Before the
Federal Communications Commission
Washington, D.C. 20554

In the matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
	)	
	)	
National Exchange Carrier Association, Inc. Proposed 2002 Modification of Average Schedule Formulas	)	

ORDER

Adopted: July 29, 2002 **Released: July 30, 2002**

By the Deputy Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. In this Order, the Wireline Competition Bureau (Bureau) adopts formulas for distributing high-cost universal service support to average schedule carriers for 2002.[1] The Bureau now adopts a cost-per-loop formula (CPL formula) for calculating high-cost loop support and approves the proposed methodology for implementing on behalf of average schedule carriers the modifications to the high-cost loop support mechanisms for rural carriers adopted in the *RTF Order*. In approving these formulas, the Bureau completes its review of the formulas contained in the *NECA 2002 Filing* and establishes the appropriate high-cost loop support for average schedule carriers for 2002.[2]

[1] *See* 2002 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., October 1, 2001 (*NECA 2002 Filing*); *see also National Exchange Carrier Association, Inc. Proposed 2002 Modification of Average Schedule Formulas*, APD 01-07, Order, DA 01-2969, 17 FCC Rcd 15 (Accounting Policy Div. 2001) (*December 2001 Order*).

[2] The Commission is considering how to simplify average schedule process in a pending rulemaking proceeding. *See 2000 Biennial Review—Requirements Governing the NECA Board of Directors under Section 69.602 of the Commission's Rules And Requirement for the Computation of Average Schedule Company Payments under Section 69.606 of the Commission's Rules*, CC Docket No. 01-174, Notice of Proposed Rulemaking, 16 FCC Rcd 16027 (2001).

II. DISCUSSION

A. Universal Service Formula for Average Schedule Carriers

1. Background

2. Under the Commission's rules, eligible telecommunications carriers serving high-cost areas may receive universal service support to promote the availability of affordable service.[3] A rural carrier is eligible for high-cost loop support to the extent that its cost per loop (CPL) exceeds certain benchmarks relative to the nationwide average CPL.[4] To receive high-cost support, rural carriers must file their loop cost data with the National Exchange Carrier Association, Inc. (NECA) pursuant to section 36.611 of the Commission's rules.[5] NECA then compares each carrier's CPL to the nationwide average CPL to calculate a support amount, or "expense adjustment," for each carrier.[6]

3. Average schedule carriers generally do not file cost data with NECA.[7] Although the Commission's rules do not specifically provide for expense adjustments for average schedule carriers,[8] some average schedule carriers have loop costs that are above the national average. Thus, the Commission has permitted average schedule carriers to receive high-cost loop support pursuant to formulas developed by NECA and approved or modified annually by the Bureau.[9] These formulas are developed by NECA using data from a sample group of average schedule carriers and from similarly situated companies that file cost data and are used to determine support amounts for all average schedule carriers. NECA files proposed modifications to the formula on October 1 of each year, for an effective date of the subsequent January 1.[10]

4. Over the past three years, the Bureau has rejected NECA's proposed modifications to the average schedule high-cost loop formula.[11] Each year, the Bureau considered, as it had in

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[3] 47 C.F.R. § 36.601 *et seq.*; *see also* 47 U.S.C. § 254.

[4] 47 C.F.R. § 36.631.

[5] 47 C.F.R. § 36.611.

[6] 47 C.F.R. §§ 36.613, 36.631. This support is referred to as an "expense adjustment" because it permits carriers with high loop costs to assign a greater portion of loop-related costs to the interstate jurisdiction than would be permitted otherwise under the Commission's jurisdictional separations rules, thereby reducing the costs allocated to the intrastate jurisdiction. Carriers recover the incremental allocation from the high-cost loop mechanism. *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8891 para. 209 (1997) (*Universal Service Order*).

[7] As discussed below, a sample group of average schedule carriers do file cost data with NECA annually.

[8] *See* 47 C.F.R. § 36.601 *et seq.*

[9] *See, e.g., National Exchange Carrier Association, Inc. Proposed Modification to the 1999-2000 Interstate Average Schedule Formulas*, Order, FCC 99-395, 15 FCC Rcd 1819, 1819-20 para. 2 (1999) (*Commission 1999 Order*). Only average schedule carriers that are rural carriers may receive high-cost loop support pursuant to part 36 of the Commission's rules.

[10] Under Part 36 of our rules, high-cost loop support payments become effective for a 12-month period beginning January 1. *See* 47 C.F.R. § 36.601 *et seq.*

[11] *National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, DA 99-530, 14 FCC Rcd 4049, 4051-55 paras. 6-12 (Comm. Car. Bur. 1999) (*Bureau 1999 Order*); *National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal*

(continued....)

previous years, whether the proposed modifications more reasonably predicted costs per loop for average schedule carriers than the formula then in use.[12] Each time, the Bureau concluded that the new expense adjustment per loop (EAPL) formula proposed by NECA did not approximate cost per loop for the sample companies as reasonably as the then-current formula.[13] The Bureau therefore retained the formula adopted in 1998, adjusted by growth in lines.[14] The Bureau continued to urge NECA to develop a formula that would more accurately predict cost per loop.[15]

5. On October 1, 2001, NECA filed a proposal to modify the average schedule expense adjustment formula for 2002.[16] NECA proposes an EAPL formula much like the one that the Bureau has rejected in recent years.[17] In contrast to recent years, however, NECA also presents an alternative CPL formula in its filing.[18] In NECA's opinion, however, the support produced by the CPL formula is lower than the actual support amount to which average schedule carriers should be entitled and therefore represents the lower limit of payments to average schedule

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Service Formulas, Order, DA 00-588, 15 FCC Rcd 5065, 5067-68 paras. 5-7 (Comm. Car. Bur. 2000) (*2000 Order*); *National Exchange Carrier Association, Inc. Proposed 2001 Modification of Average Schedule Universal Service Formulas*, Order, DA 00-2891, 16 FCC Rcd 25, 27-30 paras. 5-8 (Comm. Car. Bur. 2000) (*2001 Order*).

[12] *See*, *e.g.*, *National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, DA 98-1297, 13 FCC Rcd 17351, 17356-60 paras. 12-18 (Comm. Car. Bur. 1998) (*1998 Order*) (approving NECA's proposed expense adjustment per loop formula because it was a better predictor of costs per loop than the then-current CPL formula.). The *1998 Order* was the last time the Bureau approved a NECA-proposed modification to the average schedule high-cost formula.

[13] *Bureau 1999 Order*, 14 FCC Rcd at 4052-53 paras. 8-9; *2000 Order*, 15 FCC Rcd at 5067 paras. 5-7 ("[NECA's] proposed formula does not provide a reasonable correlation between the estimated cost per loop data and the sample cost per loop data which may justify its use in determining USF payments for average schedule carriers"); *2001 Order*, 16 FCC Rcd at 28-30 para. 7 (2000).

[14] *Bureau 1999 Order*, 14 FCC Rcd at 4055-56 paras. 13-14; *Bureau 1999 Order*, 14 FCC Rcd at 4055-56 paras. 13-14; *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30 para. 8. The Commission denied NECA's Petition for Review of the Bureau's *1999 Order*, concluding that the Bureau could properly reject NECA's proposed EAPL formula because it failed to accurately predict costs per loop. *Commission 1999 Order*, 15 FCC Rcd at 1820-22 para. 4. NECA subsequently appealed the Commission's order to the U.S. Court of Appeals for the District of Columbia, claiming that the decision to reject the proposed EAPL formula and instead adjust the expense adjustment by growth in lines was arbitrary and capricious. *National Exchange Carrier Association, Inc. v. Federal Communications Commission*, 253 F.3d 1 (2001). The court denied NECA's appeal, concluding that NECA "fail[ed] to articulate an intelligible explanation of its substantive claim . . . ." *Id.* at 2. The court also denied NECA's procedural claim that the Commission failed to follow notice and comment rulemaking procedures required under the Administrative Procedures Act. *Id.* at 4. NECA's petitions for review of the *2000 Order* and the *2001 Order* remain pending.

[15] *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30 para. 8.

[16] *NECA 2002 Filing*.

[17] *NECA 2002 Filing* at I-16 ("In this filing, NECA again proposes an expense adjustment formula for determining average schedule USF payments. This model, based on current data, continues to provide the best available way of satisfying the 'payment simulation' standard specified in section 69.606(a) of the Commission's rules.").

[18] *NECA 2002 Filing* at I-16 ("Recognizing the Commission's apparent preference for a formula that simulates the cost per loop data of sample companies, however, NECA also presents a statistically-valid cost per loop formula for Commission consideration.")

carriers for high-cost loop support.[19]

6. On December 26, 2001, the Bureau released an order directing that average schedule carriers continue to receive high-cost loop support at their 2001 level, pending further review of NECA's filing.[20] Specifically, the Bureau indicated the need to further review the EAPL and CPL formulas and, particularly, NECA's claim that the CPL formula is downwardly biased with respect to the support that average schedule carriers receive.[21] At the request of Bureau staff, NECA supplemented its filing on several occasions to better explain both the EAPL formula and the CPL formula, and the relative advantages and disadvantages of each.[22]

7. NECA uses regression analyses to develop both the EAPL and CPL formulas. For each, NECA collects Part 32 account data from a sample group of average schedule carriers.[23] NECA then applies cost allocation factors—developed from the cost studies of similarly situated cost companies—to the account balances of each sample average schedule company to estimate a CPL for each of the sample companies.[24] NECA then uses regression analyses to predict loop costs and expense adjustments for all average schedule carriers. For the CPL formula, the regression is performed on the sample companies' estimated CPLs to develop a formula from which CPLs can be derived for all average schedule carriers.[25] Each average schedule company's derived CPL is then used to calculate the appropriate support amount. For the EAPL formula, NECA calculates an EAPL for each sample company from its estimated CPL, and then performs a regression analysis on those EAPLs to derive a formula which is used to calculate a support amount for each average schedule company.[26]

2. Discussion

8. We adopt the CPL formula presented in NECA's October 1, 2001 filing. Because the high-cost support mechanism is intended to provide support to carriers with higher than average loop costs, any formula adopted for the provision of high-cost loop support to average schedule

[19] *NECA 2002 Filing* at III-37.

[20] *December 2001 Order*, 17 FCC Rcd at 16- 17 paras. 3-5. In the *December 2001 Order*, the Bureau adopted the modification to the Local Switching Support formula for average schedule carriers proposed by NECA in the *NECA 2002 Filing*. *Id.* at 15-16 para. 2.

[21] *December 2001 Order*, 17 FCC Rcd at 17 para. 5.

[22] *See*, *e.g.*, Letter from Regina McNeil, NECA, to William F. Caton, FCC, dated February 26, 2002; Letter from Richard A. Askoff, NECA, to William F. Caton, FCC, dated March 22, 2002; Letter from Regina McNeil, NECA, to William F. Caton, FCC, dated March 29, 2002; Letter from Regina McNeil, NECA, to William F. Caton, FCC, dated April 2, 2002; Letter from Regina McNeil, NECA, to William F. Caton, FCC, dated April 3, 2002; Letter from Regina McNeil, NECA, to William F. Caton, FCC, dated April 5, 2002; Letter from Richard A. Askoff, NECA, to William F. Caton, FCC, dated April 12, 2002; Letter from Regina McNeil, NECA, to Marlene H. Dortch, FCC, dated April 26, 2002; Letter from Regina McNeil, NECA, to Marlene H. Dortch, FCC, dated May 15, 2002; Letter from Stephen M. Quinnan, NECA, to Geoffrey Waldau, FCC, dated July 3, 2002 (collectively, *NECA Supplemental Filings*).

[23] *See NECA 2002 Filing* at I-2 to I-6. To estimate current year costs, NECA applies forecasted growth factors to data collected from sample average schedule carriers one and two years prior to the current year.

[24] *See NECA 2002 Filing* at I-2 to I-6.

[25] *See NECA 2002 Filing* at III-34 to III-37.

[26] *See NECA 2002 Filing* at III-5 to III-23.

carriers should reasonably approximate such carriers' loop costs.[27] We conclude that NECA's CPL formula is, for average schedule carriers as a whole, a more accurate predictor of costs per loop than NECA's proposed EAPL formula. For the sample average schedule carriers, the CPL formula predicts costs per loop that are, in the aggregate, the same as the costs per loop estimated based on the part 32 data collected from the sample average schedule carriers. Accordingly, subject to the limitations of the data available for average schedule carriers, the CPL formula will similarly predict the most reasonably accurate costs per loop for all average schedule carriers. In contrast, it appears, based on our examination, that the EAPL formula proposed by NECA routinely overstates the costs per loop for average schedule carriers.[28] In fact, NECA agrees that the CPL formula is an unbiased predictor of costs per loop, and that its EAPL formula is a biased predictor of costs per loop.[29]

9. The Bureau also concludes that neither formula under consideration offers a substantial advantage over the other with respect to its ability to allocate support among average schedule carriers. Each method uses loops per exchange as the independent variable in the formula. As a result, each method allocates support among carriers based on the relative number of loops per exchange that each carrier serves. Because loops per exchange demonstrates a similar "goodness of fit" to costs per loop as it does to expense adjustments per loop, the quality of the allocation among carriers is similar for each method.[30] Accordingly, the Bureau does not find this particular factor to provide any significant basis for favoring or disfavoring either of the formulas under consideration.

10. We reject NECA's claim that the Commission must adopt an EAPL formula because section 69.606(a) of the Commission's rules require that the approved formula accurately simulate "disbursements" to average schedule carriers.[31] According to NECA, this provision requires that the Bureau approve a formula, such as the EAPL formula, that predicts average schedule carriers' expense adjustments per loop, rather than a formula that predicts their costs per loop. Section 69.606(a), however, relates only to access settlements distributed to cost companies pursuant to section 69.607, not to universal service support provided pursuant to Part 36 of the Commission's rules.[32] We therefore find that we are not required to adopt a formula based on its ability to predict expense adjustments per loop, *i.e.*, "disbursements," compared to a

[27] *See*, *e.g.*, *2001 Order*, 16 FCC Rcd at 29-30 para. 7 ("[B]ecause USF expense adjustments are based on the carriers' cost per loop, a good model for determining average schedule carriers' USF expense adjustments should provide results that reflect the cost data obtained from the sample of average schedule carriers.").

[28] In the EAPL formula, cost per loop is derived by "backcasting" the cost per loop necessary to require the expense adjustment per loop produced for a particular carrier by the EAPL formula.

[29] Letter from Regina McNeil, NECA to William F. Caton, FCC, dated February 26, 2002, Attachment 1. As noted below, we disagree with NECA's argument that section 69.606(a) of the Commission's rules requires the Commission to adopt a formula that predicts "disbursements" rather than costs per loop. *See infra* para. 10.

[30] A measure of "goodness of fit" for a formula is the coefficient of determination, or R-square. This is a statistic that measures how closely a formula fits the data. In this case, the correlation between loops per exchange and cost per loop is similar to the correlation between loops per exchange and expense adjustment per loop.

[31] *NECA 2002 Filing* at I-12; *see* 47 C.F.R. § 69.606(a) ("Payments shall be made in accordance with a formula approved or modified by the Commission. Such formula shall be designed to produced disbursements to an average schedule company that simulate the disbursements that would be received pursuant to § 69.607 by a company that is representative of average schedule carriers.")

[32] 47 C.F.R. § 69.606(a).

formula's ability to predict costs per loop.

11. For the reasons discussed above, we hereby adopt the CPL formula presented by NECA.[33] The CPL formula shall apply to support for the 2002 calendar year and we therefore direct the Universal Service Administrative Company (USAC), as administrator of the high-cost loop support mechanism, to provide support to average schedule carriers consistent with this Order retroactive to January 1, 2002. Specifically, USAC shall provide to average schedule carriers the balance of support due for the first quarter concurrent with its disbursements for the third quarter of 2002, and the balance of support due for the second quarter concurrent with the disbursements for the fourth quarter.

B. *Rural Task Force Order* Implementation

1. Background

12. On May 23, 2001, the Commission released the *RTF Order* modifying the high-cost support mechanism for rural carriers.[34] Among other things, the Commission adopted the "safety net additive" and "safety valve support." The Commission also clarified the requirements for filing line-count and loop cost data in study areas with competitive eligible telecommunications carriers.

13. The safety net additive provides additional support to carriers who make significant investment in rural infrastructure. The safety net additive is only available in years in which demand for high-cost support exceeds the indexed cap on the high-cost loop support fund.[35] To qualify for the safety net additive, a carrier must demonstrate that its growth in telecommunications plant in service (TPIS) per line in its study area is at least 14 percent greater than the study area's TPIS per line in the prior year.[36] The safety net additive support allows a carrier to recover, in the qualifying year, the difference between the incremental increases in capped and uncapped support in the qualifying year and the base year.[37] Qualifying carriers may receive this safety net additive in each year that the cap is triggered for the five years of the plan.

14. Safety valve support provides additional high-cost loop support to rural carriers

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[33] Even as we approve the CPL formula, we note that it might be improved. For example, use of an independent variable with a higher correlation to loop costs than loops per exchange would make NECA's CPL formula a much better allocator of support among companies than it is presently. We expect to address these kinds of issues, including the use of an EAPL formula on a long-term basis, in the context of the pending rulemaking proceeding.

[34] *See Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket Nos. 96-45 and 00-256, 16 FCC Rcd 11244, 11276-99 paras. 77-135 (2001) (*RTF Order*).

[35] In years when the cap is not triggered, rural carriers would receive support in an amount that would cover the added expense associated with the new investment, and thus it is unnecessary to provide safety net additive in those years. *RTF Order*, 16 FCC Rcd at 11276 n. 196.

[36] *See* 47 C.F.R. § 32.2001.

[37] See 47 C.F.R. § 36.605(b) ("Safety net additive support = (Uncapped support in the qualifying year – Uncapped support in the base year) – (Capped support in the qualifying year – Amount of support received in the base year).").

acquiring lines from another carrier.[38] Safety valve support enables the acquiring carrier to receive additional support reflecting "post-transaction investment made to enhance the infrastructure of and improve the service in these exchanges."[39] Safety valve support is provided for up to 50 percent of any positive difference between the rural incumbent local exchange carrier's index year expense adjustment for the acquired exchanges and subsequent year expense adjustments.[40]

15. Finally, in the *RTF Order*, the Commission added the requirement that, when a competitive eligible telecommunications carrier (CETC) enters a rural carrier study area, both the incumbent carrier and the CETC are required to file line count data to USAC on a quarterly basis. This requirement ensures that only one carrier receives support for each line served.[41] The incumbent carrier may file updates of its loop cost data at its discretion.[42]

2. Discussion

16. Safety net additive. We approve NECA's proposed method for providing safety net support to average schedule carriers. NECA proposes to calculate the safety net additive for average schedule carriers in the same manner as for cost-based companies.[43] The safety net additive for qualifying average schedule carriers, *i.e.*, those companies whose current year TPIS is 14 percent greater than the prior year, would be determined by computing the capped and uncapped support for both the base year and the qualifying year, using the cost per loop produced by the approved high-cost loop formula in effect for the relevant year, and applying the safety net additive formula. We find that NECA's proposed methodology to provide the safety net additive to average schedule carriers is consistent with Commission rules and will provide average schedule carriers with incentives to make significant investments. Average schedule carriers, like all other carriers seeking the safety net additive, must file the appropriate reports and data with USAC in order to be eligible for the safety net additive. Failure to file the appropriate reports and data will result in disqualification for the safety net additive.[44]

17. Safety valve support. We approve NECA's proposed method for providing safety valve support to average schedule carriers. We find that NECA's proposal to provide safety valve support to average schedule carriers is consistent with Commission rules and will provide average schedule carriers additional incentives to make significant investments to improve the telecommunications infrastructure and service to newly-acquired exchanges. NECA proposes that a qualifying average schedule company will separately report line counts for the acquired

[38] *See RTF Order*, 16 FCC Rcd at 11281-92 paras. 91-119. Prior to the adoption of safety valve support, carriers acquiring lines from another carrier could only receive the same per-line support that the seller received prior to the transfer. See also *Universal Service Order* 12 FCC Rcd at 8942-43 para. 308.

[39] *See RTF Order*, 16 FCC Rcd at 11282-83 para. 94.

[40] *See* 47 C.F.R. § 54.305. The index year expense adjustment is the high-cost expense adjustment for the acquired exchanges calculated at the end of the company's first year of operating the acquired exchanges.

[41] *See RTF Order*, 16 FCC Rcd at 11298 para. 133; s*ee also* 47 C.F.R. § 36.612.

[42] *See* 47 C.F.R. § 36.612.

[43] *See NECA 2002 Filing* at IV-1.

[44] *See* 47 C.F.R. § 36.605(c)(2).

exchanges. NECA will use this data to calculate safety valve support for qualifying companies.[45] The index year safety valve support and subsequent years' safety valve support will be determined by calculating the cost per loop for the acquired exchanges using the appropriate high-cost loop formula in effect at that time. Safety valve support will be up to 50 percent of the difference between the index year expense adjustment and the subsequent year expense adjustment. In no year, however, may a carrier receive safety valve support greater than the difference between a carrier's uncapped study area loop cost expense adjustment calculated pursuant to section 36.631 and transferred support amounts available to the acquired exchange(s) under section 54.305(a).[46]

18. Support in study areas with CETC. NECA proposes that, upon entry of a CETC into a rural average schedule company's study area, NECA will begin providing updated loop counts for that company to USAC on a quarterly basis pursuant to Commission rules.[47] In addition, NECA proposes that, at the request of the company, it may begin to provide updated quarterly loop cost and expense adjustment information for that study area pursuant to the formula approved by the Commission, consistent with the optional quarterly update process afforded cost companies.[48] The revised per line support amounts would then be available for both the incumbent average schedule company and the CETC based on the voluntary revision. We find that NECA's proposal regarding the reporting of quarterly line counts and loop cost data upon the entry of a CETC into average schedule company's study area is consistent with section 36.612 of the Commission's rules.

III. ORDERING CLAUSES

19. ACCORDINGLY, IT IS ORDERED that, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that the average schedule cost-per-loop formula proposed by NECA on October 1, 2001, for high-cost loop support IS ADOPTED, effective January 1, 2002.

20. IT IS FURTHER ORDERED, pursuant to section 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that NECA's proposed methodologies for calculating safety net additive and safety valve support for average schedule carriers, and for filing average schedule company data pursuant to section 36.612 of the Commission's rules ARE APPROVED.

[45] *See NECA 2002 Filing* at IV-3; s*ee also* 47 C.F.R. § 54.305.

[46] *See* 47 C.F.R. § 54.305(d).

[47] *See NECA 2002 Filing* at IV-3 to 4; *see also* 47 C.F.R. § 36.612

[48] *See NECA 2002 Filing* at IV-3 to IV-4

21. 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 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that THIS ORDER IS EFFECTIVE UPON ITS RELEASE.

FEDERAL COMMUNICATIONS COMMISSION

Carol E. Mattey
Deputy Chief, Wireline Competition Bureau