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

In the Matter of	)	
	)	
1993 Annual Access Tariff Filings	)	CC Docket No. 93-193
	)	
1994 Annual Access Tariff Filings	)	CC Docket No. 94-65
	)	

ORDER

Adopted: March 17, 2005 **Released: March 17, 2005**

Responses from Verizon and BellSouth Due: April 18, 2005

By the Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. In this order, we review the refund plans submitted by various price cap local exchange carriers (LECs) in response to the Commission's order concluding the investigation of the 1993 and 1994 access tariffs of price cap LECs that implemented a sharing or lower formula adjustment in 1992 or 1993.[1] We approve the refund filing of Qwest Corporation (Qwest), which results in no refund liability. We also approve the refund plans of SBC Communications Inc. (SBC), and the Sprint Incumbent Local Exchange Companies (the Sprint LECs), with the modifications we specify in this order. We disapprove the refund plans submitted by Verizon and BellSouth Telecommunications, Inc. (BellSouth). We direct Verizon and BellSouth to recalculate their refund liability using the proper methodology discussed below, and to resubmit their refund plans for our approval.

II. BACKGROUND

2. Under price cap regulation, the maximum price a LEC can charge for its interstate access services is determined by the Price Cap Index (PCI), a complex formula that is adjusted annually by a measure of inflation minus a productivity factor, or "X" factor.[2] The original price cap plan included certain "back stop" adjustments to the PCI. Specifically, the Commission required price cap LECs to share a portion of their earnings above a certain level with their interstate access customers by lowering their PCIs and rates in the following year.[3] The Commission's rules also permit price cap LECs that earn

[1] *1993 Annual Access Tariff Filings,* CC Docket No. 93-193, *1994 Annual Access Tariff Filings,* CC Docket No. 94-65, Order, 19 FCC Rcd 14949 (2004) (*Add-Back Tariff Investigation Order*).

[2] *See* 47 C.F. R. § 61.45; *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6792, paras. 47-49 (1990) (*LEC Price Cap Order*), *reconsideration granted in part and denied in part*, Order on Reconsideration, 6 FCC Rcd 2637 (1991).

[3] *LEC Price Cap Order,* 5 FCC Rcd at 6801-02, paras. 122-126. To provide LECs greater incentives to increase efficiency, the Commission subsequently eliminated this obligation in 1997. *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, Fourth Report and Order, *Access Charge Reform*, CC Docket No.

less than 10.25 percent in a particular year to make a lower formula adjustment, that is, to raise their PCIs and rates in the following year to a level that allows them to target an earnings rate of at least 10.25 percent.[4] The first application of these adjustments occurred with the 1992 annual access tariff filings, when some price cap LECs incurred a sharing obligation or made a lower formula adjustment based on their 1991 earnings. When these LECs then filed annual access tariffs in 1993, some "added-back," or adjusted their 1992 earnings by the amounts they were required to refund through sharing or permitted to recoup through a lower formula adjustment, and some did not. The add-back requirement had been part of the rate-of-return regulatory regime for interstate access tariffs that preceded the adoption of price cap regulation.[5] Due to the LECs' differing add-back practices, the Common Carrier Bureau, now the Wireline Competition Bureau (Bureau), suspended the 1993 and 1994 interstate access tariffs of price cap LECs with a sharing or lower formula adjustment in order to determine whether or not add-back was required under price cap regulation.[6] Prior to completing the add-back investigation, the Commission in 1995 issued a rule that required add-back for the 1995 annual access tariffs of price cap LECs with a sharing obligation or lower formula adjustment, and all subsequent annual access tariffs of such LECs.[7] This Commission rulemaking left open the question of the appropriate treatment of sharing obligations and lower formula adjustments for the 1993 and 1994 access tariffs.[8]

3. On July 30, 2004, the Commission concluded its add-back tariff investigation.[9] It found just and reasonable the 1993 interstate access tariffs of price cap LECs that implemented a sharing or lower formula adjustment in their 1992 PCIs and that applied add-back in computing their 1992 earnings and rates of return and resulting 1993 PCIs.[10] The Commission also found unjust and unreasonable the 1993 annual access tariffs of price cap LECs that implemented a sharing or lower formula adjustment in their 1992 PCIs and that failed to apply add-back in computing their 1992 earnings and rates of return and resulting 1993 PCIs.[11] The Commission made the same findings for the 1994 interstate access tariffs of price cap LECs that implemented a sharing or lower formula adjustment in their 1993 PCIs.[12] Finally, the Commission ordered price cap LECs that implemented a sharing or lower formula adjustment and failed

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96-262, Second Report and Order, 12 FCC Rcd 16642, 16699-70, paras. 147-48 (1997), *aff'd in part, rev'd in part and remanded in part sub nom. U.S. Telephone Ass'n v. FCC*, 188 F.3d 521 (D.C. Cir. 1999).

[4] 47 C.F.R. § 61.45(d)(1)(vii); *see also LEC Price Cap Order*, 5 FCC Rcd at 6802, para. 127. The lower formula adjustment has been eliminated for price cap LECs that exercise pricing flexibility. 47 C.F.R. § 69.731.

[5] *See Amendment of Part 65, Interstate Rate of Return Prescription: Procedures and Methodologies to Establish Reporting Requirements*, CC Docket No. 86-127, Report and Order, 1 FCC Rcd 952, 956-57, para. 43 and Appendix C (1986).

[6] *1993 Annual Access Tariff Filings*, CC Docket No. 93-193, *National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates,* Transmittal No. 556*, GSF Order Compliance Filings,* CC Docket No. 93-123, *Bell Operating Companies' Tariff for the 800 Service Management System and 800 Data Base Access Tariffs,* CC Docket No. 93-129, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, 8 FCC Rcd 4960, 4965, para. 32 (Com. Car. Bur. 1993); *1994 Annual Access Tariff Filings*, CC Docket No. 94-65, *National Exchange Carrier Association Universal Service Fund and Lifeline Assistance Rates,* Transmittal No. 612*,* Memorandum Opinion and Order Suspending Rates, 9 FCC Rcd 3705, 3713, para. 12 (Com. Car. Bur. 1994).

[7] *Price Cap Regulation of Local Exchange Carriers, Rate-of-Return Sharing and Lower Formula Adjustment*, CC Docket No. 93-179, Report and Order, 10 FCC Rcd 5656 (1995) (*Add-Back Order*).

[8] *Id.* at 5657 n.3.

[9] *See Add-Back Tariff Investigation Order*, 19 FCC Rcd 14949.

[10] *Add-Back Tariff Investigation Order*, 19 FCC Rcd at 14949, para. 1.

[11] *Id.*

[12] *Id*.

to apply add-back in their 1993 and 1994 access tariff filings to: 1) recalculate their 1992 and 1993 earnings and rates of return making such an adjustment; 2) determine the appropriate sharing or lower formula adjustment to their PCIs for the subsequent tariff year; 3) compute the amount of any resulting access rate decrease; and 4) submit a plan for refunding the amounts owed to customers plus interest as a result of any such rate decrease.[13]

4. On August 30, 2004, the Commission received the refund plans required by the *Add-Back Tariff Investigation Order* from BellSouth, SBC (on behalf of the Ameritech Companies, Nevada Bell and Pacific Bell), the Sprint LECs (on behalf of numerous Sprint and United incumbent LECs), and Verizon (on behalf of the former Bell Atlantic and several former GTE LECs).[14] AT&T Corp. (AT&T) and Sprint Corporation (Sprint Corp.), on behalf of its incumbent LEC, competitive LEC, long distance and wireless operations, filed reply comments on the refund plans,[15] and several parties filed *ex parte* comments.[16] This order resolves various issues raised in these refund plans and responsive pleadings, and determines the appropriate treatment for each refund plan.

III. DISCUSSION

A. Headroom and Refund Calculations

5. All of the LECs filing refund plans except BellSouth argue that their refund liability should be offset by the amount of "headroom" in their tariffs, or the amount by which the interstate access rates they potentially could have charged pursuant to the price cap regime exceeded the rates they actually charged.[17] The Commission's price cap rules set a separate PCI for each of the four service baskets that were included within interstate access service at the time the tariffs being investigated in this proceeding

[13] *See id.* at 14961, para. 29.

[14] *See* BellSouth Refund Plan; Letter from Melissa E. Newman, Vice President - Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, Federal Communications Commission (Qwest Refund Plan); Refund Plan of SBC Communications Inc. (SBC Refund Plan); Recalculation and Refund Plan of the Sprint Incumbent Local Exchange Companies (Sprint LECs Refund Plan); Verizon Refund Plan (filed Aug. 30, 2004); *see also* Verizon Refund Plan Errata (filed Sept. 10, 2004). These companies filed refund plans for their price cap LEC subsidiaries that filed access tariffs in 1993 and 1994 and implemented a sharing or lower formula adjustment and failed to apply add-back. Price cap LECs that did not implement a sharing or lower formula adjustment, or that implemented a sharing or lower formula adjustment and applied add-back, such as the former NYNEX LECs, did not file refund plans. *See* Verizon Refund Plan at 3 n.4.

[15] Reply Comments of AT&T Corp. (filed Sept. 13, 2004) (AT&T Reply); Sprint's Reply to Verizon Refund Plan and Refund Plan of SBC Communications Inc. (filed Sept. 13, 2004) (Sprint Corp. Reply).

[16] *See, e.g.,* Letter from Davida Grant, Senior Counsel, SBC Telecommunications Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Sept. 23, 2004) (SBC Sept. 23 *Ex Parte*); Letter from Christopher T. Shenk, attorney for AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Oct. 5, 2004) (AT&T Oct. 5 *Ex Parte*); Letters from Richard M. Sbaratta, Senior Regulatory Counsel, BellSouth, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Sept. 24, 2004, and Oct. 20, 2004) (BellSouth Sept. 24 and Oct. 20 *Ex Partes*); Letter from Craig T. Smith, General Attorney, Sprint, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Sept. 24, 2004) (Sprint Sept. 24 *Ex Parte*); Letters from Joseph Mulieri, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Oct. 1, 2004, Oct. 18, 2004, and Oct. 26, 2004) (Verizon Sept. 24, Oct. 18, and Oct. 26 *Ex Partes*); Letter from Jeff Lindsey, Director, Federal Regulatory Affairs, Sprint Corp., to Marlene H. Dortch, Secretary, Federal Communications Commission (filed Oct. 18, 2004) (Sprint Oct. 18 *Ex Parte*).

[17] Verizon Refund Plan at 6-7; Qwest Refund Plan at 1-2; SBC Refund Plan at 1-2, 4, Ex.4-6; Sprint LECs Refund Plan at 4. BellSouth's calculations indicate that its proposed APIs were above its recalculated PCIs for tariff years 1993 and 1994. *See* BellSouth Refund Plan at Ex. 6.

were filed: common line, traffic sensitive, trunking/special access, and interexchange.[18] Under the price cap regime, the PCI sets an upper limit on the interstate access rates a LEC may charge, but the LEC may set its rates below the PCI. Thus, if a LEC's Actual Price Index (API) for a particular basket is lower than the applicable PCI, it has headroom in that basket, measured by the amount by which the PCI exceeds the API. This headroom can be used to offset any potential refund liability, the LECs argue, because it represents charges that could have been, but were not, collected from customers.[19] No party disputes the general rule that LECs may use headroom to offset refund liability.

6. The LECs differ, however, in the methods they use to apply headroom to their refund liability. To determine their refund liability, Qwest, SBC, and the Sprint LECs apply add-back to recalculate their sharing obligations and determine adjusted revenues and PCIs for each price cap basket for each tariff year. If the adjusted PCI for each price cap basket still exceeds the API for that basket, Qwest, SBC, and the Sprint LECs recalculate their access rates, offsetting any refund liability due to reduced rates by the amount that the adjusted PCI exceeds the API for that basket for that tariff year, thus determining available headroom separately by price cap basket and by tariff year. Using this method, if Qwest, SBC, or one of the Sprint LECs determines that it lacks headroom for any price cap basket for any one of the two tariff years relevant to this investigation, its reduced rates result in refund liability.[20] Qwest, for example, used this method to determine that it had an additional sharing obligation of approximately $1.6 million for its 1994 access tariffs, but that it still had headroom available for each price cap basket and that its overall headroom was only reduced from roughly $46.5 million to slightly less than $45 million.[21] Qwest thus concludes that it has no refund liability.[22] SBC and the Sprint LECs use a similar method to determine their refund amounts. If the adjusted PCI for any price cap basket in any one of the two relevant tariff years falls below the API, SBC and the Sprint LECs have no headroom for that price cap basket for that tariff year, and must make refunds. No party disputes this offsetting of refund liability with headroom in the refund calculations of Qwest, SBC, or the Sprint LECs.[23]

7. Verizon, however, applies headroom in an entirely different manner, which, it concludes, results in no refund liability. It begins the calculation in the same way as Qwest, SBC, and the Sprint LECs, recalculating its PCIs, comparing the adjusted PCI to the API, and determining whether it has

[18] *See* 47 C.F.R. § 61.42; *see also LEC Price Cap Order,* 5 FCC Rcd at 6788, 6811, para. 13, 201. As discussed below at paragraph 12, the number and type of baskets evolved during the course of the price cap rulemaking and have continued to evolve since the Commission adopted price caps in 1990. *See Access Charge Reform*, CC Docket No. 96-262, *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. .94-1, Sixth Report and Order, 15 FCC Rcd 12962, 13016, para. 132 (2000) (*Calls Order*), *rev'd in part on other grounds sub nom. Texas Office of Public Utility Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001), *cert. denied*, 535 U.S. 986 (2002).

[19] When the Commission was deliberating the *Add-Back Tariff Investigation Order*, Verizon and Qwest similarly argued that headroom precluded the Commission from ordering refunds. *See* Letter from Joseph Mulieri, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, Federal Communications Commission at 8-12 (filed March 1, 2004); Letter from John W. Kure, Executive Director – Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, Federal Communications Commission at 2 (filed March 29, 2004). In response, the Commission stated that the merits of the headroom claims would be addressed in conjunction with review of the refund plans submitted in response to the order. *Add-Back Tariff Investigation Order,* 19 FCC Rcd at 14962, para. 30.

[20] Because SBC and the Sprint LECs filed refund plans for several individual companies filing separate access tariffs, they calculate refund liability separately for each individual company, and then combine these separate refund amounts to determine their total refund liability.

[21] Qwest Refund Plan at 1-2 and related exhibits.

[22] Qwest had no sharing obligation related to its 1993 access tariffs and, therefore, has no refund liability for these tariffs. *See id.*

[23] *See, e.g.,* AT&T Reply at 10.

headroom for each price cap basket for each tariff year. For Bell Atlantic,[24] Verizon thus determines that it had headroom in all price cap baskets for its 1993 access tariffs. For its 1994 access tariffs, Verizon had headroom in only the interexchange price cap basket, and refund liability for the other price cap baskets.[25] Verizon then combines available headroom for all price cap baskets and both relevant years, arguing that Bell Atlantic's total headroom calculated in this manner exceeds its refund liability.

8. For its GTE companies, all of which filed separate interstate access tariffs in 1993 and 1994, Verizon aggregates headroom and refund liability across all GTE companies, effectively offsetting the refund liability for one GTE company with the headroom available to another GTE company.[26] Verizon applies add-back to determine that those GTE companies that had sharing obligations in 1993 and 1994 now have increased sharing obligations and decreased PCIs for their 1993 and 1994 access tariffs, which would trigger refunds. But for other GTE companies that had lower formula adjustments, Verizon applies add-back to increase their lower formula adjustments and raise their PCIs. Verizon then offsets the increased sharing obligations for the first set of GTE companies against these increased lower formula adjustments for the second set of GTE companies.[27] Verizon thus argues that, even though it may have insufficient headroom for certain companies, price cap baskets, or tariff years, when headroom is aggregated and increased sharing is offset by increased lower formula adjustments, its GTE companies had more than $690 million in headroom for the combined 1993 and 1994 tariff periods. Accordingly, Verizon argues, it should not be required to make any refunds for the GTE companies either.[28]

9. AT&T disputes Verizon's calculation methodology in several respects. Specifically, AT&T states:

> AT&T does not object to proper accounting for headroom in computing refunds for failure to apply add-back. But, under established Commission precedent, headroom must be applied on a period-by-period basis and on a basket-by-basket basis. This means that headroom associated with a tariff in a particular time period cannot be used to offset overcharges in a different period, and further that headroom associated with a particular price cap basket cannot be used to offset overcharges in a different price cap basket.[29]

AT&T also states that Verizon's aggregation of headroom for its GTE companies, thus offsetting the refund liability for some GTE companies with the headroom for others, is unlawful.[30] AT&T further

[24] In 1993 and 1994, Bell Atlantic's LEC subsidiaries consisted of the Bell Atlantic Telephone Companies of Delaware, Maryland, New Jersey, Pennsylvania, Virginia, Washington, DC, and West Virginia. Bell Atlantic filed a single interstate access tariff for these LECs in 1993 and 1994.

[25] Verizon Refund Plan at 8-9 (citing Ex. 4 East, Revised). Using the method employed by Qwest, SBC, and the Sprint LECs, this result would dictate that Verizon owes a refund for 1994.

[26] *See* AT&T Reply at 14 n.40.

[27] Verizon Refund Plan at Ex. 4 West.

[28] *Id.* at 15-16.

[29] AT&T Reply at 10 (citing *800 Data Base Access Tariffs and the 800 Service Management System Tariff*, CC Docket No. 93-129, *Provision of 800 Service,* CC Docket No. 86-10, Order on Reconsideration, 12 FCC Rcd 5188, para. 11 (1997) (*800 Data Base Access Tariffs Reconsideration Order*); *800 Data Base Access Tariffs and the 800 Service Management System Tariff*, CC Docket No. 93-129, *Provision of 800 Service,* CC Docket No. 86-10, Memorandum Opinion and Order, 12 FCC Rcd 8396, 8400-01, para. 11 (Com. Car. Bur. 1997) (*800 Data Base Access Tariffs Order*); *1993 Annual Access Tariff Filings*, CC Docket No. 93-193, *Phase I, Part 2, GSF Order Compliance Filings, 1994 Annual Access Tariff Filings*, CC Docket No. 94-65, 12 FCC Rcd 8349 (Com. Car. Bur. 1997) (*1993 Access Tariff Order*)).

[30] AT&T Reply at 14.

argues that Verizon's offsetting of increased sharing obligations with increased lower formula adjustments for its GTE companies amounts to retroactive rate increases, which the Commission has repeatedly rejected.[31] Sprint Corp. agrees, stating in its reply comments that:

> Verizon's Refund Plan is flawed because it nets overearning and underearning across baskets and tariff filing entities. Such a methodology is not reflective of how customers -- carriers or end users -- purchase access, nor is it reflective of how rates are calculated under the price cap regime which follows a very strict basket by basket, tariff filing entity by tariff filing entity approach.[32]

10. We agree with AT&T and Sprint Corp. that Verizon's calculation methodology is flawed. Commission precedent precludes aggregating available headroom across price cap baskets, tariff filing periods, or tariff filing entities. In the *800 Data Base Access Tariffs Reconsideration Order*, which arose out of a tariff investigation similar to this add-back investigation, the Commission ordered LECs to recalculate their PCIs and rates resulting from its disallowance of certain exogenous costs of providing 800 data base services.[33] In ordering refunds, the Commission found "unpersuasive [the] arguments by various incumbent LECs that we should not require refunds because they could have raised rates in other baskets."[34] It determined that allowing such offsets would be inconsistent with the Supreme Court's decision in *FPC v. Tennessee Gas Co*., where the court found that a price-regulated company must make refunds to one set of customers for rates found to be excessive, but could not recoup losses from another set of customers for rates found to be too low.[35] If such offsets were allowed, the overcharged customers would forego their refunds in order to retroactively pay for service provided to the customers who had paid rates lower than the maximum allowed. Such efforts to recoup past undercharges, according to the Supreme Court, amounted to an impermissible retroactive rate increase.[36] Thus, in reviewing the refund plans submitted by LECs in response to the Commission's *800 Data Base Access Tariffs Reconsideration Order*, the Bureau applied the Commission's ruling to preclude the LECs from "offset[ting] amounts they could have raised in the other price cap baskets (up to the maximum PCI) against refunds owed because of the unlawfully high rates in the traffic sensitive basket."[37] The Bureau has applied similar reasoning to prohibit price cap LECs ordered to recalculate PCIs for the common line basket from recalculating PCIs for other price cap baskets and offsetting their refund liability by any resulting rate increases in price cap baskets other than the common line basket.[38] This precedent also precludes Verizon from aggregating headroom across tariff filing years and tariff filing entities. Indeed, citing *FPC v. Tennessee Gas. Co.*, the Bureau in the *1993 Access Tariff Order* prohibited Bell Atlantic from carrying unused headroom forward

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[31] *Id.* at 16.

[32] Sprint Corp. Reply at 1. Sprint Corp. elaborates that such a methodology is inconsistent with the manner in which customers purchase access and the manner in which price cap LECs calculate their access rates. The Sprint LECs, like Verizon, filed a refund plan for numerous separate incumbent LEC tariff filing entities, and Sprint Corp. argues alternatively that, if Verizon is permitted to aggregate overearnings and underearnings across price cap baskets and tariff filing entities, it should be allowed to as well. *Id.* at 2.

[33] *800 Data Base Access Tariffs Reconsideration Order*, 12 FCC Rcd at 5197, para 20.

[34] *Id*. at 5195, para. 17.

[35] *Id.* at 5195-96, para. 17 (citing *FPC v. Tennessee Gas Co.,* 371 U.S. 145, 152-53 (1962)).

[36] *FPC v. Tennessee Gas Co.,* 371 U.S. at 152-53 ("[A] rate for one class or zone of customers may be found by the Commission to be too low, but the company cannot recoup its losses by making retroactive the higher rate subsequently allowed; on the other hand, when another class or zone of customers is found to be subject to excessive rates and a lower rate is ordered, the company must make refunds to them.").

[37] *800 Data Base Access Tariffs Order*, 12 FCC Rcd at 8403, para. 16 (citing *800 Data Base Access Tariffs Reconsideration Order*, 12 FCC Rcd at 5195-96, para. 17).

[38] *1993 Access Tariff Order*, 12 FCC Rcd at 8349, para. 1.

from one year to the next.[39] Accordingly, Verizon may not combine headroom across price cap baskets, tariff filing years, and tariff filing entities.

11. For the same reason, Verizon also may not offset increased sharing obligations for certain GTE companies with increased lower formula adjustments for other GTE companies. Rather, "[t]he Commission does not allow carriers, at the end of a Section 204 investigation, to recoup past undercharges or to offset revenues foregone from one rate element against refunds owed for overcharges absent unusual circumstances and prior notice to customers."[40] Consistent with *FPC v. Tennessee Gas Co.,* such retroactive rate increases are impermissible. In the current proceeding, which was also initiated under section 204, Verizon seeks to offset the increases in its sharing obligation resulting from add-back with increases to its lower formula adjustment, thus negating any resulting rate decrease with a rate increase, and eliminating any actual refunds. Verizon is attempting to recoup past undercharges due to its miscalculated lower formula adjustment and offset these underearnings against the amount it overearned by miscalculating its sharing obligation. This offsetting is precisely the kind of retroactive rate increase prohibited by the decisions cited above.

12. Further, Verizon's aggregating of headroom across price cap baskets would contravene the Commission's purpose in establishing four separate baskets with a PCI applicable to each. While the Commission adopted price cap regulation to allow LECs to reap the rewards of increased efficiency by allowing pricing flexibility, it nonetheless sought to retain some control over prices.[41] Thus, rather than allowing LECs to set prices for the various services subject only to a single, aggregate price cap, the Commission separated access service into broad baskets subject to separate PCIs.[42] The Commission reasoned that this separation "assures . . . that cross-subsidization of services outside the basket by those inside does not occur. This is so because the carrier cannot go above the cap applicable to the basket to recoup revenues siphoned off to subsidize other services."[43] Initially, the Commission proposed establishing two baskets for switched and special access services, but sought comment on whether further disaggregation should be required, finding that "[d]isaggregation could be carried out by separating less competitive services from services which are subject to a greater degree of competition, thus lessening the risk of cross-subsidy and discrimination."[44] The Commission then proposed three baskets; common line, traffic sensitive switched, and all other;[45] but ultimately determined that a fourth basket for the more competitive interexchange service was necessary to achieve its goal of preventing cross-subsidization.[46] Permitting Verizon to aggregate headroom across price cap baskets, tariff filing years, and tariff filing entities would destroy the Commission's carefully constructed system for preventing dominant carriers from cross-subsidizing access services in an anticompetitive manner.

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[39] *See id.* at 8355-57, paras. 14-18.

[40] *Tariffs Implementing Access Charge Reform*, CC Docket No. 97-250, Memorandum Opinion and Order, 13 FCC Rcd 14683, 14750-51, para. 174 (1998) (*Access Charge Reform Tariff Order*) (citing, *inter alia, FPC v. Tennessee Gas Co.,* 371 U.S. at 152-53). We note that Verizon does not assert that it has provided such prior notice to its customers. In any case, as discussed, we do not find that unusual circumstances exist here.

[41] *See LEC Price Cap Order*, 5 FCC Rcd at 6787, paras. 1-3, 6788, paras. 11-12, 6810-11, para. 198.

[42] *Id.* at 6810-11, para. 198; *see also Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3483-84 (1988) (*Price Cap FNPRM*).

[43] *Price Cap FNPRM,* 3 FCC Rcd at 3352, para. 279.

[44] *Id.* at 3355, para. 283.

[45] *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3235, para. 751 (1989).

[46] *LEC Price Cap Order*, 5 FCC Rcd at 6812, para. 213.

13. Verizon argues that the Commission's broad equity powers in determining whether to order a refund allow it to approve Verizon's approach.[47] The Commission has such broad powers, and has articulated the following standard for applying them:

> [R]efunds are largely a matter of equity, and in arriving at a decision as to whether or not refunds should be awarded, we must balance the interest of both the carrier and the customer in determining the public interest. In addition, each case must be examined in light of its own particular circumstances.[48]

We cannot ignore Commission precedent and the actual damage to those customers who overpaid for their interstate access services to approve Verizon's unique calculation methodology. Allowing Verizon's aggregation of headroom would be inequitable because the customers that overpaid for some access services are not necessarily the same customers that underpaid for other Verizon access services. Verizon claims that the customers purchasing access services in one price cap basket and tariff year were the same customers purchasing access in other price cap baskets, but Sprint Corp. and AT&T deny this claim and Verizon offers no proof of its assertion.[49] Even if it were true, however, Verizon cannot justify aggregating of headroom across separate companies that provided access services in different geographic areas.[50] Therefore, we order Verizon to recalculate its refund liability using the proper methodology.[51]

14. BellSouth appears to have calculated its sharing obligation using 50 percent of its earnings above 12.75 percent.[52] In the *LEC Price Cap Order*, however, the Commission required carriers using a productivity factor of 3.3 to share 50 percent of their earnings between 12.25 percent and 16.25 percent, and carriers using a productivity factor of 4.3 to share 50 percent of their earnings between 13.25 and 17.25 percent.[53] Accordingly, we direct BellSouth to recalculate its sharing obligation using the

[47] Verizon Refund Plan at 7, 10-11.

[48] *American Television Relay, Inc.,* Docket No. 19609, Memorandum Opinion and Order, 67 FCC 2d 703, 708-09, para. 15 (1978).

[49] *See* AT&T Reply at 13-14; Sprint Corp. Reply at 1-2.

[50] As discussed above, in *FPC v. Tennessee Gas Co., supra,* the Supreme Court found that a rate regulated company may not offset losses from customers whose rates were too low against refunds due other customers whose rates were too high.

[51] AT&T also claims that Verizon makes a technical error in its headroom calculation by mistakenly assuming that changes in its PCIs took effect on March 1, 1995, when they actually took effect on March 17, 1995. AT&T Reply at 18-21. According to AT&T, a letter that Bell Atlantic filed on February 14, 1995, adjusting its PCIs effective "March 1995" became effective on March 17, 1995, when Bell Atlantic's tariff transmittal with the new rates resulting from these adjusted PCIs took effect. *Id.* at 19 and Ex. D. In response, Verizon provides several examples of adjustments to its PCIs made by letter filings. Verizon Oct. 18, 2004 *Ex Parte*. We agree with Verizon that its letter of February 14, 1995, was sufficient to adjust its PCIs effective March 1, 1995, and that it may calculate its headroom assuming that its PCI adjustments took effect on that date.

[52] *See*, *e.g.,* BellSouth Refund Plan, Exs. 3-4.

[53] *See LEC Price Cap Order*, 5 FCC Rcd at 6801-02, paras. 124, 126. All earnings above 16.25 (or 17.25 for carriers using the 4.3 factor) were required to be returned to ratepayers through adjustments to the PCIs in the following year. *Id*. at paras. 125-26. Subsequently, in the *Price Cap Performance Review First Report and Order*, which was released 1995, the Commission allowed carriers to choose from among three interim productivity factors of 4.0, 4.7, and 5.3 percent. LECs choosing the 4.0 factor were required to share 50 percent of their earnings between 12.25 and 13.25 percent, those selecting the 4.7 factor were required to share 50 percent of their earnings between 12.25 and 16.25 percent, and LECs selecting the 5.3 factor were not required to share. *Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9055, 9057-58, paras. 214, 220-22 (1995) (*Price Cap Performance Review First Report and Order*), *rev. denied sub nom. Bell Atlantic Telephone Companies v. FCC*, 79 F.3d 1195 (D.C. Cir. 1996).

correct sharing thresholds. We direct Verizon and BellSouth to meet with Commission staff at the earliest possible opportunity after this order is released to discuss how to correct their calculations and to file corrected refund plans 30 days from the release date of this order. SBC and the Sprint LECs appear to have used the correct add-back methodology and we approve those carriers' refund plans with the modifications we specify in this order. Finally, our review of Qwest's Refund Plan convinces us that carrier has no further obligation to refund for add-back. Accordingly, we approve Qwest's Refund Plan.

B. Interest Rates

15. The *Add-Back Tariff Investigation Order* directed the price cap LECs that failed to apply add-back in their 1993 or 1994 access tariffs to refund amounts due their customers with interest.[54] The parties advocate two different interest rates. All of the LECs with refund obligations urge us to apply the Internal Revenue Service (IRS) rate for large corporate overpayments (Large Corporate Overpayment Rate), or overpayments of more than $10,000.[55] Some of these LECs argue that this interest rate applies because the refunds due are more than $10,000 and will be made to large corporations.[56] Some LECs also claim that rates higher than this rate are inapplicable because carriers should not be penalized for failing to add-back.[57] They rely for this claim on a refund ruling in a formal complaint proceeding conducted under section 208 of the Act, *GCI v. ACS*.[58] AT&T also relies on *GCI v. ACS*, however, to argue that we should apply a different IRS rate, the corporate overpayment rate (Corporate Overpayment Rate), which is 1.5 percentage points higher than the Large Corporate Overpayment Rate.[59]

16. None of the parties correctly construes or applies *GCI v. ACS.* AT&T asserts, citing *GCI v. ACS*, that the Commission has established that LECs ordered to make refunds because their rates are determined to be too high must compute interest using one of three IRS rates: 1) the corporate underpayment rate, applied when the LEC has engaged in willful misconduct; 2) the Corporate Overpayment Rate, applied when a LEC has constructive knowledge that its tariff can be found unlawful; and 3) the Large Corporate Overpayment Rate for amounts exceeding $10,000, applied when unlawful rates result from a miscalculation.[60] AT&T's interpretation overstates the Commission's finding in *GCI v. ACS*. In that case, the Commission did state that it "might appropriately apply" the Large Corporate

[54] *Add-Back Tariff Investigation Order,* 19 FCC Rcd at 14961, para. 29.

[55] BellSouth Refund Plan at 3; SBC Refund Plan at 4; Sprint LECs Refund Plan at 5; Verizon Refund Plan at 17; BellSouth Sept. 24 *Ex Parte*; BellSouth Oct. 20 *Ex Parte*; SBC Sept. 23 *Ex Parte*; Sprint Sept. 24 *Ex Parte*; Verizon Oct. 26 *Ex Parte*; *see also* 26 U.S.C. § 6621(a)(1)(B).

[56] *See, e.g.,* Verizon Refund Plan at 16; Sprint LECs Refund Plan at 5.

[57] BellSouth Sept. 24 *Ex Parte* at 1-2; SBC Sept 23 *Ex Parte* at 1. Verizon Refund Plan at 17; Verizon Oct. 26 *Ex Parte* at 2; Sprint LECs Refund Plan at 5-7.

[58] *General Communication, Inc. v. Alaska Communications Systems Holdings*, *Inc. and Alaska Communications Systems, Inc. d/b/a ATU Telecommunications d/b/a Anchorage Telephone Utility*, EB-00-MD-016, Memorandum Opinion and Order, 16 FCC Rcd 2834 (2001) (*GCI v. ACS*), *aff'd in part, remanded in part sub nom. ACS of Anchorage, Inc. v. FCC*, 290 F.3d 403 (D.C. Cir. 2002); *see also* 47 U.S.C. § 208.

[59] AT&T Reply at 5-8; AT&T Oct. 5 *Ex Parte*; *see also* 26 U.S.C. § 6621(a)(1)(B). While not discussed by the parties, the IRS imposes four separate interest rates based on the type of erroneous tax payments and the nature of the entity making the erroneous payment. In ascending order these are: 1) the large corporate overpayment rate (over $10,000) (lowest rate); 2) the corporate overpayment rate; 3) the individual over and underpayment and corporate underpayment rate; and 4) the large corporate underpayment rate (over $100,000) (highest rate). *See* 26 U.S.C. § 6621. These interest rates are pegged to federal short-term interest rates and are adjusted quarterly. The Large Corporate Overpayment Rates in effect for the period for which refunds are due and that have been applied by the LECs in their refund filings generally range from 6 to 8 percent.

[60] AT&T Reply at 4-5 (citing *GCI v. ACS*, 16 FCC Rcd at 2863, para. 74); AT&T Oct. 5 *Ex Parte* at 1.

Overpayment Rate to refunds arising out of a carrier's misallocation of certain costs.[61] Nevertheless, it imposed the higher Corporate Overpayment Rate because it found that the refunding carrier had "constructive knowledge" that the Commission recently had rejected other carriers' attempts to achieve the same misallocation.[62] When the Court of Appeals for the District of Columbia Circuit reviewed the Commission's decision on appeal, it questioned the Commission's selection of the higher rate, noting that the Commission had imputed "constructive knowledge" of events occurring *after* the original rate filing and collection. The court remanded the case, directing the Commission to further explain its interest rate selection,[63] but the parties settled and filed a joint motion to dismiss the complaint before a remand order ever issued.[64]

17. SBC and Verizon similarly misinterpret *GCI v. ACS* by claiming that the Commission has determined that a rate higher than the Large Corporate Overpayment Rate applies as a penalty only upon a finding that the carrier knew that the Commission had already found its conduct to be unlawful.[65] To the contrary, the Commission has applied the higher individual overpayment rate where, as is the norm in ordering refunds in a tariff investigation, it is merely requiring compensation for the use of money over time. For example, in *Long-Term Telephone Number Portability Tariff Filings*, the Bureau applied the individual overpayment rate, not to penalize the carriers whose tariffs were found unlawful, but to compensate the end-users (hence the individual rather than corporate overpayment rate) for the use of their money.[66] There, the Bureau followed *Western Union*, where the Commission adopted "the commonly held view that interest is not a penalty, but is simply the price that one pays for using another person's money."[67] The Commission relies on the interest rates specified by the IRS because those rates are readily available, easily applied, and periodically revised.[68]

18. Based on this precedent, rather than on an assessment of what the LECs knew or should have known, we order BellSouth, SBC, the Sprint LECs, and Verizon to apply the IRS corporate overpayment rate to the refunds ordered by the Commission in this investigation, based upon the size of the particular refund. Thus, for refunds exceeding $10,000, the Large Corporate Overpayment rate shall apply, and for refunds of $10,000 or less, the Corporate Overpayment Rate shall apply.[69] As the Commission and Bureau have previously determined, use of the applicable IRS rate best achieves the stated goal of a refund of overcharges, which is not to assign blame or penalize, but to compensate the

[61] *GCI v. ACS*, 16 FCC Rcd at 2863, para. 74.

[62] *Id.*

[63] *ACS of Anchorage, Inc, v. FCC*, 290 F.3d at 414-15.

[64] *General Communication, Inc. v. Alaska Communications Systems Holdings, Inc. and Alaska Communications Systems, Inc. d/b/a ATU Telecommunications d/b/a Anchorage Telephone Utility,* EB-00-MD-016, Order, 18 FCC Rcd 6331 (Enf. Bur. 2003) (granting joint motion to dismiss complaint).

[65] SBC Sept. 23 *Ex Parte* at 1; Verizon Oct. 26 *Ex Parte* at 2.

[66] *Long-Term Telephone Number Portability Tariff Filings of Ameritech Operating Companies, Pacific Bell, Southwestern Bell Telephone Companies, and U S West Communications Inc*., CC Docket No. 99-35, Memorandum Opinion and Order, 14 FCC Rcd 17339, 17341-42, para. 5 (Com. Car. Bur. 1999).

[67] *Western Union Telegraph Co*., CC Docket No. 78-97, Memorandum Opinion and Order, 10 FCC Rcd 1741, 1748, para. 38 (1995) (citations omitted) (*Western Union*), *rev. denied sub nom. Graphnet Inc. v. FCC*, 79 F.3d 169 (D.C. Cir. 1996).

[68] *US Sprint Communications Limited Partnership v. Pacific Northwest Bell Telephone Company, Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, Pacific Bell Telephone Company, and Southern New England Telephone Company*, File Nos. E-89-368, et al., 8 FCC Rcd 1288, 1299 n.109 (1993) (citing *Teleprompter of Fairmont, Inc. and Teleprompter Corporation, Complainants, v. Chesapeake and Potomac Telephone Company of West Virginia*, 79 FCC 2d 232 (1980).

[69] The non-corporate overpayment rate would apply to any entity that did not purchase access as a corporation.

parties for the time value of their money. Interstate access customers have been denied the use of the funds they overpaid for the period of this investigation, a factor we must consider in determining an appropriate interest rate. We apply here the same reasoning we applied in previous refund situations cited above, and find that the IRS overpayment rate that is applicable to the entity and amount to be refunded best compensates the overcharged interstate access customers for the use of the money they overpaid.

C. Procedural Issues

1. Calculation and Identification of Customers

19. BellSouth, the Sprint LECs, and Verizon state that they will apportion their refund liability among their 1993 and 1994 access customers based upon actual billing records indicating the amount of interstate access service purchased by these customers in 1993 and 1994.[70] These LECs will then make the refunds by bill credits if the 1993 and 1994 customers are still purchasing access from them, and by check if the 1993 and 1994 customers are no longer purchasing access. We approve this apportionment and refund procedure.

20. SBC has a unique problem in apportioning its refund liability among its access customers because it is unable to locate any billing records from 1993 and 1994.[71] SBC proposes two proxies for identifying customers and refund amounts in the absence of actual billing records. First, it will allow customers 30 days from approval of its refund plan to submit refund claims based on actual billed interstate access minutes-of-use. Then it will calculate the percentages of its total billed access minutes that these minutes represent, and thus determine the proportion of its total refund liability owed to each customer submitting a claim.[72] For any refund liability remaining after claims are submitted and reimbursed, SBC will use Commission presubscribed telephone line data from 1993 and 1994 to determine the market shares of any customers failing to submit claims, and divide refunds among them in proportion to their market share.[73] SBC will then refund amounts due by bill credit or check.[74] Sprint Corp. protests this second proxy, arguing that actual interexchange carrier toll revenues from 1993 and 1994 are available from public sources, are highly correlated to switched access service revenues, and are a more accurate proxy for determining relative market share.[75] According to Sprint Corp., interexchange carrier toll revenues are more accurate because, using SBC's second proposed proxy, presubscribed access lines with higher-than-average usage, including lines of many Sprint Corp. customers, will be undercounted.[76] We agree with Sprint Corp. that interexchange carrier toll revenues provide a more accurate proxy for market share than presubscribed line counts, and direct SBC to use interexchange carrier toll revenues as its second proxy for determining market share and apportioning refunds among its access customers.

21. The LECs other than SBC propose differing methods for identifying customers that may be owed refunds but, due to factors such as bankruptcies, changes in ownership, or simple passage of time, may no longer be readily identifiable.[77] The LECs also assert that some customers may have purchased access in such small amounts that the cost of locating such customers and determining the

[70] BellSouth Refund Plan at 3-4; Sprint LECs Refund Plan at 7; Verizon Refund Plan at 4-5.

[71] SBC Refund Plan at 2, 5.

[72] *Id.*

[73] *Id.* at 2-3, 6.

[74] *Id.* at 3.

[75] Sprint Oct. 18 *Ex Parte; see also* Sprint Corp. Reply at 2-3.

[76] Sprint Corp. Reply at 2.

[77] *See, e.g.* BellSouth Refund Plan at 3- 4; Sprint LECs Refund Plan at 7; Verizon Refund Plan at 5.

amounts they are owed significantly outweighs any refund liability to such customers. The Sprint LECs, for example, state that 682 out of their 760 access customers from the 1993 and 1994 tariff years are owed $1000 or less, and represent only 0.29 percent of its total refund liability.[78] The average refund amount for such customers is $60. The Sprint LECs do not plan to notify these customers of their refunds, but will allow them 60 days from approval of its refund plan to submit refund claims.[79] SBC states that it will not make refunds to end user access customers.[80] BellSouth states that it will not refund amounts less than $100.[81] Verizon states that it will "submit an industry notification" requesting carriers to identify within 30 days any access customer name abbreviations (ACNAs) to which they claim ownership.[82] BellSouth states that it will provide a similar notice on its Interconnection Services Website for 60 days.[83]

22. The LECs have expended substantial effort to locate billing records and determine their refund obligations. We agree with the Sprint LECs that the cost of identifying customers owed small amounts likely outweighs the refunds they are owed. Therefore, we will not require the LECs to identify and notify customers that may be due refunds of less than $100. We do, however, require the LECs to perform the following minimum notification efforts so that customers who are no longer readily identifiable and customers who are owed less than $100 may obtain refunds. First, after release of this order, we will publish a Public Notice in the Federal Register informing parties that purchased interstate access services from BellSouth, SBC, the Sprint LECs, or Verizon during the 1993 and 1994 tariff years that they may be due refunds, and directing these parties to contact the relevant LEC within 60 days. Upon publication of this Public Notice, the LECs shall, for at least 60 days, place the same notice on their company web sites that are most often consulted by their interstate access customers, directing such customers to submit refund claims to a specified address no later than a specified date that is at least 60 days after the dated notice is first posted. Any refund liability not accounted for after these claims have been processed must be distributed proportionally among the customers receiving refunds. Each customer receiving a refund shall be provided calculations demonstrating how the amount of its refund was determined.

2. Timing

23. SBC and the Sprint LECs state that they will complete the refund process within three months of approval of their refund plans; BellSouth states that it requires six months.[84] AT&T protests the additional three months proposed by BellSouth, claiming that it should be held to the same schedule as the other LECs.[85] We agree with AT&T that the LECs should be able to make their refunds on the same schedule because their refund procedures are similar. In this order, however, we mandate a 60-day period for customers to submit claims once we have published a Public Notice in the Federal Register informing customers of their potential right to refunds, and once the LECs have placed the same notice on their web sites. Given this mandate, we believe it reasonable to require the LECs to complete the refund process within 120 days of publication in the Federal Register of our Public Notice regarding potential refunds. If any LEC encounters unforeseen complications in processing refunds, it may seek an extension of this 120-day deadline.

[78] Sprint LECs Refund Plan at 8.

[79] *Id.* at 7-8.

[80] SBC Refund Plan at 5.

[81] BellSouth Refund Plan at 4.

[82] Verizon Refund Plan at 5.

[83] BellSouth Refund Plan at 4.

[84] Sprint LECs Refund Plan at 7-8; SBC Refund Plan at 3; BellSouth Refund Plan at 4.

[85] AT&T Reply at 8-9.

IV. ORDERING CLAUSES

24. Accordingly, IT IS ORDERED that, pursuant to sections 4(i) and 204(a) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and 204(a), and through the authority delegated pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F. R. §§ 0.91 and 0.291, the refund filing of Qwest Corporation is APPROVED.

25. IT IS FURTHER ORDERED that, pursuant to sections 4(i) and 204(a) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and 204(a), and through the authority delegated pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F. R. §§ 0.91 and 0.291, the refund plans of SBC Communications Inc., and the Sprint Incumbent Local Exchange Companies are APPROVED with the modifications directed herein.

26. IT IS FURTHER ORDERED that, pursuant to sections 4(i) and 204(a) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and 204(a), and through the authority delegated pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F. R. §§ 0.91 and 0.291, the refund plan of Verizon and BellSouth Telecommunications, Inc. are disapproved, and SHALL BE MODIFIED as directed herein, and SHALL BE RESUBMITTED no later than April 18, 2005.

FEDERAL COMMUNCATIONS COMMISSION

Jeffrey J. Carlisle
Chief, Wireline Competition Bureau