NECA NATIONAL EXCHANGE CARRIER ASSOCIATION INC

2120 L Street, NW
Suite 650
Washington, D.C. 20037
202-263-1650
e-mail: gharris@neca.org

EX PARTE OR LATE FILED

Gina Harrison
Senior Counsel and Director
Washington Office

March 10, 1999

Ms. Magalie Roman Salas, Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Notice of Ex Parte Filing, CC Docket No. 96-45, Universal Service

Dear Ms. Salas:

Copies of the attached were sent to Robert Loube, Stephen Burnett, and Sharon Webber of the Accounting Policy Division today. In accordance with Commission Rules, I am submitting two copies of this notice and attachment. Kindly stamp the additional return copy provided. Please direct any questions regarding this filing to me.

Sincerely,

Gina Harrison

Attachment
Cc: S. Burnett
R. Loube
S. Webber

NECA NATIONAL EXCHANGE CARRIER ASSOCIATION

100 South Jefferson Road
Whippany, N.J. 07981
973-884-8085
email jricker@neca.org

John A. Ricker
Executive Director-
Universal Service
Program Support

March 8, 1999

RECEIVED
MAR 10 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Magalie Roman Salas
Secretary
Federal Communications Commission
455 12th Street S.W.
TW-A325
Washington, D.C. 20554

Attention: Common Carrier Bureau

Re: Universal Service Fund Data Collection

On October 1, 1998, NECA submitted the Universal Service Fund 1998 Submission of 1997 Study Results to the Federal Communications Commission in accordance with section 36.613 of the Commission's rules, 47 C.F.R. §§ 36.613. In that submission, NECA indicated that it was reviewing data submitted by one exchange carrier because of a significant increase in loop cost and expense adjustment for that company.[1]

NECA has determined that the increase in this company's loop cost and expense adjustment data is attributable to a sale lease-back arrangement between this company and an affiliate. During 1997, the company sold its motor vehicles, other work equipment, land and buildings, furniture, office equipment, general purpose computers, circuit equipment, and buried cable (non-loop related) to the affiliate, and then leased back all of this property from the affiliate for the provision of local exchange service.

The lease-back arrangement significantly impacts the calculation of the loop cost because of its impact on the relationship between loop-related investment and total investment. The Universal Service Loop Cost algorithm uses factors to allocate total company costs to the loop for USF purposes. These factors are derived from loop related investment to total investment. When virtually all of the non-loop related investment is removed from the factor calculation through the creation of a lease-back arrangement, the cost allocation factors are significantly altered.

In 1997, for example, NECA reported a study area loop cost for this company's property of $354.21. The assignment of costs to the loop was based on the following allocation factors: A Factor 0.8319; B Factor 0.0175; C Factor 0.1452 and D Factor 0.0040.[2] In the October 1, 1998 submission that reflects the introduction of the lease-back arrangement, the allocation factors are: A Factor of 0.9038; B Factor of 0.0815; C Factor of 0.4015; and D Factor of 0.0425, producing a study area loop cost of $878.98. The lease-back arrangement results in an increase in percent of Investment, Accumulated Depreciation and Maintenance Expenses assigned to the loop of approximately 13.6 percent. The percent of the remaining expenses, taxes, rents and benefits

---

1 Universal Service Fund 1998 Submission of 1997 Study Results, National Exchange Carrier Association, October 1, 1998, @ Tab 1, page 4, (Moultrie Independent Telephone Company, study area code 341060).

2 *Id* @ Tab 4. The A Factor and B Factor are used to assign Investment, Accumulated Depreciation and Maintenance Expenses to the loop, while the C and D factors are used to assign the remaining expenses, taxes, rents and benefits to the loop.

assigned to the loop goes from approximately 15 percent of those costs to over 44 percent. Thus, through the creation of an affiliate lease-back arrangement, this company realized an increase in its Universal Service funding from approximately $15.00 per loop support per year to $433 per loop per year.[3]

So far as NECA is able to determine, lease rates for the arrangement described above are in conformance with the Commission's Part 32 rules.[4] Rather, the dramatic increase in loop cost and expense adjustment associated with this sale/lease-back transaction occur as a function of the USF algorithm and the allocation process described above. When a company sells substantially all of its non-loop investment as occurred here, and incurs substantial expenses associated with leasing that equipment back, the loop allocation factors (and USF expense adjustment levels) are driven upward regardless of whether lease rates are at market levels or fully distributed costs.

Section 36.2(c)(2) of the Commission's rules, which applies to the treatment of affiliate sale/lease-back arrangements between affiliated companies for purposes of cost separation studies, produces a different result. This provision requires that in the case of property rented from affiliates, if substantial in amount, the property and related expenses be included with, and the rent expenses excluded from, the telephone operations of the company making the separations. This essentially nullifies the effect of affiliate sale/lease-back arrangements in the separations and access charge ratemaking contexts. Since Universal Service Fund computations rely on unseparated (*i.e.*, Part 32) investment and expense data, however, it is questionable whether the exclusion principal stated in section 36.2 can be applied to USF data..

NECA accordingly seeks a determination as to the calculation of USF expense adjustments when affiliate sale/lease-back arrangements are involved.

Should you require additional information, please contact either Mr. Tom Webb at 973 884-8067 or me.

John A Ricker

cc: Accounting Safeguards Division
Accounting Policy Division
Ms. Cheryl Parrino, USAC CEO
Ms. Heather Gold, Chair, USAC High Cost and Low Income Committee
Mr. Robert Haga, USAC Secretary-Treasurer

---

3 Data supporting the calculation of the allocation factors was provided on diskettes with the October 1, 1998 Submission.

4 Section 32.27(c) of the Commission's rules requires carriers that receive service from an affiliated company to record that service at the lower of fair market value and fully distributed costs. 47 C.F.R. § 32.27(c).