Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Verizon Telephone Companies	)	WC Docket No. 02-317
Tariff FCC Nos. 1, 11, 14 and 16	)	
	)	

DIRECT CASE OF VERIZON
REDACTED PUBLIC VERSION

Of Counsel
Michael E. Glover
Edward Shakin

Ann H. Rakestraw

1515 North Court House Road
Suite 500
Arlington, VA 22201
Tel (703) 351-3174

October 29, 2002

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Introduction and Summary

To ensure that healthy carriers are not unfairly burdened by the plight of financially distressed carriers, ILECs should be able to obtain the same types of commercially reasonable protections that companies in other industries have, and that other carriers in *this* industry already have, to protect against nonpayment by customers who are unable or unwilling to pay their bills in a timely manner. As explained more fully below, the proposed tariff provisions are reasonable, just and non-discriminatory. In addition, they include alternatives to the cash security deposit option allowed by current tariffs – namely, a letter of credit or payment in advance – that are specifically designed to limit the amount of cash that customers would need to provide to ensure adequate assurance of payment.

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[1] The Verizon telephone companies ("Verizon") are the local exchange carriers affiliated with Verizon Communications Inc., and are listed in Exhibit F. With permission from Bureau staff, Verizon is filing its Direct Case one day late due to a power outage that affected Courthouse Road for several hours on the afternoon of Oct. 28, 2002. Because the filing was delayed, Verizon is serving copies of the public version of this filing on all parties that filed comments regarding the tariffs when they were first proposed.

Moreover, Verizon and other ILECs are limited in their ability to restrict service to their customers, which means they need more – not less – protections than other companies to protect against customer bad debt. Indeed, while other carriers have stated they will be "weeding out less stable customers" during the industry downturn, *see Level 3 Communications*, Communications Daily, Sept. 5, 2002, ILECs simply do not have that option. Carriers such as Verizon should not be legally mandated to continue to provide such service without adequate protection against nonpayment. Such a policy unfairly forces ILECs to bear 100% of the costs that inevitably occur when those customers fail to pay for services.

The provisions in Verizon's revised tariffs set forth reasonable, objective criteria for requiring that a customer give a security deposit or advance payment, and set reasonable and adequate time periods for notice of nonpayment and time to comply with a request for a deposit or advance payments. Moreover, they provide alternatives to the two-month cash security deposit already allowed in existing tariffs (*i.e.*, letter of credit or advance payments) that allow for flexibility in dealing with customers with financial difficulties. These provisions do not materially alter term plans, and, at any rate, there exists "substantial cause" for applying the revised tariff provisions to term plan customers.

It is interesting to note that the carriers that are challenging tariff provisions as "vague," "unjust" or "unreasonable" when proposed by Verizon and other ILECs, have in their own tariffs provisions allowing them to seek security deposits or advance payments from customers with questionable creditworthiness, on terms far less objective and reasonable than those set forth in Verizon's proposed tariffs.[2] And although these carriers purport to have problems specific to Verizon's tariffs, they have objected to *every* ILEC's attempt to adopt deposit or advance payment provisions, no matter the terms.[3] The Commission should reject these transparent efforts to prevent ILECs from having available the same market-based and reasonable protections that these carriers and other companies have long had at their disposal.

I. The Tariffs Set Forth Criteria for Requiring a Security Deposit or Advance Payment that Are Just, Reasonable, and Nondiscriminatory, and Are Especially Needed During the Current Industry Turmoil

The first set of issues designated by the Bureau concern Verizon's proposed criteria for requiring a deposit or advance payment from a customer. Answers to specific Bureau questions are attached hereto at Exhibit A and attachments thereto.

The revised tariffs provide that a security deposit (cash or letter of credit) or advance payments may be required only if one or more specific, objectively defined events occur.[4] As discussed below, the criteria Verizon has established for requiring a

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[2] *See generally* Reply Comments of Verizon to Petitions to Reject or Suspend and Investigate, *Verizon Telephone Companies Tariff F.C.C. Nos. 1, 11, 14, and 16*, Transmittal No. 226 (filed Aug. 7, 2002) ("Verizon Tariff Reply"), at 5-15 & Exhibit C thereto.

[3] *See Iowa Telecommunications Services, Inc. Tariff FCC No. 1, Transmittal No. 22*, Order, WC Docket No. 02-303, DA 02-2317 (rel. Sept. 18, 2002); *BellSouth Telecommunications Inc. Tariff FCC No. 1, Transmittal No. 657*, Order, WC Docket No. 02-304, DA 02-2318 (rel. Sept. 18, 2002).

[4] Those events are: (1) a customer's account balance has fallen in arrears in any two months out of any consecutive twelve-month period; (2) the customer owes $250,000 or more to Verizon that is 30 days or more past due; (3) the customer or its parent "informs [Verizon] or publicly states that it is unable to pay its debts as such debts become due"; (4) the customer or its parent has initiated a voluntary receivership or bankruptcy proceeding, or if such a proceeding has been initiated against the customer or its parent; (5) the senior debt securities of a customer or its parent are below investment grade; or (6) the senior debt securities of a customer or its parent are rated at the lowest

deposit is similar to – or even more limited than – the criteria set forth in other carriers' tariffs.[5] Moreover, even if the proposed new provisions were not similar to those already present in existing tariffs of other carriers, which is strong evidence of their reasonableness, they are just and reasonable on their own terms.

Indeed, the provisions regarding the nature of the security that will be requested reflect an effort to provide greater flexibility and additional options to carriers than the existing provisions of Verizon's tariffs. For example, the tariffs state that if a deposit is required, the customer may provide a letter of credit instead of cash, which will limit the cash outlay the customer must provide. *See* Verizon FCC Tariff No. 1, § 2.4.1(A)(4). Similarly, the tariffs permit a carrier to pay in advance for services, on a monthly basis, "in lieu of" requiring a deposit. Verizon Tariff FCC No. 1, §§ 2.4.1(A)(2) and (3). This provision does not increase the carrier's financial obligations at all, but simply makes a slight shift in the timing of payments. Under the advance payment plan, a customer would pay one month in advance for services, on a recurring basis, rather than paying two months' worth of charges as a deposit. Again, this allows customers who claim that they have cash flow problems an option to conserve their cash.

Some of the opposing carriers have argued that while they can (and do) impose similar deposit or advance payment requirements, ILECs such as Verizon should not

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investment grade rating category by a nationally recognized statistical rating organization, and are put on review for a possible downgrade. *See* Verizon Tariff FCC No. 1, § 2.4.1(A)(2). Because the proposed tariff revisions are similar, for simplicity, in this brief and supporting exhibits Verizon will cite only to Tariff FCC No. 1.

[5] *See, e.g.*, Verizon Petition for Declaratory Emergency and Other Relief, WC Docket No. 02-202, at 1-4 (filed July 24, 2002) ("Verizon Emergency Petition"); Verizon Tariff Reply, at 5-15 & Exhibit C thereto.

have the same protections, because they are "dominant."[6] However, because of the obligations imposed on ILECs, and their more restricted ability to refuse service to competing carriers, Verizon needs these tariff protections even more, not less.

A. The Criteria Set Forth As Triggers Are Valid Predictors of Potential Customer Bad Debt

The Bureau has questioned whether four of the criteria for requiring a deposit or advance payments "are valid predictors of the likelihood of a customer paying its access bill, or . . . are better predictors of whether a customer will pay its bills in the future than the customer's past payment history." Designation Order, ¶ 21.[7] These criteria are valid predictors of future payment, and are similar to (or more generous to the customer than) criteria already being used by other carriers and other industries. For example, AT&T's tariff states that a security deposit may be required, *inter alia*, if the customer has "an unsatisfactory credit rating."[8] The tariff does not specify what will be deemed "unsatisfactory," but lists a number of criteria that *may* be considered, including "bankruptcy history," "financial statement analysis," and commercial credit bureau

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[6] *See, e.g.*, AT&T Tariff Opposition, at 7 n.2 (filed Aug. 1, 2002) (opposing Verizon's tariff but stating that AT&T has "from time-to-time insisted on provisions in its contracts with customers that require security deposits and other provisions that protect against default").

[7] The Bureau has not asked about the first two criteria for requiring a deposit – *i.e.*, those that allow Verizon to require a deposit or advance payments when a customer "has fallen in arrears in its account balance in any two (2) months out of any consecutive twelve (12) month period" or "owes $250,000 or more to the Telephone Company that is thirty (30) days or more past due." Verizon's existing tariffs already provide that Verizon can require a security deposit from "a customer which has a proven history of late payments to the Telephone Company." Verizon Tariff FCC No. 1, § 2.4.1(A). Thus, Verizon can *already* require a security deposit in those instances; the new language just makes more concrete specific instances that will qualify as a "proven history of late payments."

[8] AT&T Tariff FCC No. 30, § 3.5.5(A).

rating.[9] Other carriers' tariffs give them even more discretion in whether to require a deposit. For example, WorldCom's tariff simply states that it can require a security deposit of customers "whose credit worthiness is not acceptable to the Company or is not a matter of general knowledge," without specifying what criteria will be used to determine what will constitute an "acceptable" credit risk.[10] And even more broadly, US LEC's tariff states merely that it may require a "suitable" deposit "[i]n order to safeguard its interests," without specifying the amount of the deposit or what, if any, criteria it will use to determine whether a deposit will be required.[11] Verizon is not asking for such broad provisions in its federal access tariffs; however, the fact that other carriers who are able to operate under non-regulated market conditions all have similar or broader criteria for requiring a security deposit constitutes strong evidence that the criteria set forth in Verizon's proposed tariffs for requiring a deposit or advance payment are market-based and reasonable. Verizon should be permitted to require advance payments or security deposits from customers that exhibit behavior indicating that they may be unable or unwilling to pay their bills on a timely basis.

While a customer's past payment history is still a good predictor of future payment, it cannot be the only one. If Verizon is compelled to wait until a carrier has stopped paying its bills before instituting protective measures, it may be that much more difficult for the defaulting carrier to provide adequate assurances of payments. If, even after a carrier has shown objective indications of a lack of creditworthiness, Verizon and other carriers are forced to wait until *after* these customers stop paying their bills, *plus* a

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9 *Id.* (emphasis added).

10 WorldCom Texas PUC Tariff No. 1, § 2.7 ("WorldCom Tariff No. 1").

11 US LEC Tariff FCC No. 2, § 2.5(A)(1) ("US LEC No. 2").

significant amount of time after that (for example, to allow for notice, and a period of negotiation with the customer), before it could embargo (*i.e.* refuse to accept orders for new service, or pending service requests) or discontinue services, Verizon could be left carrying months of carrier bad debt. Given the dollar volumes that many carriers generate through their CLEC and IXC operations, the exposure can be substantial. That is the situation Verizon and other ILECs find themselves in today, and it has cost – and, unless remedied, will continue to cost – Verizon and other ILECs hundreds of millions of dollars in uncollectible bad debt. For example, the combined total pre- and post-petition debt owed to Verizon just for bankruptcy cases since the start of 2000 is roughly **{BEGIN PROPRIETARY}** . **{END PROPRIETARY}** *See* Exhibit A, Issue 15. Even if Verizon is able to recover part of those amounts owed to it by bankrupt customers, the vast majority of these bankruptcies are still open and it could take years to recover any cure or settlement money.

In addition, requiring ILECs to wait until a financially troubled customer fails to pay its bills before the ILEC will be able to require a security deposit or payment in advance will not insulate these customers from such demands. Other creditors and suppliers of the customers, which are not faced with the regulatory restrictions that are imposed upon Verizon and other ILECs, would demand additional assurance of payment at the earliest signs of customer financial trouble before they would continue to provide services.[12] Thus, requiring ILECs to wait until nonpayment before implementing such

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12 *See, e.g.,* Tanya Irwin and Andrew McMains, *Kmart to Launch "Real Life" Ads*, Adweek Magazines Newswire (Jan. 28, 2002) (reporting that "it is likely that the retailer will be asked to pay for media upfront"); Kevin Maney and Andrew Backover, *WorldCom Drops Bomb on Telecom*, USA Today (July 23, 2002) (noting that vendors "have begun to demand cash payments up front"); Jeffry Bartash, *WorldCom*

protective measures as those set forth in this tariff would only serve to put ILECs in line behind other creditors, ensuring that the brunt of any bad debt would fall disproportionately on Verizon and the ILEC segment of the telecommunications industry.

1. Customer or its Parent Is in Bankruptcy or Receivership, or Admits its Inability to Pay Debts as They Become Due

The revised tariffs allow Verizon to require a deposit or advance payment of charges if a customer or its parent (1) "informs [Verizon] or publicly states that it is unable to pay its debts as such debts become due"; or (2) "has commenced a voluntary receivership or bankruptcy proceeding (or had a receivership or bankruptcy proceeding initiated against it)." Section 2.4.1(A)(2). The Bureau has questioned why these criteria "are valid predictors of the likelihood of whether a customer will pay its bills in the future." Designation Order, ¶ 21. The answer should be obvious: if a customer or its parent satisfies one of the criteria above, it is stating that it is *unable* to pay all of its future bills. In that instance, the fact that the customer paid its bills in the past is of little comfort to a supplier, such as Verizon, that will continue to provide services in the future. Indeed, the fact that a customer that has filed for bankruptcy is more likely to default on future payments is further evidenced by the fact that the Bankruptcy Code specifically allows utilities to require "adequate assurance" of payment before continuing to provide service to the bankrupt debtor.[13] Although Verizon can seek a deposit or advance payment provisions pursuant to the Bankruptcy Code, it is important to allow Verizon to

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files for Chapter 11 (July 21, 2002) (noting that "nervous WorldCom suppliers have demanded upfront payment").

[13] *See, e.g.*, 11 U.S.C. § 366(b) (A "utility may alter, refuse, or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for

demand such protections in its tariffs, as courts have specifically held that "[t]he amount constituting adequate assurance of payment *may be initially set by the utility*."[14]

Moreover, Verizon's Tariffs already in effect use bankruptcy as a trigger for requiring a security deposit.[15] Other carrier's tariffs have similar provisions. *See, e.g.*, AT&T Tariff FCC No. 30, § 3.5.5(A). Indeed, even though several commenters vehemently opposed Verizon's proposed tariffs, including the provisions that set potential bankruptcy as a trigger, *not one* questioned whether these criteria were reasonable predictors of a customer's inability or unwillingness to pay future bills.

2. Investment Grade Rating

The other two criteria questioned in the Designation Order state that Verizon may require a deposit or payment in advance if the senior debt securities of a customer or its parent are below investment grade, or are rated at the lowest investment grade rating category by a nationally recognized statistical rating organization and are put on review for a possible downgrade. Verizon Tariff FCC No. 1, § 2.4.1(A)(2). These criteria are specifically defined by reference to objective definitions found in federal securities regulations, and thus cannot be characterized as "ambiguous" or "vague." *See id.*[16] They

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relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date.").

14 *In re Tarrant*, 190 B.R. 704, 708 (S.D.Ga. 1995) (emphasis added); *see also In re Best Products*, 203 B.R. 51, 54 (E.D.Va. 1996). As stated in Exhibit A, Issue 16, the proposed tariff provisions are entirely consistent with United States bankruptcy law.

15 *See, e.g.*, BOC Tariff (for Verizon, BellSouth, SBC, and Qwest) FCC No. 1, 800 Service Management System (SMS/800) Functions, § 2.4.1(B) ("SMS/800 Tariff"); Verizon West Coast Inc. General Exchange Tariff, Section 2, Establishment and Re-Establishment of Credit, A.1.b (Cal. P.U.C. Sheet 13, eff. May 1, 1997).

16 For example, while one commenter argued that the term "nationally recognized statistical rating organization" is vague, it is a term that is used repeatedly in

establish concrete, objective criteria for invoking the right to request additional assurances of payment – criteria that are far less vague than the language many of the carriers opposing these tariffs have long included in their own tariffs.[17]

Moreover, these criteria are reasonable predictors of whether a customer will pay its bills in the future. It is well established that "[c]redit ratings provide objective, consistent and simple measures of creditworthiness" and are regarded as "a key measure of a company's financial health."[18] Private contracts often use downgrades in investment ratings as triggers for requiring adequate assurance.[19] Indeed, Moody's reports that "over 90% of all rated companies that have defaulted since 1983 were rated Ba3 [one of the highest "junk" grade ratings] or lower at the beginning of the year in which they defaulted."[20] As a corollary, one commenter opposing Verizon's tariff revisions noted

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SEC regulations that reference "investment grade" ratings. *See, e.g.*, 17 CFR § 240.3a1-1(b)(3)(v).

[17] *See, e.g.*, WorldCom Tariff No. 1, § 2.7 (stating that it can require a deposit of a customer "whose credit worthiness is not acceptable to the Company or is not a matter of general knowledge"). *See generally* Verizon Tariff Reply, Exhibit C, at 1.

[18] Moody's Investor Service, Rating Policy, "Understanding Moody's Corporate Bond Ratings and Rating Process," at 5 (May 2002) *available at* www.moodys.com/moodys/cust/ratingdefinitions/rdef.asp; BusinessWeek Online, "The Credit-Raters: How They Work and How They Might Work Better," (April 8, 2002), *available at* www.businessweek.com/magazine/content/02_14/b3777054.htm.

[19] *See* Moody's Investor Service, Rating Policy, "Understanding Moody's Corporate Bond Ratings and Rating Process," at 6 (May 2002) ("Investors and counterparties embed ratings as triggers into private contracts in order to protect themselves from potential deterioration in the creditworthiness of an obligor's financial position"). *See also* Jonathan Stempel, Issuer in the News, "Moody's, S&P Say Demanding More Disclosure on Risks," Feb. 6, 2002, *available at* www.markets.reuters.com/cabonds/Editorial/IssuerInTheNews/IssuerInTheNews898.htm (noting that companies' contracts often have clauses requiring that they pay off their debt or pay a higher interest rates in the event of an investment downgrade).

[20] Moody's Investor Service, Rating Policy, "Understanding Moody's Corporate Bond Ratings and Rating Process," at 9 (May 2002).

that public data shows that *one in ten* issuers of securities that currently are below investment grade will default on the securities. *See* WorldCom Tariff Opposition, at 10-11 (filed Aug. 1, 2002).

And it appears that currently for the telecommunications industry, the default rate is much higher than average. According to one analyst, "Through the first half of 2002, 55% of defaults by volume and 37% as a percentage of issuers have been telecommunications firms."[21] In addition, because defaulting on securities obligations will often trigger default clauses and shut off future financing, these companies are likely to default on securities obligations last – *i.e.*, long *after* they have stopped paying their bills for telephone service. Verizon's own internal analysis confirms this. Verizon looked at selected carrier customers with outstanding balances above a threshold (more than $1.75 million dollars) as of a date certain in July.[22] Of the companies with publicly rated securities, there was a correlation between below investment grade S&P credit ratings and the percent of billable revenues outstanding 90 days or more for these customers. *See* Verizon Tariff Reply, at 14 & Exhibit D. A copy of the exhibit illustrating that point is attached at Exhibit A-11. In other words, the lower the customer's credit rating, the more likely it is the customer will have a higher percentage of its outstanding receivables due for 90 days or more.

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[21] *See* Moody's Investor Service, Special Comment, "Corporate Defaults Refuse to yield in 2002", at 4 (July 2002) *available at* http://riskcalc.moodysrms.com/us/research/defrate/Q202_comment.pdf.

[22] Data from customers in the Northeast and Western states were used for this analysis. Because of differences in accounting for the number of days receivables are outstanding, data from Mid-Atlantic states were not used.

B. Price Caps Do Not Adequately Compensate for Increased Uncollectibles And, Regardless of Price Cap Rates, Carriers Should Be Allowed To Protect Against Customer Bad Debt

There can be no doubt that the recent, dramatic growth in uncollectibles is something that has occurred disproportionately in the telecommunications industry, and thus is not reflected in the inflation factor (GDP-PI) or the X factor used to adjust the normal price cap formulas. Countless industry analysts and even the Commission Chairman have declared the industry to be in "utter crisis,"[23] and there have even been Congressional hearings dedicated to the financial turmoil in the telecommunications marketplace.[24] The current uncollectible revenue situation for access revenues cannot be considered endogenous to price caps.

Current costs due to extraordinary carrier uncollectibles certainly are *not* already included in the price cap rates. Before price cap regulation, ILECs such as Verizon developed rates based on revenue requirements. Thus, figures reported in ILECs' 1990 rate of return filing were used in setting the initial price cap rates in 1991. Although rate of return and price cap access rates have historically included an embedded calculation of expected uncollectibles, the uncollectible figures used to set initial rates are extremely out of date, represent an uncollectible amount that has not kept pace with the changing nature

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[23] *See* Yochi J. Dreazen, *FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom*, Wall St. J., July 15, 2002, at A1 (Chairman Powell noting that the telecommunications industry currently is "in a state of 'utter crisis'"); Andrea Ahless, Survival of the fittest, Fort Worth Star-Telegram, July 28, 2002, at A1 (analysts state that the telecommunications industry is in turmoil and many, including AT&T President David Dorman, predict that the sector will continue to lag behind recovery of the broader economy).

[24] *See generally* Opening Statement of Sen. Fritz Hollings, Hearing on the Financial Turmoil in the Telecommunications Marketplace and Maintaining the Operations of Essential Facilities (July 30, 2002), available at http://hollings.senate.gov/~hollings/statements/2002730337.html.

of the telecommunications marketplace, and do not sufficiently account for Verizon's costs due to the extraordinary growth in carrier bad debt.

For the last interstate annual revenue requirements filings in 1990 and the first price cap filings in 1991 (as well as throughout most of the 1990s), the uncollectible levels were far lower than they are today – both in absolute numbers and as a percentage of overall revenues. Verizon's predecessors' last rate of return filings with the Commission, filed on July 1, 1990, included \$20.2 million in interstate revenue requirements for the Verizon-East, and \$4.0 million in uncollectibles attributable to interstate for Verizon-West. By contrast, Verizon's reported interstate uncollectibles for 2001 were \$110.3 million for Verizon-East and \$18.96 million for Verizon-West. *See* Exhibit A-1.[25] Thus, in the last decade, interstate uncollectibles increased a whopping 445% and 375% in the East and West respectively. In case the enormity of that growth is not evident, it should be noted by comparison that interstate access revenues grew only approximately 35% in the East and 65% in the West during the same time period.

In addition, carrier uncollectibles have been growing far more rapidly than end user uncollectibles. Because end users represent a cross-section of the economy, while carriers are unique to the telecommunications industry, this disparity demonstrates that the growth in interstate uncollectibles is a result of factors unique to the telecommunications industry. Indeed, based on internal calculations, Verizon has estimated that, while end-user uncollectibles for Verizon-East grew approximately **{BEGIN PROPRIETARY}** **{END PROPRIETARY}** between 1990/91 and

[25] As noted in that Exhibit, the data have been adjusted slightly from ARMIS for the sale of exchanges, in order to ensure that current figures are comparable to 1990.

2001, during the same time period carrier uncollectibles for Verizon-East increased **{BEGIN PROPRIETARY}** **{END PROPRIETARY}**

During the early 1990s, when the rate-of-return and early price cap filings were being made, there were different relationships between the carrier customers and the LECs as the access suppliers. At that time, the overwhelming amount of uncollectibles experienced by LECs was associated with end user customers, rather than with carriers. In 1996, for instance, only approximately 2% of Verizon's total uncollectibles for interstate and intrastate revenues were attributable to uncollectible carrier revenues (as opposed to uncollectible end user revenues).[26] However, in 1999, carrier uncollectibles accounted for more than 12% of total uncollectibles. By 2000, that percent had grown to more than 15%. And in 2001, roughly 30% of total uncollectible revenues were due to carrier uncollectibles. There are no longer only a handful of access carriers as there were when price cap regulation was initiated. Indeed, Verizon is dealing with more carrier *bankruptcies* now than it had carrier *customers* at the inception of price caps. There are hundreds of carriers and end users purchasing access services from the Verizon access tariffs. Due to the increase in those carriers, and the "utter crisis" in the industry due to the failure of many of these customers, the level of uncollectibles ILECs are currently experiencing are far greater than contemplated by original price cap rates and formulas. The proposed tariff revisions cannot solve that problem by themselves, but they will help to restore a balance in the LEC–customer relationship that has eroded substantially since price caps was initiated.

[26] For purposes of this discussion, carrier uncollectible and receivable figures include access charges as well as uncollectibles and receivables from unbundled network elements ("UNEs") and resale.

The Bureau has asked whether Verizon believes the risks of uncollectibles have increased permanently and, if so, what accounts for this change. Designation Order, ¶ 16. Much of the risk of uncollectibles undoubtedly is a result of the regulatory and political decisions to move to a model that encourages new competitors to enter the market. This element of risk is permanent. In a competitive industry, where the market rather than regulators decides which carriers will succeed and which will fail, carriers that cannot successfully compete will fail. Some of the market-based shakeout is especially pronounced now, due to a combination of over-investment and poor business plans by new entrants, and the recent economic downturn.[27] However, even if the trend in growing uncollectibles will slow, it is not likely to do so in the near future. And as the telecommunications industry moves to a more and more competitive model, there will always be a risk of uncollectibles that carriers – like other market-placed players – must be allowed to address. The tariff provisions proposed by Verizon are intended to lower the relative risk and correct the current imbalance that exists in the customer-supplier relationship.

The Bureau questions whether allowing ILECs to revise their tariff conditions regarding security deposits or advance payments "significantly alter[s] the balance that was struck in the early 1980s when access charges were instituted." Designation Order, ¶ 11. However, this statement misses the point, in at least two respects. First, there was no "balance that was struck" regarding the issues present here – namely, what to do with volumes of customers who are on the verge of bankruptcy – as the situation simply was

[27] *See, e.g.,* Simon Flannery, Morgan Stanley Equity Research, *The Local Report, A Break in the Clouds?,* Oct. 8, 2002; *Policy Experts Examine Telecom "Meltdown," How to Cure It*, Communications Daily, May 20, 2002.

not present in 1980s. The relatively stable, low-risk market of the 1980s, where large carriers operated under rate-of-return regulation and had limited exposure to bad debt, simply no longer exists.

Moreover, to the extent that the "balance" has shifted, it has shifted in favor of debtor carriers. Highly leveraged companies that use Verizon and other carrier-suppliers to fund their services were not part of the "balance" in the 1980s. And part of that shift may be a result of failed policies set by the Commission. As the Chairman recently acknowledged, "the FCC may have erred in the past by implicitly encouraging the formation of hundreds of Bell competitors without realizing how few of them would ultimately be able to survive."[28] This policy – coupled with individual carriers' flawed business plans and mismanagement – made the current shakeout inevitable. And because carriers such as Verizon were compelled by government fiat to provide service to the now-bankrupt carriers, any charges that cannot be collected result directly from this compulsion. In any event, the Commission should not allow an outdated solution to customer bad debt that was created almost twenty years ago to now limit carriers from adjusting their practices to account for the extraordinary and uncontrollable growth in uncollectibles.

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[28] Yochi J. Dreazen, FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom, Wall St. J., July 15, 2002, at A1.

C. Other Factors – Such As Whether the Customer Pays for Services in Advance or Arrears, or Whether Verizon Owes the Customer Money – Do Not Mitigate Against the Need for a Security Deposit or Advance Payments

The Designation Order asks "whether different security deposit or advance payment provisions should apply depending upon whether the service is billed in advance or billed in arrears." Designation Order, ¶ 14. The requirements should not be different. As an initial matter, it is important to note that even when carriers are *billed* for services in advance that does not mean they are required to *pay* in advance. Thus, a customer that is "billed in advance" for services typically would receive a bill at the beginning of the month for services that it will use during the month, but it would have thirty days or more after the billing date before payment is due. Therefore, even when a customer timely pays for services that are "billed in advance," it pays for the services at the end of the month – *i.e.*, *after* they are provided. If the customer does not pay and Verizon is then forced to give thirty days notice before issuing an embargo or discontinuing services, even for those services that were billed in advance, Verizon could easily have been required to provide two months of services before it could terminate services. A two-month security deposit therefore is the *minimum* that is required to protect against the risk of nonpayment. When services are not billed in advance, or when there are other delays to terminating service (such as during periods of negotiation with the customer, or because regulators or a bankruptcy court opposes the stopping of service), the risk of outstanding debt can be even greater.[29]

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[29] Even if the Commission were to grant Verizon's request for a shorter notice period than the thirty-day period set forth in the existing tariffs, there inevitably will be lags between the time when Verizon is first able to issue such a notice and when it

The Bureau also asked Verizon to "discuss the extent to which it has a debtor relationship with its customers and how that may affect Verizon's credit risk." Designation Order, ¶ 14. The answer is that, even when Verizon is purchasing services from some of its carrier-customers, that generally does not mitigate the level of risk that Verizon faces with uncollectibles. As an initial matter, the amounts that Verizon may owe another carrier (in most cases, this is limited to reciprocal compensation or compensation for ISP-bound traffic) for the most part are not nearly as large as those amounts the carrier-customer owes to Verizon. For example, compared to the more than $450 million in debt to Verizon amassed by WorldCom in the months prior to its bankruptcy filing, Verizon's average monthly undisputed intercarrier compensation payables to all the WorldCom entities was a combined average of only **{BEGIN PROPRIETARY}** **{END PROPRIETARY}** Similarly, based on internal calculations of customers that present a significant credit risk, Verizon has calculated that only a small portion of the amounts owed to it by these customers have potentially offsetting receivables owed by Verizon. *See* Exhibit A, Issue 12.

Moreover, carrier operations are frequently organized by state jurisdiction, and in many cases CLECs have organized separate carrier entities to pursue specific business plans that many not generate intercarrier compensation. Often, there simply will not be a match of debt against intercarrier compensation obligations when these corporate formalities are taken into account. For example, NorthPoint and Rhythms created significant debt exposure for Verizon, and yet presented virtually no payment obligations

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ultimately does issue the notice. Allowing the shorter notice period will provide incentives for Verizon to delay issuing the notice, because it will face having to provide service for only seven days (rather than thirty days) after the notice is issued.

flowing from Verizon to those carriers, and thus no opportunities for setoff. In addition, even when setoff is available, customers often vehemently oppose Verizon's rights to use amounts it owes the customer as an offset against pending debt the customer owed Verizon.

D. Verizon Should Be Permitted to Obtain a Security Deposit or Advance Payments Immediately Upon Objective Indications that a Customer's Creditworthiness is Suspect

The Bureau has asked why the proposed criteria for requiring a security deposit are "better" than current criteria of past payment history. Designation Order, ¶ 21. The point is not that one criteria is "better" or worse than another, but that one type of criteria alone (*e.g.,* past payment history) is not enough. There may be several objective events that, if any occurred, would lead to a reasonable assumption that a customer presents a bad credit risk. Rather than requiring that Verizon choose only one criterion and hope that the one-size-fits-all approach will work for all customers, like other carriers and companies in other industries, it should be allowed to consider a variety of factors in determining whether there is a reasonable indicia of creditworthiness.

The Bureau also has suggested that "[o]ne alternative would be to phase in deposit requirements over several months after a trigger had been reached." Designation Order, ¶ 16. That "alternative" is neither warranted nor workable. In the first instance, the Commission in previous proceedings has expressly upheld a two-month security deposit as reasonable. *See Investigation of Access and Divestiture-Related Tariffs*, Memorandum Opinion and Order, 97 FCC 2d 1082, Appendix D, at discussion of Section 2.4.1(A) (1984). If the terms for requiring a security deposit are reasonable, then the amount of the deposit included in the tariffs – which is the same as that previously approved by the Commission, or even more flexible to the carrier – is necessarily so.

In addition, there are several reasons why this proposed "alternative" simply would not work. First, Verizon's proposed tariff revisions provide alternatives to a cash security deposit that were specifically designed to minimize the financial impact on a carrier. If a customer cannot either provide enough cash for two months worth of service or obtain a letter of credit guaranteeing such payment, and also cannot pay for services even one month in advance, that is a customer from which there is more – not less – of a need to obtain a security deposit. If a customer cannot obtain a letter of credit, a bank is essentially stating that the customer's credit is so bad that it is unwilling to guarantee a loan. In such an instance, requiring Verizon to provide service while the customer "phases in" a deposit payment will essentially require Verizon to provide a loan (in the amount of services that are unpaid) when a bank would not. Moreover, the "phase in" "remedy" in most cases would only serve to exacerbate the uncollectible situation if the Commission were to rule that Verizon could not terminate a carrier – even if that carrier was failing to pay its bills, or said it would not pay its bills in the future – until the customer had "several months" to pay a security deposit. Verizon could be left carrying months of extra carrier bad debt.

II. The Shortened Periods for Notice for Termination or Embargo, and for Payment of a Deposit or Advance Payment, Are Necessary and Adequate

Verizon's existing tariffs allow it to refuse additional service, or to discontinue service, on thirty days written notice if a customer fails to pay or does not comply with the provisions regarding a deposit or advance payment. The revised tariffs shorten the notice period from thirty to seven days to reflect the fact that circumstances can change very quickly (as demonstrated by recent events, including the WorldCom bankruptcy). In addition, they are necessary because a termination or embargo notice almost always would come after an already lengthy process, which typically includes protracted negotiations for payment. Again, this modification is in line with terms already present in other carriers' existing tariffs. For example, AT&T's tariff states that if the customer refuses to make advance payments, AT&T may "*immediately* and upon written notice to the Customer . . . restrict, suspend, or discontinue providing the service." AT&T Tariff FCC No. 30, § 3.5(H). Sprint and WorldCom have similar notice provisions in their tariffs.[30]

As Verizon stated in its initial description and justification, the notice period before halting new or pending orders, or discontinuing service, often is in addition to other mandatory wait periods (such as after bills are already overdue, or for payment for services that are billed in arrears), and is usually triggered by Verizon only after it and the customer have been involved in protracted negotiations. *See generally* Exhibits A-5 and A-6 (describing standard collection processes).

As an initial matter, it is important to note that even at the earliest, the notice period before terminating or embargoing service can only begin *after* Verizon has provided services for which it has not been paid, and *after* the customer has had time to review its bill. For services that are billed in arrears, the customer may have received two months' worth of service without paying Verizon before Verizon can even send a notice of termination or embargo and start the notice period running. That is because the bill is

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[30] *See* Sprint Schedule No. 11, § 2.15 (stating that it may, by written notice, "immediately" cancel service); WorldCom Tariff No. 1, § 2.7 (stating that it may cancel service "upon written notice").

sent out only in the month after the charges are incurred, and then the customer has another thirty days after the bill date before payment is due. And even for services that are billed in advance, the customer will have received one month's worth of services before Verizon could even *send* a notice of discontinuance. That is due to the fact that, even if the bill is sent out at the beginning of the month in which service is provided, the customer's payment is not *due* until thirty days after the bill date –*i.e.*, at the end of the month, after services have been provided. Thus, even if Verizon were to send out a notice the first day after a customer failed to pay, Verizon likely will have provided one or two months of unpaid service to the customer before a termination or embargo notice can even be *sent*.

Moreover, Verizon almost never sends notice of termination or embargo to a customer on the first day that it is entitled to send such a notice. That is because Verizon generally will embargo services only after it and the customer have been involved in negotiations, and after an outstanding balance is ninety days or more past due. *See* Exhibit B, Issue2. Termination notices are even more rare – in fact, Verizon has issued a termination of service carrier to only **{BEGIN PROPRIETARY}**

{END PROPRIETARY} in undisputed charges. *See* Exhibit A. Requiring an *additional* thirty days notice after the customer has defaulted and the negotiations have stalled is simply not necessary. Given the already long lag time that often occurs between providing services and receiving payment for the services, the extended period of negotiation that typically occurs before notice of termination or embargo is given, and the fact that a customer who is given notice of termination or embargo for failure to pay past bills is likely not to pay voluntarily for debts incurred for future services, shortening the notice period to seven days is not only reasonable, but is more than adequate to allow customers time to analyze their bills and make payments. In addition, granting a shorter notice period encourages Verizon to continue to negotiate with the carrier to reach a solution short of sending a termination or embargo notice. Because Verizon currently has to wait thirty days after the notice has been sent before taking action, there is an incentive to send out the notice earlier in the process.

Long ago, the Commission ruled that a thirty-day notice period is not necessary to protect the customer's interests. In 1987, the Commission allowed BellSouth to revise its tariff to provide for discontinuance of service 15 days after nonpayment, if it made certain other modifications to the tariff. *See Annual 1987 Access Tariff Filings*, Memorandum Opinion and Order, 2 FCC Rcd 280, 290 (1986). The main concern expressed by the Commission in its 1987 Order was that customers receive their bills with enough time to give them an "opportunity to review their bills properly." *Id.* In this regard, the Commission asks whether it "should prescribe the time within which a bill must be presented to the customer if a shortened notice period is allowed, in order to permit the customer sufficient time to review the bill and pursue its dispute rights." Designation Order, ¶ 27. In particular, it asks whether Verizon could commit to a "three-day requirement" – *i.e.*, ensuring that the customer receive the bill within three days of the bill date. *See id.* ¶ 27 & n. 50.

As set forth below, the Commission should not prescribe a specific time limit, and in particular should not prescribe a three-day time limit, which Verizon could not guarantee that it could always meet.

Verizon is committed to sending customer bills on a timely basis. Indeed, as explained in the answer to Exhibit B, Issue 1 above, it has an excellent record of timely billing. However, Verizon currently would not be able to guarantee that it could ensure that a customer received a bill within three days after the bill date. This is especially true with paper bills that are mailed to the customer, which depend on the United States mail or messenger service for delivery. Answers to specific Bureau questions regarding notice periods are set forth at Exhibit B and attachments thereto.

III. The Terms Regarding Refunds of Deposit Amounts Are Reasonable and Specific

The proposed tariff revisions state that Verizon may require a security deposit and, if it elects, may require payment in advance in lieu of a deposit. Verizon FCC Tariff No. 1, § 2.4.1(A)(2), (3). The Designation Order has asked that Verizon "explain how these tariff provisions can be applied in a non-discriminatory manner." Designation Order, ¶ 19. As an initial matter, the tariffs do not grant Verizon unlimited discretion regarding security deposits or advance payments – it can require such payment assurances *only* if a customer has presented objective evidence of lack of creditworthiness. Moreover, there is simply no incentive for Verizon to apply these provisions in a "discriminatory" manner. Pursuant to the tariffs, Verizon must pay significant interest of 18.25% to the customer on security deposits. And advance payment calculations must be performed manually, and updated periodically, at considerable cost and burden to Verizon.

In addition, any discretion that is built into the tariffs is designed to benefit *customers*, not Verizon. For example, rather than having a provision that mandated that Verizon require a security deposit or advance payment whenever one of the triggers was satisfied, the current provisions would allow Verizon to work with the customer to determine whether such assurances were needed, or if alternative arrangements could be negotiated. Such "discretion" is similar to the type that Verizon's tariffs already can – and should – provide in dealing with customers. For example, Section 2.1.8(A) states that if a customer fails to comply with certain tariff provisions, including payment provisions, Verizon "may" refuse additional applications of service, and/or refuse to complete pending orders for service. *See* Verizon Tariff FCC No. 1, § 2.1.8(A). Similarly, Verizon "may" discontinue service only if the customer fails to meet certain criteria, such as if it fails to pay its bills in a timely manner. *Id.* § 2.1.8(B). If it is reasonable for Verizon's tariffs to allow the company discretion in determining whether to refuse to process applications for service, or to discontinue service altogether, it should also be reasonable for Verizon to exercise the same discretion when deciding to undertake the lesser remedy of requesting adequate assurance of payment. Moreover, it is hard to believe that the alternative to "discretion" – *i.e.*, requiring that Verizon *must* demand a security deposit or advance payment when customers satisfy objective criteria – would be something that the carriers objecting to these tariff provisions would actually want. Answers to specific Bureau questions regarding the refund of deposits are set forth at Exhibit C and attachments thereto.

IV. The New Tariff Provisions Do Not Materially Alter Term Plans and, Even if They Did, Would Meet the "Substantial Cause" Test

A. The Tariff Provisions Do Not Materially Alter the Term Plans, But Only Provide Adequate Assurance of Performance

Verizon's term agreements simply contain pricing options for services contained in the general tariff sections. These plans enable a customer to obtain a lower price than the generally tariffed rate, in exchange for a commitment for an amount of service and a length of time the services will be in place. As simple pricing plans, the term plans detail the prices and length of the agreement between the customer and Verizon, but do not govern the payments or security deposits related to the plans. The general terms and conditions that apply to the term plans are those contained in the applicable general access tariff. Thus, changes to the general terms in Verizon's access tariffs apply automatically to the term plans as well.

However, the tariff revisions in this filing do not alter the operative conditions of the term plans – the rates, volumes or length of the term plans. Consequently, they do not alter the term plans themselves at all. The term plans that reference the changes that will warrant early termination of the terms reference material changes to *rates*.[31] Moreover, even if the revisions were considered (incorrectly) to modify some aspect of the term plans, the revisions still would not be of the type the Commission has considered to be "material."[32] Instead, most of the changes simply enumerate in detail the situations in which Verizon can require "adequate assurance" and the form that assurance will take. In large part, these provisions either echo steps that Verizon can already take pursuant to the tariff (or if the customer files for bankruptcy), simply clarify when they will be invoked, or offer opportunities for assurance that are *more* favorable to the customer than existing provisions. *See* section II.A., *supra*. Indeed, the concept of allowing a party to

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31 *See, e.g.*, Verizon Tariff FCC No. 1, § 7.4.13(C) ("In the event that the Telephone Company initiates a rate increase and the total discounted monthly rate for the affected service increases by eight percent (8%) or more, the customer may cancel its TPP for the affected service without termination liability").

32 *See, e.g., AT&T Communications Contract Tariff No. 374*, 10 FCC Rcd 7950, 7952 (1995) (proposing to modify contract price and volume discount); *RCA American Communications, Inc. v. Revisions to Tariff FCC Nos. 1 and 2*, 86 FCC 2d 1197 (1981) (considering proposals to "substantially" increase tariff rates or shorten the service of tariff terms).

require "adequate assurance" is one that is often implied as a matter of law in commercial contracts, even if the contract is silent as to those terms.[33] And for most customers – *i.e.*, those that make timely payments and are creditworthy – these changes will have no effect at all. Under these circumstances, the tariff revisions cannot be of the type that result in "surprise or hardship"[34] and thus are not material.

B. Even if the Changes Are Deemed Material, There Is "Substantial Cause" for the New Tariff Provisions

As an initial matter, it must be noted that the "substantial cause" test is not "an additional hurdle that [Verizon's] otherwise reasonable new tariff has to overcome." *Showtime Networks, Inc. v. FCC*, 932 F.2d 1, 6 (D.C. Cir. 1991) (citation and internal quotation marks omitted). Rather, it has a "limited role" as an "aid" in determining whether the changes meet the reasonableness test set out in 47 U.S.C. § 201. *See id.* Under this test, to determine whether the tariff revisions are reasonable, the Commission weighs both the "carrier's explanation of the factors necessitating the desired changes at that particular time," and the "position of the relying customer." *Hi-Tech Furnace Systems, Inc. v. FCC*, 224 F.3d 781, 791 (D.C. Cir. 2000) (*quoting RCA American Communications, Inc.*, 86 FCC 2d 1197, 1201 (1981)).

As set forth above, the current economic climate – which has shown an explosive growth in carrier uncollectibles – makes these changes absolutely essential. The changes

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33 *See, e.g.*, Restatement (Second) of Contracts § 251; UCC § 2-609(1).

34 UCC § 2-207, Official Comment 4 states that a modification to a contract is "material" if it would result in "surprise or hardship." Although the Commission does not have to follow this test, it has held that basic contract and commercial transactions law is "highly relevant" in examining whether contract terms are just and reasonable. *See Tariff Filing Requirements for Nondominant Common Carriers*, 10 FCC Rcd 13653, ¶ 14 (1995).

are specifically designed to provide certainty and, in many cases, allow the customer more flexibility than current provisions. Under these circumstances, Verizon has shown substantial cause for the tariff revisions. Answers to specific Bureau questions about term plan customers are set forth at Exhibit D and attachments thereto.

Conclusion

The Commission should permit Verizon's tariffs to become effective.

Respectfully submitted,

Ann H. Rakestraw

Michael E. Glover
Edward Shakin
Of Counsel

1515 North Courthouse Road
Suite 500
Arlington, VA 22201
(703) 351-3174

Attorney for the
Verizon telephone companies

October 29, 2002