

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

In the Matter of)
)
Valor Telecommunications of Texas, L.P.)
) WCB/Pricing File No. 03-16
Petition for Waiver of the 2003 X-Factor)
Reductions Under Section 61.45(b)(1)(i) of)
the Commission’s Rules)

ORDER

Adopted: June 11, 2003

Released: June 11, 2003

By the Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. In this order, we address the petition filed by Valor Telecommunications of Texas, L.P. (Valor Texas), which seeks a waiver of application of the X-factor in the price cap indices formula set forth in section 61.45(b)(1)(i) of the Commission’s rules.¹ For the reasons discussed below, we deny Valor Texas’ waiver request and, accordingly, require it to make X-factor rate reductions in its 2003 annual access filing.

II. BACKGROUND

2. In 2000, the Commission adopted an integrated interstate access reform and universal service regime for price cap local exchange carriers (LECs), which required the LECs to choose between rates adopted for the five-year term of the *CALLS Order* or rates reinitialized on the basis of forward-looking economic cost.² Carriers that elected the *CALLS* plan subject their interstate average traffic sensitive (ATS) access rates to an X-factor of 6.5 percent until certain

¹ See Valor Telecommunications of Texas, L.P. Petition for Waiver of the 2003 X-Factor Reductions Under Section 61.45(b)(1)(i) of the Commission’s Rules at 1, 9, 14 (filed April 14, 2003) (Valor Texas Petition); 47 C.F.R. § 61.45(b)(1)(i). We grant Valor Texas’ Motion for an Extension of Time (filed May 12, 2003) in the filing of its reply comments in this proceeding, Valor Texas’ Reply to Oppositions to Petition for Waiver of the 2003 X-Factor Reductions Under Section 61.45(b)(1)(i) of the Commission’s Rules (Valor Texas Reply). Valor demonstrates good cause, *i.e.*, it received AT&T’s Opposition comments one business day before Valor’s reply was due, and no party opposes the extension of time.

² See *Access Charge Reform*, CC Docket No. 96-262, Sixth Report and Order, 15 FCC Rcd 12962, 12964, 12974, 12984, paras. 1, 29, 57 (2000) (*CALLS Order*).

target rates are reached.³ Traditionally, the X-factor represented the amount by which LEC productivity gains could be expected to exceed productivity gains in the economy as a whole.⁴ The *CALLS Order* altered the traditional function of the X-factor so that it now serves as a transitional mechanism to reduce certain access charges over the term of the *CALLS* plan.⁵ The target rate for ATS charges for primarily rural LECs is 0.95 cents.⁶ Once the ATS target rate is reached, the 6.5 percent X-factor is applied to reduce carrier common line (CCL) charges.⁷ After the elimination of the CCL charges, or on June 30, 2004, whichever comes earlier, the X-factor is set to inflation.⁸

3. Valor Texas acquired partial study areas from GTE, elected the *CALLS* plan, and began local exchange operations in September 2000. Valor Texas has reached the 0.95 cent target rate but has not yet eliminated its CCL charges.⁹ Consistent with the *CALLS Order*, Valor Texas must apply the X-factor of 6.5 percent, offset by inflation, to the Common Line, Marketing, and Transport Interconnection Charge (CMT) basket, thereby reducing CMT revenues, until its CCL charge is eliminated.

4. Last year, Valor Texas and Valor Telecommunications of New Mexico, LLC (Valor New Mexico) (collectively, Valor) filed a waiver petition requesting that the X-factor not be applied in any of the years that they make a low-end adjustment.¹⁰ The Bureau found that Valor New Mexico did not satisfy the legal test for a waiver and denied this request.¹¹ The Bureau, however, did provide partial relief by allowing Valor Texas to delay its required 2002 X-factor

³ *Id.* at 13028, para. 161.

⁴ *E.g.*, *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6796, paras. 74-75 (1990) (*LEC Price Cap Order*) and *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Fourth Report and Order, 12 FCC Rcd 16642 (1997) (*X-Factor Order*) (subsequent history omitted). *See also CALLS Order*, 15 FCC Rcd 12962, 13018-13029, paras. 135-140.

⁵ *CALLS Order*, 15 FCC Rcd at 13021, paras. 140-141. The *CALLS* plan includes two X-factors: one for switched access service and a separate X-factor for special access services. After predetermined target rates are reached, the switched access X-factor will be equal to a measure of inflation (GDP-PI); the special access X-factor will also be adjusted to GDP-PI on July 1, 2004. *Id.*

⁶ *Id.* at 13029, para. 163; 47 C.F.R. § 61.3(qq)(2).

⁷ *Id.* at 13022, para. 144. The Carrier Common Line (CCL) charge is a per-minute charge assessed on an end user's interexchange carrier (IXC) whenever the end user places an interstate long-distance call. *Access Charge Reform*, CC Docket No. 96-262, Report and Order, 12 FCC Rcd 15982, 16004-16006, paras. 54-60 (1997) (*Access Charge Reform Order*). At the time of the *CALLS Order*, only BellSouth, Citizens, and certain study areas served by GTE, Frontier, and Sprint collected CCL charges. *CALLS Order*, 15 FCC Rcd at 12987, para. 68.

⁸ 47 C.F.R. § 61.45(i)(4); *CALLS Order*, 15 FCC Rcd at 13029, para. 163.

⁹ Valor Texas Reply at App. 1. Valor Texas projects CCL charges will be completely eliminated in 2003 if a waiver is not granted. *Id.*

¹⁰ Petition of Valor Telecommunications of Texas, L.P. and Valor Telecommunications of New Mexico, LLC for Waiver of Application of the X-factor as applied in Section 61.45(b)(1)(i) at 1 (filed April 12, 2002).

¹¹ *Valor Telecommunications of Texas and Valor Telecommunications of New Mexico Petition for Waiver of the Operation of the X-factor in the Price Cap Indices Formula Set Forth in Section 61.45(b)(1)(i)*, WCB/Pricing File No. 02-11, Order, 17 FCC Rcd 10646, 10650, para. 12 (2002) (*Valor Texas 2002 Order*).

reductions until 2004.¹² Both Valor Texas and Valor New Mexico received low-end adjustment relief.

5. Valor Texas filed the instant petition on April 14, 2003, requesting waiver of X-factor rate reductions in 2003 for interstate access services under section 61.45(b)(1)(i) of the Commission's rules.¹³ Valor Texas asserts that it continues to suffer from a unique combination of operational circumstances that have caused its ongoing financial problems, thus justifying a waiver.¹⁴ Valor Texas states that a "dangerously low" interstate return again last year makes it eligible this year for an unprecedented, third-straight low-end adjustment,¹⁵ that relief granted last year has proven insufficient, and that it needs the waiver "to ensure the ongoing viability of the company."¹⁶ Because the Bureau deferred 2002 X-factor reductions until 2004, Valor Texas argues that another such deferral of the 2003 X-factor is not an option because it would force Valor Texas into a double X-factor reduction in 2004, and a deferral until 2005 also would be inappropriate because the CALLS plan is set to expire then.¹⁷ AT&T, MCI, and Sprint oppose the petition. They contend that additional relief beyond the low-end adjustment is not necessary or justified because this mechanism is already working to retarget Valor's return to 10.25 percent and is available annually, if needed, to address Valor Texas' low earnings concerns.¹⁸ Further, they argue, granting a waiver would undermine the Commission's incentive regulation and price cap policies.¹⁹

III. DISCUSSION

6. The Commission has discretion to waive a rule for "good cause" shown.²⁰ Generally, the Commission may grant a waiver of its rules where the particular facts make strict compliance inconsistent with the public interest if applied to petitioner and when the relief requested would not undermine the policy objective of the rule in question.²¹ Petitioner must demonstrate that, in

¹² *Valor Texas 2002 Order*, 17 FCC Rcd at 10650-51, paras. 14-16.

¹³ Valor Texas Petition at 1; 47 C.F.R. § 61.45(b)(1)(i).

¹⁴ Valor Texas Petition at 4-6 (citing study area acquisition issues, extraordinary and unanticipated expenses including storm and critical telecommunications facilities required at the President George Bush's ranch in Crawford, TX, a five-year infrastructure and service improvement commitment with an employee force increase, and loss of revenues in a sluggish economy). Valor Texas also asserts that its "low-density, high-cost service area creates intrinsic difficulties in that [its] lines have to run further and its expenses have to be spread among fewer customers than other price cap carriers." *Id.* at 5.

¹⁵ Valor Texas Petition at 7-8, 15.

¹⁶ Valor Texas Reply at 2.

¹⁷ Valor Texas Petition at 9-10.

¹⁸ AT&T Opposition at 2-7; MCI Opposition at 2; Sprint Opposition at 4-6.

¹⁹ *E.g.*, Sprint Opposition at 4-5.

²⁰ 47 C.F.R. § 1.3.

²¹ *WAIT Radio v. FCC*, 418 F.2d 1153 (D.C. Cir. 1969), *appeal after remand*, 459 F.2d 1203 (D.C. Cir. 1972), *cert. denied*, 409 U.S. 1027 (1972) ("*WAIT Radio*"); *Northeast Cellular Tel. Co. v. FCC*, 897 F.2d 1164 (D.C. Cir. 1990) ("*Northeast Cellular*").

view of unique or unusual factual circumstances, application of the rule(s) would be inequitable, unduly burdensome, or contrary to the public interest.²²

7. Valor Texas asserts that “no other carrier has ever employed three consecutive low-end adjustments,” and this demonstrates special circumstances for a waiver.²³ Since Valor Texas began operating three years ago, it has experienced low and declining rates-of-return: 6.7 percent in 2000, 5.7 percent in 2001, and 5.37 percent in 2002.²⁴ As a result of low-end adjustment relief granted pursuant to Commission rules, however, Valor Texas was able to earn additional revenues that raised its annual returns to slightly above 10.25 percent in 2001 and 2002.²⁵ The Bureau stated last year that, although consecutive low-end adjustments are unusual, this “is by itself an insufficient basis for concluding that a company cannot increase its productivity and operate more efficiently than it did in the past.”²⁶ The Bureau additionally found, however, that Valor Texas was eligible for limited relief based on the combination of consecutive low earnings, acquisition of partial study areas, and substantial capital expenditures due to circumstances beyond Valor’s control.²⁷

8. Here, Valor Texas relies largely on the same circumstances for a waiver as it did last year, in addition to another year of low earnings as noted above.²⁸ Opposing parties contend, however, that Valor Texas cites expenditures that occurred in past years, and these are therefore not relevant to the upcoming tariff year for which the waiver is sought.²⁹ Valor Texas has identified only about \$229,000 in additional depreciation expense that will be incurred this year due to an ice storm that took place in 2000.³⁰ Valor Texas documents no other impact in 2003 due to substantial capital expenditures beyond Valor’s control. We also note that Valor Texas relies in part on the assumption that adverse economic conditions will not improve but provides no supporting evidence.³¹ Thus, Valor Texas fails to establish that it will incur substantial capital expenditures in 2003 due to circumstances beyond Valor’s control, and we cannot conclude that Valor Texas demonstrates unique or unusual circumstances that satisfy the waiver standard set by the Commission and the courts.

9. Furthermore, we find that the low-end adjustment was designed for the circumstances that Valor Texas faces and provides adequate relief. When the Commission adopted the low-end

²² *WAIT Radio*, 418 F.2d at 1159.

²³ Valor Texas Reply at 2.

²⁴ Valor Texas Reply at 7-8.

²⁵ Valor Texas Reply at 7. Valor’s low-end adjustment for 2002 will be recovered in its access rates beginning July 1, 2003.

²⁶ *Valor Texas 2002 Order*, 17 FCC Rcd at 10651, para. 15.

²⁷ *Valor Texas 2002 Order*, 17 FCC Rcd at 10651, para. 15.

²⁸ Valor Texas Petition at 1-6.

²⁹ *E.g.*, MCI Opposition at 3.

³⁰ Letter from Gregory J. Vogt, Counsel for Valor Texas, to Marlene H. Dortch, Secretary, Federal Communications Commission, WCB/Pricing File No. 03-16 at 1 (May 22, 2003) (Valor Texas *Ex Parte* Letter).

³¹ Valor Texas Petition at 5. Part of the Bureau’s reasoning in rejecting X-factor rate reduction relief for Valor New Mexico last year included “nothing in the record to suggest that this economic downturn will continue in the future.” *Valor Texas 2002 Order*, 17 FCC Rcd at 10650, para. 13.

adjustment mechanism, it sought “to protect [LECs] from events beyond their control that are likely to affect earnings to an extraordinary degree, such as local or regional recessions.”³² Thus, the low-end adjustment is available to protect Valor Texas from precisely the circumstances that it alleges here. Although Valor Texas contends that it requires a waiver of the 2003 X-factor rate reductions “to lessen the impact of [its] vicious cycle of low returns,”³³ low-end adjustment relief does just that. The low-end adjustment has enabled Valor Texas to earn slightly more than 10.25 percent the past two years, including 10.66 percent in 2002.³⁴ Although we agree with Valor Texas that low-end adjustments are not normally expected to be “an annual exercise,”³⁵ our rules do not prohibit them, and as discussed above, Valor Texas has not shown extraordinary circumstances that would warrant a departure from this proven remedy.

10. Valor Texas further argues that, even if it receives low-end adjustment relief this year, the X-factor rate reductions would operate to prevent it from earning 10.25 percent this year, and therefore, they should be waived.³⁶ The Bureau rejected this argument last year.³⁷ The Commission intended X-factor rate reductions to operate at the same time that a carrier makes a low-end adjustment.³⁸ While the X-factor reduces CCL charges, its application does not prevent a carrier from increasing its earnings by increasing its productivity through improved operating efficiencies and innovations.³⁹ Moreover, the Commission has never said that price cap LECs were entitled to a 10.25 percent rate-of-return, or that a lower return is necessarily confiscatory. The Bureau specifically stated last year that “10.25 percent is not a prescribed minimum rate of return for price-cap carriers, but a low-end adjustment mark that triggers a backstop mechanism.”⁴⁰ The purpose of the low-end adjustment mechanism is not to guarantee a certain level of minimum profit for price cap LECs for an upcoming year,⁴¹ but instead to allow a LEC to temporarily increase its price cap indices (PCI), and consequently its access rates, by retargeting its prior year rate of return to 10.25 percent.⁴²

³² *LEC Price Cap Order*, 5 FCC Rcd at 6804, para. 148.

³³ Valor Texas Petition at 1.

³⁴ Valor Texas Reply at 7.

³⁵ Valor Texas Petition at 15; *see LEC Price Cap Order*, 5 FCC Rcd at 6804, para. 147.

³⁶ Valor Texas Reply at 11.

³⁷ *Valor Texas 2002 Order*, 17 FCC Rcd at 10646-50, paras. 1-11.

³⁸ *Valor Texas 2002 Order*, 17 FCC Rcd at 10649, para. 8 (citing the *CALLS Order*, 15 FCC Rcd at 13034, para. 173).

³⁹ *Valor Texas 2002 Order*, 17 FCC Rcd 10649 at para. 8. “Under the *CALLS Order*, the X-factor and low-end adjustment complement each other and strike the best balance between competing interests.” *Id.*

⁴⁰ *Valor Texas 2002 Order*, 17 FCC Rcd at 10648-49, para. 7 (citing *LEC Price Cap Order*, 5 FCC Rcd at 6804-6807, paras. 147-165; *CALLS Order*, 15 FCC Rcd at 13038, para. 182).

⁴¹ *Valor Texas 2002 Order*, 17 FCC Rcd at 10648-49, para. 7 (citing *LEC Price Cap Order*, 5 FCC Rcd at 6804, paras. 147-48).

⁴² *Valor Texas 2002 Order*, 17 FCC Rcd at 10648-49, para. 7. Price cap indices (PCI) limit the prices carriers charge for service, and allow them to retain earnings generated through improved operating efficiencies and innovations. The PCI formula contains three components: (1) a measure of inflation (GDP-PI), (2) the X-factor, and (3) certain exogenous cost factors. The low-end adjustment is treated in PCI formulas as an exogenous cost. *See* 47 C.F.R. § 61.45.

11. Valor Texas also argues that a waiver is needed to guard against the risk that earnings below 10.25 percent would impair its ability to raise capital and thereby affect service.⁴³ The low-end adjustment, as MCI correctly asserts, is intended to address this concern.⁴⁴ The Commission established the low-end adjustment to prevent harm to customers or shareholders because unusually low earnings over a prolonged period could threaten a LEC's ability to raise the capital necessary to provide modern, efficient services.⁴⁵ Despite assertions that a waiver is in the public interest to ensure that it is able to raise capital investment and continue its service improvement efforts, Valor Texas provides no evidence that it would be unable to do so if it continues to receive a low-end adjustment without a waiver.

12. Given the availability of the low-end adjustment, Valor Texas similarly fails to justify why it is entitled to the specific relief it requests here. If the Bureau were to grant Valor Texas' waiver, Valor Texas' revenues would increase less than two percent of its rate base.⁴⁶ Thus, because Valor Texas would likely earn less than the 10.25 percent level that triggers the low-end adjustment, granting the requested waiver would in no way obviate the need for another low-end adjustment. Moreover, Valor Texas fails to substantiate how the requested relief affects the "viability of the company" when the waiver would provide a relatively small, albeit permanent, increase in earnings.

13. While the revenue Valor seeks is relatively small in terms of Valor's total rate base, however, the waiver requested would nevertheless constitute a significant departure from the Commission's rules, and exceeds the relief granted last year.⁴⁷ In the *Valor Texas 2002 Order*, the Bureau deferred X-factor reductions instead of waiving them because of concerns about the impact of a waiver on long-term rates.⁴⁸ Waiving the X-factor even one time results in rates permanently higher than they would be had the X-factor been applied.⁴⁹ The Commission has never before granted a waiver of this price-cap rule. Valor Texas does not dispel concerns that granting a waiver would undermine the policy objective of the rule in question, i.e., the

⁴³ Valor Texas Petition at 3, 8, 11.

⁴⁴ MCI Opposition at 2; *LEC Price Cap Order*, 5 FCC Rcd at 6804, paras. 147-49. "A LEC with earnings below 10.25 percent is likely to be unable to raise the capital necessary to provide new services that its local customers expect. It may even find it difficult to maintain existing levels of service. Thus, while our lower end adjustment mechanism protects LECs to some extent from errors and misjudgment, it also protects them from events beyond their control that are likely to affect earnings to an extraordinary degree, such as local or regional recessions." *LEC Price Cap Order*, 5 FCC Rcd at 6804, para. 148.

⁴⁵ *LEC Price Cap Order*, 5 FCC Rcd at 6804, para. 147.

⁴⁶ Valor Texas Reply at 2. Valor Texas states that the waiver would produce \$1.77 million in revenue. Valor Texas *Ex Parte* Letter at 2. This amounts to about a 1.72% increase based on a rate base of \$103,180,000 as Valor Texas reported April 1, 2003, on FCC Form 492A for calendar year 2002.

⁴⁷ We agree with Valor Texas that deferring the X-factor reductions until 2004 or 2005 would not be appropriate relief. Valor Texas could not reasonably be expected to make a double X-factor reduction in 2004, and due to the expiration of the five-year CALLS plan on June 30, 2005, a deferral to July 1, 2005 is also inappropriate. See *CALLS Order*, 15 FCC Rcd at 12974-75, paras. 29-30.

⁴⁸ *Valor Texas 2002 Order*, 17 FCC Rcd at 10651, para. 16.

⁴⁹ *Valor Texas 2002 Order*, 17 FCC Rcd at 10651, para. 16.

elimination of CCL charges.⁵⁰

14. Finally, we note that the low-end adjustment is not the sole remedy for low earnings, particularly, as is the case here, where Valor Texas contends that low earnings are tied to large expenditures. The *LEC Price Cap Order* provides for above-cap filings that must be documented with cost support “in the unlikely event that [the price cap] rules have the effect of denying a LEC the opportunity to attract capital and continue to operate, despite the low end adjustment mechanism and the opportunity provided the LEC to increase its earnings through greater efficiency.”⁵¹ We invite Valor Texas to make such a filing if it believes that it meets these criteria.

15. In conclusion, we find that in light of other relief available to address Valor Texas’ low earnings, relief that is provided for in our current rules, Valor Texas has not shown good cause for a waiver of the X-factor rate reductions under section 61.45(b)(1)(i) of the Commission’s rules.⁵²

IV. ORDERING CLAUSES

16. Accordingly, IT IS ORDERED that, pursuant to sections 4(i)-(j), and 201 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i)-(j), and 201, and sections 0.291 and 1.3 of the Commission’s rules, 47 C.F.R. §§ 0.291 and 1.3, Valor’s petition for waiver of application of the X-factor under section 61.45(b)(1)(i) of the Commission’s rules, 47 CFR § 61.45(b)(1)(i), IS DENIED.

17. IT IS FURTHER ORDERED that this Order is effective upon release.

FEDERAL COMMUNICATIONS COMMISSION

William F. Maher, Jr.
Chief, Wireline Competition Bureau

⁵⁰ *Valor Texas 2002 Order*, 17 FCC Rcd 10651 at para. 16. Because the cost of the incumbent LEC’s common line does not increase with usage, the CCL, as a per minute charge, violates a basic principle of cost causation. *Access Charge Reform Order*, 12 FCC Rcd at 15998-16000, paras. 36-40; *CALLS Order*, 15 FCC Rcd at 12969-12970, para. 18. To the extent that the CCL charge does not reflect the underlying cost of providing access service, it also embodies an implicit subsidy from high-volume users of interexchange services to users that make few or no long distance calls. The Commission’s rules reflect a desire to eliminate such implicit subsidies from interstate access charges to the extent possible. *CALLS Order*, 15 FCC Rcd at 12975, para. 31.

⁵¹ *LEC Price Cap Order*, 5 FCC Rcd at 6823, para. 304. A carrier must provide cost support normally required in annual access tariff filings for LECs subject to rate of return regulation and other information sufficient to establish that the increase is needed to attract capital. The Commission also notes that this likely requires suspension of the rate increase until an investigation is completed. *Id.*

⁵² 47 C.F.R. § 61.45(b)(1)(i).