Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

In the Matter of	)	
	)	
National Exchange Carrier Association, Inc.	)	ASD 00-42
Proposed 2001 Modification of Average	)	
Schedule Universal Service Formulas	)	

ORDER

Adopted: December 22, 2000 Released: December 26, 2000

By the Chief, Accounting Safeguards Division, Common Carrier Bureau:

I. INTRODUCTION

1. On October 2, 2000, the National Exchange Carrier Association, Inc. (NECA) filed proposed modifications to the current universal service formulas for average schedule companies, requesting that they take effect on January 1, 2001, and remain in effect through December 31, 2001.[1] These formulas include a local switching support formula and a universal service fund (USF) expense adjustment formula. On October 18, 2000, a public notice was issued soliciting comments on NECA's filing.[2] For reasons discussed below, we approve NECA's proposed modifications for the local switching support formula and reject NECA's proposed modifications to the USF expense adjustment formula. We direct NECA to continue use of the current USF expense adjustment formula as described herein.

II. BACKGROUND

2. Average schedule companies receive compensation for their interstate common carrier services on the basis of formulas developed by NECA and approved or modified by the Commission.[3] Under section 69.606(a), NECA develops average schedule formulas that are designed to simulate

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[1] *See* 2001 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., October 2, 2000 (*NECA Filing*).

[2] Pleading Cycle Established for Comments on NECA's 2001 Modification of Average Schedule Universal Service Formulas, ASD 00-42, DA 00-2354 (*rel*. October 18, 2000). Comments were filed in support of NECA's proposed formula revisions by the National Telephone Cooperative Association and the Organization for the Promotion and Advancement of Small Telecommunications Companies.

[3] *See* 47 C.F.R. Sections 69.605(c) and 69.606.

disbursements for access charges that would be received by a cost company that is representative of average schedule companies.[4] Section 69.606(b) of the Commission's rules requires NECA either to file revised average schedule formulas on or before December 31 of each year, or to certify that no such revisions are necessary.[5] If the proposed average schedule formulas are approved or modified by the Commission, they take effect on July 1.[6]

3. Although the Commission's rules do not specifically provide for USF expense adjustments[7] for average schedule companies, the Commission has recognized that some average schedule companies may incur loop costs that are above the national average.[8] Thus, as discussed below, the Commission has permitted average schedule companies to receive USF expense adjustments pursuant to approval of NECA's proposed USF formula for high cost loops. The Commission has also permitted average schedule companies to receive USF support for a portion of interstate local switching pursuant to approval of NECA's local switching support formula. This support, which is now explicit, was formerly provided implicitly in switched access rates under the Commission's Dial Equipment Minutes (DEM) weighting rules in Part 36.[9] For these two USF formulas (USF expense adjustment and local switching support), NECA files proposed modifications on October 1 each year, for an effective date of January 1.[10]

III. DISCUSSION

4. *Local Switching Support Formula.* The current interstate local switching support formula was approved on December 29, 1999.[11] NECA proposes minor modifications to the current formula, which if approved, would increase annual payments for local switching support from approximately $77.8

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[4] 47 C.F.R. § 69.606(a).

[5] 47 C.F.R. § 69.606(b).

[6] Once average schedule formulas are approved or modified, they are included in the computation of NECA's annual interstate access tariff rates, and normally scheduled to become effective in the next tariff period (July 1 – June 30).

[7] *See generally*, 47 C.F.R § 36.601 *et. seq*.

[8] *See e.g.,* NECA's Proposed Revisions to the Average Schedules, *Memorandum Opinion and Order*, 5 FCC Rcd 4068, 4070-71.

[9] *See* 47 C.F.R. §§ 36.125(f) and 54.301. As of January 1, 1998, the Commission's rules require that the subsidy corresponding in amount to that generated formerly by DEM weighting be recovered from universal service support mechanisms. The remainder of local switching settlements is recovered through access charges. *See also NECA Filing*, p. II-1.

[10] Under Parts 36 and 54 of our rules, USF payments become effective for a 12-month period beginning January 1. *See* 47 C.F.R. Part 36, Subpart F and 47 C.F.R. Part 54.

[11] *See* National Exchange Carrier Association, Inc., Proposed Modifications to the 1999-2000 Interstate Average Schedule Formulas, *Order*, DA 99-3021, 15 FCC Rcd 87 (1999).

million to $78.8, an increase of approximately 1.3%.[12] We have reviewed NECA's filing and find that the method NECA used to develop this year's proposed formula is the same method that it used to develop the formula we approved for use during the last payment period.[13] We find that the proposed formula is consistent with our requirements and therefore we approve it.

5. *USF Expense Adjustment Formula*. USF expense adjustments are intended to provide USF support to carriers with high loop costs based on the degree that an individual company's cost per loop exceeds the national average.[14] Because average schedule companies are not required to perform company-specific cost studies[15] – the basis upon which a carrier's USF expense adjustment is calculated[16] – the Commission has permitted USF expense adjustments to average schedule companies based on formulas derived from a sample of average schedule companies' costs.[17] The Commission has made clear, however, that given the underlying policy for entitlement to high cost loop support,[18] the costs per loop of the sample average schedule companies is a predominant factor, and that an appropriate USF expense adjustment formula should reasonably approximate the costs per loop of the sample average schedule companies and allocate funds accurately to the average schedule companies.[19]

6. In recent orders, the Commission and the Bureau have expressed concerns about NECA's proposed USF expense adjustment formulas. In an order released on December 20, 1999 (*December 1999*

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[12] *See NECA Filing* at II-11.

[13] *See* 15 FCC Rcd 87.

[14] *See generally,* 47 C.F.R. Part 36, subpart F.

[15] Average schedule companies have been permitted by the Commission to estimate some or all of their costs through the use of average schedules to avoid the difficulties and expenses involved with conducting company-specific cost studies. *See e.g., ALTEL Corp. v. FCC*, 838 F. 2d 551, 553 (D.C. Cir 1988). *Accord NARUC v. FCC*, 737 F.2d at 1127.

[16] Company specific cost studies, which require performance of detailed jurisdictional separations and cost allocation studies under Parts 32, 36, 64 and 69 of the Commission's rules, are used in calculating the carrier's entitlement to USF expense adjustments. *See e.g.,* 47 C.F.R. Part 36, subpart F. The costs used in calculating a carrier's average cost per loop are specified in 47 C.F.R § 36.621(a).

[17] *See e.g., supra*. n. 8; *infra* n. 19.

[18] A carrier's entitlement to high cost loop support is determined by the extent to which its cost per loop exceeds the nationwide average cost per loop and by the number of loops it provides. *See* 47 C.F.R § 36.631.

[19] *See e.g.,* National Exchange Carrier Association, Inc., Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas, *Order on Reconsideration and Order*, DA 97-2710, 13 FCC Rcd 10116, 31-32 (1997); National Exchange Carrier Association, Inc., Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas, *Order*, DA 98-1297, 13 FCC Rcd 17351, 56-57 (1998); National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas, *Order*, DA 99-530, 14 FCC Rcd 4049, 4051-52 (1999) (*March 1999 Order*), *aff'd* 15 FCC Rcd 1819.

Order),[20] the Commission upheld the Bureau's *March 1999 Order*,[21] which found that NECA's proposed USF expense adjustment formula for the period January 1, 1999 – December 31, 1999, was not consistent with the Part 36 rules that base entitlement to high cost support on a carrier's cost per loop.[22] In the underlying *March 1999 Order*, the Bureau found that NECA's proposed modifications to the USF expense adjustment formula did not reasonably approximate the cost per loop of sample average schedule companies, but had an upward bias resulting in estimated costs per loop widely disparate from the cost per loop data of its sample average schedule companies.[23] The Bureau found this result was not justified or consistent with the Commission's policies on high cost loop support.[24] The Bureau ordered NECA to retain the USF formula approved in 1998,[25] and adjust the payments to reflect the growth rate in working loops for the average schedule companies.[26] A similar finding was made by the Bureau in an order released on March 16, 2000 (*March 2000 Order*)[27] with respect to NECA's proposed USF expense adjustment formula for the period January 1, 2000 – December 31, 2000, in which NECA proposed virtually the same methodology that had earlier been rejected by the Commission.[28]

7. NECA's proposed USF expense adjustment formula in the instant proceeding uses the same methodology that we rejected in two earlier proceedings and raises the same concerns that led us to reject those proposals.[29] As we have stated in our earlier decisions, because USF expense adjustments are

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[20] National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas, *Order*, FCC 99-395, 15 FCC Rcd 1819 (1999) (*December 1999 Order*), *petition for review filed*, *National Exchange Carrier Association, Inc. v. FCC*, No. 00-1055 (D.C. Cir., filed Feb. 17, 2000).

[21] 14 FCC Rcd 4049.

[22] *Id*. at 4054; 15 FCC Rcd 1822.

[23] 14 FCC Rcd 4052-53.

[24] *Id*. at 4052-4055.

[25] *See* 13 FCC Rcd 17351.

[26] 14 FCC Rcd 4055-56. There was almost no change in the cost per loop for sample average companies' or in the nationwide cost per loop from the previous year; however, there was a small percent increase in the growth rate of working loops. 14 FCC Rcd 4054. Recognizing that the industry experienced loop growth, and that under the Commission's rules the rate of growth of the USF was limited to the rate of growth in the total number of working loops nationwide, the Commission determined that an increase in support to accommodate this growth would be reasonable.

[27] *See* National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal Service Formulas, *Order*, DA 00-588, 15 FCC Rcd 17351 (2000) (*March 2000 Order*). NECA filed an Application for Review of the Bureau's *March 2000 Order*, which is currently before the Commission.

[28] *See supra*. n. 19, citing *March 1999 Order* and supra. n. 20 citing *December 1999 Order*.

[29] *Id.* and *supra.* n. 27.

based on the carriers' cost per loop, a good model for determining average schedule companies' USF expense adjustments should provide results that reflect the cost data obtained from the sample of average schedule companies.[30] Our review of NECA's proposed USF expense adjustment formula in this proceeding finds that the formula methodology that NECA proposes does not provide a reasonable correlation between estimated cost per loop data and the sample cost per loop data that might justify its use in determining USF payments for average schedule companies.[31] Further, under the proposed formula, USF expense adjustments for average schedule companies would increase by approximately 38%,[32] even though the estimated cost per loop and loop growth factors for average schedule companies are only marginally different than those of local exchange carriers (LECs) nationwide. Sample average company cost per loop estimates, on average, increased by 1.5%[33] compared with 0.17% for LECs nationwide.[34] Also, the loop growth rate for average schedule companies is only 2.59%[35] compared with 2.86% for LECs nationwide.[36] These factors – cost per loop and loop growth – are key determinants in establishing

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[30] *See e.g.*, 13 FCC Rcd 10132; 13 FCC Rcd 17357; 14 FCC Rcd 4051-52; 15 FCC Rcd 88; and 15 FCC Rcd 5067. The sample data and the estimated cost per loop data for the average schedule companies provide a central measure of cost for the average schedule companies. Thus, we continue to stress, that a formula that produces expense adjustments for the average schedule companies should be based on this central measure of the sample of average schedule companies' estimated cost data.

[31] NECA's methodology does not use cost per loop as a basis in developing its USF exchange adjustment formula. Instead, NECA uses regression to estimate a formula for aggregate USF payments based on sample data access lines and exchanges. *See NECA Filing* at III-18. Once the aggregated USF payments are determined, NECA then backs into a 'derived' cost per loop amount. These 'derived' cost per loop amounts, which are based on an intended outcome, rather than the estimated cost per loop data determined from the sample companies, are used to obtain USF payments, thereby producing a tenuous relationship between the proposed formula and the sample cost per loop data. A strong indicator of this faulty analysis is the negative coefficient of determination of –0.163 that results under NECA's model. The coefficient of determination, or R^2, represents the measure of how closely a model follows the data. Using standard regression analysis techniques, the deviations between the individual data points and the model is minimized. Using these techniques, the model's coefficient of determination will fall between 0.0 and 1.0. The closer the coefficient is to 1.0, the better the correlation. A negative R^2 indicates that NECA did not use a standard regression analysis technique in its model, thus providing no meaningful relationship between the proposed formula and the sample cost per loop data.

[32] *See NECA Filing* at III-1.

[33] The average cost per loop for the average schedule companies was derived from sample data provided in the current *NECA Filing* and NECA's previous filing (*See* 2000 NECA modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., October 1, 1999) (*October 1999 Filing*).

[34] *See* Universal Service Fund, 2000 Submission of 1999 Study Results by the NECA, Inc., September 29, 2000 at Section 10, p. 253.

[35] The loop data for average schedule companies was derived from population data provided in the current *NECA Filing* and NECA's *October 1999 Filing*.

[36] *See* Universal Service Fund, 2000 Submission of 1999 Study Results by the NECA, Inc., September 29, 2000 at Section 10, p. 253.

carriers' entitlement to high cost loop support.[37]

8. As in our previous orders rejecting the same methodology that NECA proposes in this proceeding, we find NECA's proposed USF expense adjustment formula does not reasonably estimate the sample average schedule companies' costs per loop and yields results that are not consistent with the Commission's policies for providing high cost loop support. Thus, we reject it. We direct NECA to retain the current formula, and allow NECA to adjust payments resulting under this formula to increase consistent with the average schedule companies' loop growth rate, *i.e.*, 2.59%. We will also permit payments to be increased by an additional amount, to be identified by NECA, to ensure that no carrier experiences unreasonable reductions in per loop support compared with last year's levels. We direct NECA to submit a schedule to us within 30 days of the release of this order that sets forth the payments to each average schedule company. Such submission should identify additional amounts above the amounts stated on the payment schedule that may be necessary to ensure that individual companies serving the smallest exchanges will not experience unreasonable reductions in per loop support in 2001 compared with their 2000 amounts. The requested submission does not preclude NECA from beginning payments to average schedule companies, under the modified formula, at the next regular payment cycle.

IV. ORDERING CLAUSE

9. Accordingly, IT IS ORDERED, pursuant to Sections 0.91 and 0.291 of the Commission rules, 47 C.F.R. §§ 0.91, 0.291, that the average schedule formula proposed by the National Exchange Carriers Association, Inc. on October 2, 2000, for local switching support is adopted and SHALL BECOME EFFECTIVE January 1, 2001.

10. IT IS FURTHER ORDERED, pursuant to Sections 0.91 and 0.291 of the Commission rules, 47 C.F.R. §§ 0.91, 0.291, that the average schedule formula proposed by the National Exchange Carriers Association, Inc. on October 2, 2000, for USF expense adjustments IS REJECTED.

11. IT IS FURTHER ORDERED, pursuant to Sections 0.91 and 0.291 of the Commission rules, 47 C.F.R. §§ 0.91, 0.291, that NECA shall retain the current USF expense adjustment formula as provided in section III. of this order.

12. IT IS FURTHER ORDERED, pursuant to Section 4(i) of the Communications Act of 1934, as amended, 47 U.S.C. § 154(i), and Sections 0.91, 0.291, 1.103 and 1.4(b)(2) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.103 and 1.4(b)(2) that THIS ORDER IS EFFECTIVE UPON ITS RELEASE.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran
Chief, Accounting Safeguards Division

[37] *See supra*. notes 16 and 18.