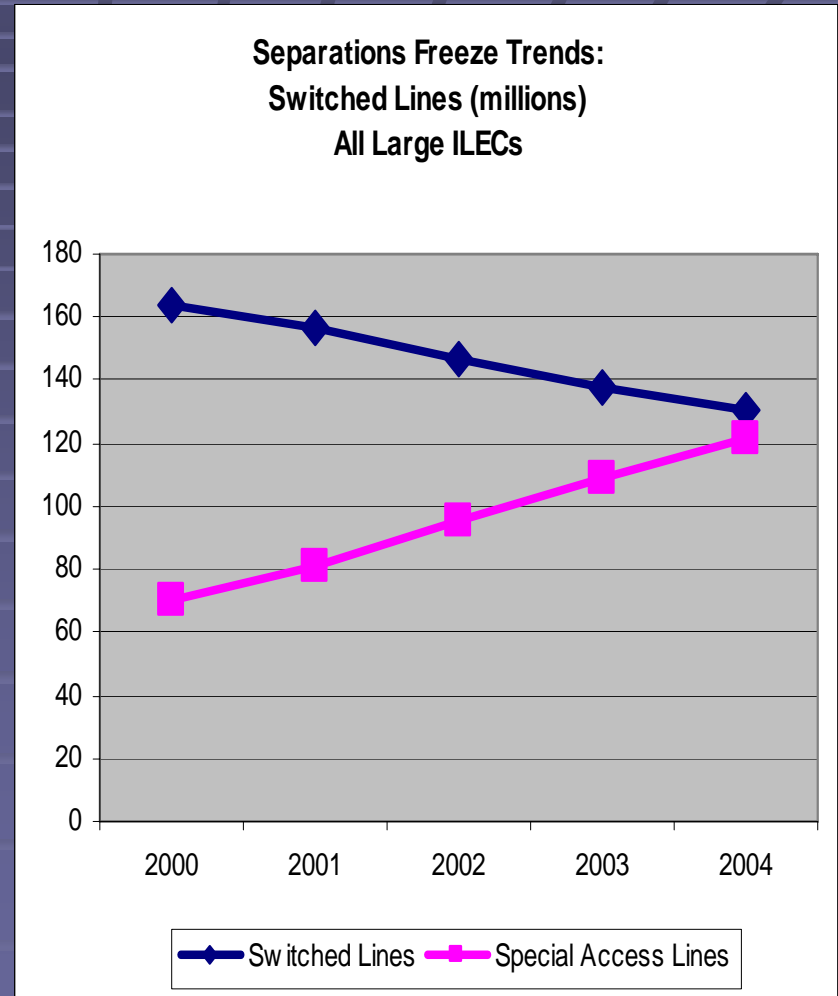
Separations Freeze Trends: Revenues

- State Revenues are down 18%
- Interstate revenues are up 6%



Separations Freeze Trends: Lines

- Switched lines down 20%
- Special access lines up 73%



Return to “Old Separations”

- Few Favor This
 - Traffic measurements of questionable relevance.
 - Company cost high, expertise low.
- How else can we address the issues?

Pending Issues #1- Deregulation

- State Rate Deregulation
 - Complicates effects of separations changes
 - Some states don't care
- Should there be a state-by-state election to keep the freeze?
- Does increasing competition mean more local rate increases?

#2 – Special Access

- Special Access Investment Not Updated
 - Problem anticipated in 2000.
 - Rules and order both said direct assignment would continue.
 - FCC advised carriers in 2004 not to do “studies.”
 - Categories have been unchanged, despite significant change in balance of products.

#3 & 4 – DSL

- FCC has jurisdiction over DSL and revenues.
- State has most of the costs for the embedded facilities.
 - Carriers are directly assigning DSLAMs to interstate.
 - Loops remain 75% with state
 - Loop conditioning expenses going mostly to state
- When DSL sold without voice, there is no state revenue.

#5 - FTTH

- Fiber To The Home
 - Purpose of upgrades is to provide unregulated services
 - Costs much higher than POTS
 - NID costs in \$100s
 - Substantial installation expense
 - Separations treats FTTH as like a copper cable upgrade
 - 75% of investment and expense to state

#6 - Internet

- Internet traffic now interstate
 - ISP-bound traffic
 - 2000 Joint Board proposal to move 5% of local usage from local to interstate.
 - VoIP traffic
 - Terminates mostly as local
- Costs and revenues remain with state
 - Some incremental costs likely.

#7 – UNEs

- UNEs prices are set with primary guidance from FCC
- Carrier practice in separating costs apparently varies.
- Carrier practice in separating revenues apparently varies.

#8 – Nonregulated Services

- Wireline broadband facilities can be excluded from ratebase and expenses.
- Removal of WB investment after separations factors have been calculated can shift separation of expense factors to states.

#9 – New Companies

- How do you “freeze” data for a new LEC that didn’t exist in 2000?
- Possibilities:
 - If LEC uses tandems, find some kind of average schedule method.
 - If the LEC is pure IP, give all costs and revenues to FCC.