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: December 26, 2002 **Released: December 27, 2002**

By the Deputy Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. On October 1, 2002, 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, 2003, and remain in effect through December 31, 2003.[1] These formulas include a local switching support formula and a Part 36 high-cost support formula. On October 11, 2002, a public notice was issued soliciting comments on NECA's filing.[2] For the reasons discussed below, we approve NECA's modified local switching support formula and, with respect to Part 36 high-cost support, we adopt NECA's cost per loop formula (CPL formula). We deny NECA's request for supplemental payments for certain average schedule companies.

II. LOCAL SWITCHING SUPPORT FORMULA

2. The local switching support formula is used to determine the amount of support for switching costs that will be provided from universal service support mechanisms. The current

[1] *See* 2003 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., October 1, 2002 (*NECA 2003 Filing*).

[2] *Pleading Cycle Established for Comments on National Exchange Carrier Association, Inc. 2003 Modification of Average Schedule Universal Service Formulas*, Public Notice, DA 02-2626 (rel. Oct. 11, 2002). The Bureau received comments in support of the *NECA 2003 Filing* from ICORE, Inc., National Telecommunications Cooperative Association, and The Organization for the Promotion and Advancement of Small Telecommunications Companies.

interstate local switching support formula was approved on December 26, 2001.[3] NECA proposes minor modifications to the current formula that, if approved, would increase annual payments for local switching support from approximately $69.6 million in 2002 to approximately $76.4 million in 2003, an increase of 9.72 percent.[4] 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.[5] Consistent with the Bureau's prior orders, we approve NECA's proposed 2002 average schedule local switching support formula.[6]

III. PART 36 HIGH-COST SUPPORT FORMULA

A. Background

3. Part 36 high-cost support, also known as the loop expense adjustment, is intended to provide universal service support to carriers with high loop costs based on the degree that an individual company's cost per loop exceeds the national average.[7] Because average schedule companies are not required to perform company-specific cost studies – the basis upon which a carrier's expense adjustment is calculated – the Commission has permitted expense adjustments for average schedule companies pursuant to formulas developed by NECA and approved or modified annually by the Bureau.[8] 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

[3] *See*, *e.g.*, *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) (*2002 Switching Support Order*).

[4] *NECA 2003 Filing* at II-1 to II-14. The local switching support is a portion of the settlements that average schedule companies receive for providing interstate local switching access service. The remainder of the settlements continues to be recovered through NECA's local switching access charges. *Id.*

[5] *Id.*; 2002 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., October 1, 2001 (*NECA 2002 Filing*).

[6] *See*, *e.g.*, *2002 Switching Support Order*; *National Exchange Carrier Association, Inc. Proposed 2001 Modification of Average Schedule Universal Service Formulas*, ASD 00-42, Order, 16 FCC Rcd 25 (Accounting Safeguards Div. 2000) (*2001 Order*).

[7] *See* 47 C.F.R. Part 36, subpart F. The Commission's rules permit a rural carrier that has significantly higher than average loop costs to shift a portion of its loop costs from the intrastate jurisdiction to the interstate jurisdiction. The carrier then receives universal service support equal to this expense adjustment

[8] *See National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, FCC 99-395, 15 FCC Rcd 1819, 1819-20 para. 2 (1999) (*Commission 1999 Order*). Average schedule companies have been permitted by the Commission to estimate their access settlements and universal service support through the use of average schedules to avoid the difficulties and expenses involved with conducting company-specific cost studies. *See*, *e.g.*, *ALLTEL Corp. v. FCC*, 838 F.2d 551, 553 (D.C. Cir. 1998). 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 Part 36 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).

subsequent January 1.[9]

4. For 1999, 2000, and 2001, the Bureau rejected NECA's proposed expense adjustment per loop formula (EAPL formula) because it failed to provide a reasonable estimate of the cost per loop of the sample companies.[10] In each instance, the Bureau instead retained the existing formula with an adjustment for growth in the number of loops.[11] The Bureau also indicated each time that it would prefer a formula that more accurately predicted cost per loop.[12]

5. For 2002, NECA again proposed its EAPL formula, but also provided a CPL formula for the Bureau's consideration.[13] NECA contended that the EAPL formula better estimated the support that average schedule carriers would receive if they were to begin filing cost studies.[14] The Bureau concluded, however, that the CPL formula better estimated the cost per loop of average schedule companies, in the aggregate, than the proposed EAPL formula and therefore approved the CPL formula for use in 2002.[15]

6. NECA's proposal for 2003 average schedule formulas is essentially the same as its 2002 proposal.[16] NECA proposes its EAPL formula, but also provides its CPL formula for

[9] 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.*

[10] *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 (Accounting Safeguards Div. 1999) (*Bureau 1999 Order*); *National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal Service Formulas*, Order, DA 00-588, 15 FCC Rcd 5065, 5067-68 paras. 5-7 (Accounting Safeguards Div. 2000) (*2000 Order*); *2001 Order*, 16 FCC Rcd at 27-30 paras. 5-8.

[11] *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 & n. 15. 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 applications for review of the *2000 Order* and the *2001 Order* remain pending.

[12] *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30 para. 8.

[13] *NECA 2002 Filing* at I-16.

[14] *Id*.

[15] *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, 17 FCC Rcd 14236, 14239-41 paras. 8-11 (Wireline Competition Bur. 2002) (*2002 Order*), *recon. pending*. In particular, the Bureau found that the CPL formula was, for average schedule carriers as a whole, a more accurate predictor of costs per loop than the EAPL formula. The Bureau noted that NECA agreed that the CPL formula was an unbiased predictor of costs per loop.

[16] *See NECA 2003 Filing*, III-2 to III-36; *NECA 2002 Filing*, III-2 to III-38.

consideration.[17] Each formula contains minor changes from last year's formulas, but reflects the same methodology.[18] Both formulas would result in an increase in support to average schedule companies in the aggregate due to increased costs in the sample companies.[19]

7. The *NECA 2003 Filing*, unlike the *NECA 2002 Filing*, proposes that a supplemental payment be provided to some average schedule carriers if the Bureau adopts the CPL formula.[20] This supplemental payment would be provided to average schedule carriers that would otherwise receive less support on a monthly basis than they received in December 2001, the last month for which support was paid prior to the Bureau's adoption of the CPL formula for 2002. NECA contends that because, in its opinion, average schedule carriers are entitled under the Commission's rules to the amount of support calculated by the EAPL formula it proposes this year, any reduction is unwarranted.[21]

B. Discussion

8. Consistent with our reasoning in our *2002 Order*, we adopt the CPL formula for purposes of calculating average schedule company expense adjustments for 2003. NECA concedes that the CPL formula better estimates cost per loop, but argues that the Bureau should instead approve NECA's EAPL formula because NECA believes it better estimates the expense adjustments that an average schedule carrier should receive.[22] The Bureau has consistently held,

[17] *NECA 2003 Filing*, III-2 to III-36.

[18] *Id.* 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. *See id.* at I-2 to I-3, III-3 to III-4. 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. 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. *See id.* at I-2 to I-3, I-6, III-3 to III-4. NECA then uses regression analyses to predict loop costs and expense adjustments for all average schedule carriers. *See id.* at I-6 to I-11. 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. *See id.*.at III-32 to III-35. 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. *See id.* at III-5 to III-22.

[19] *Id.* at III-2 to III-3, III-35.

[20] *NECA 2003 Filing* at III-35-36. NECA requested this supplemental payment for the first time in its pending Petition for Reconsideration of the *2002 Order*.

[21] *Id.*

[22] *Id.* at I-7 to I-15. NECA again argues that section 69.606(a) of the Commission's rules requires that the Bureau adopt a formula based on its ability to simulate "disbursements" to similarly situated non-average schedule carriers, rather than its ability to estimate cost per loop, and the Bureau must therefore adopt NECA's EAPL formula. *Id.* at I-10. However, in the *Commission 1999 Order*, the Commission affirmed the Bureau's rejection of NECA's proposed EAPL formula because it did not reasonably estimate cost per loop. *Commission 1999 Order*, 15 FCC Rcd at 1820-22 para. 4 & n. 15. In the Bureau's *2002 Order*, we rejected NECA's claim that we 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. *2002 Order*, 17 FCC Rcd 14240-41 para. 10. Section 69.606(a) relates only to access settlements distributed to cost companies pursuant to section 69.607, not to universal

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however, and the Commission has upheld, that the appropriate high-cost loop support formula should reasonably approximate the cost per loop of the sample average schedule companies and allocate funds accurately to average schedule companies.[23] Because the CPL formula provided by NECA in its filing better estimates the cost per loop of sample average schedule companies than the proposed EAPL formula, the Bureau concludes, as in its *2002 Order*, that the CPL formula is a more appropriate means of calculating USF support for average schedule companies.

9. Having concluded that the CPL formula will produce appropriate support amounts for average schedule companies, we deny NECA's request for supplemental payments. NECA seeks supplemental payments for carriers that receive reductions in support under the 2003 CPL formula as compared with their annualized December 2001 support amount.[24] NECA does not argue that the reduction in support will cause any undue hardship to average schedule carriers. Instead, NECA argues that only the EAPL formula proposed by NECA will provide the "correct" support amount to an average schedule carrier.[25] Although NECA recognizes that some carriers would receive reduced support amounts if the EAPL formula were adopted, NECA apparently believes that any reduction in support resulting from the adoption of NECA's preferred EAPL formula is warranted, while any reduction resulting from the CPL formula is not.[26] For the reasons described above, we disagree with NECA's assertion that only the EAPL formula provides the "correct" support amount. Rather, we conclude that the CPL formula provides the most appropriate basis for determining Part 36 high-cost support for average schedule companies.[27] We recognize that the formulas approved by the Bureau in 1999, 2000, and 2001 contained supplemental payments similar to the one now proposed by NECA. In those years, however, NECA did not provide the Bureau with a reasonable alternative to its proposed EAPL formula, and the Bureau retained the existing EAPL formula with rudimentary adjustments to reflect growth. In the absence of a properly designed formula, it was reasonable for the Bureau to ensure that the interim solution would not result in reduced payments. Here, the Bureau finds that the CPL methodology provides an accurate basis for the provision of support. We therefore conclude that supplemental payments are not warranted.

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service support provided pursuant to Part 36 of the Commission's rules. 47 C.F.R. § 69.606(a). We again 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 formula's ability to predict costs per loop.

[23] *Commission 1999 Order*, 15 FCC Rcd at 1820-22 para. & n. 15; *2001 Order*, 16 FCC Rcd at 27-30 paras. 5-8; *2002 Order*, 17 FCC Rcd at 14239-41 paras. 8-11.

[24] *NECA 2003 Filing*, at III-35-36. NECA proposes supplemental payments to nine companies totaling $22,092. *Id.* at III-35, Appendix E.

[25] *Id*. at III-36. NECA does not attempt to demonstrate, however, that the EAPL formula provides accurate support to individual average schedule carriers rather than average schedule carriers in the aggregate.

[26] Most of the carriers for which NECA proposes supplemental payments would receive reduced support under NECA's proposed EAPL formula.

[27] *See*, *supra*, para. 8; *2002 Order*, 17 FCC Rcd at 14239-41 paras. 8-11.

IV. ORDERING CLAUSES

10. Accordingly, IT IS ORDERED, 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 formula proposed by the National Exchange Carriers Association, Inc., on October 1, 2002, for local switching support SHALL BECOME EFFECTIVE January 1, 2003.

11. IT IS FURTHER ORDERED, 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 described by NECA on October 1, 2002, for high-cost loop support SHALL BECOME EFFECTIVE January 1, 2003.

12. IT IS FURTHER ORDERED, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that NECA's request for supplemental payments for average schedule companies for 2003 IS DENIED.

13. 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

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Deputy Chief, Wireline Competition Bureau