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BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
The Verizon Telephone Companies	)	WC Docket No. 02-317
Tariff FCC Nos. 1, 11, 14 and 16	)	
Transmittal No. 226	)	

OPPOSITION TO DIRECT CASE

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OPPOSITION TO DIRECT CASE

Time Warner Telecom Corporation ("TWTC"), by its attorneys, hereby submits this Opposition to the Direct Case filed by Verizon on October 29, 2002 in the above-captioned proceeding.

I. Introduction and Summary

Transmittal No. 226 should be rejected because the relief sought therein is inconsistent with the rationale underlying price caps; the relief is unnecessary in light of Verizon's high interstate rate of return and relatively low rate of uncollectibles; and the criteria for imposing deposits and advance payments are vague and unreasonable,

II. Discussion

In Transmittal No. 226, Verizon seeks Commission approval for a fundamental change in the circumstances under which it may require that customers pay deposits as a condition of providing service. Verizon's current tariff states that it may require a customer to make a deposit where the customer has a proven history of late payment or does not have established credit. ***See*** Verizon Telephone Companies, Tariff FCC No. 1, Section 2.4.1(A) (tiled July 25, 2002). Under the revisions proposed in Transmittal No. 226, Verizon would he able to require a customer to pay a security deposit in the amount of approximately two months of charges or require advanced payment if one of six criteria *is* met. The six criteria are: (1) the 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 is subject to a receivership or bankruptcy proceeding; *(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 investment grade rating category by a nationally recognized statistical rating organization, and are put on review for a possible downgrade. *See* Verizon Transmittal No. 226, Tariff F.C.C. No. 1, § 2.4.1(A)(2). In addition, Verizon's existing tariff permits it to terminate service to a customer that fails to comply with its tariff (for example by failing to provide a deposit) upon 30 days notice. *Id.*, § 2.1.8(B). Transmittal No. 226 would shorten the notice period to just seven days. *Id.*

In its Designation Order,[1] the Commission observed that the existing tariff language regarding the terms and conditions under which Verizon may impose deposits reflects the Commission's prior attempt to balance the interests of dominant local exchange carriers in avoiding unnecessary exposure to uncollectibles and the interests of their customers in avoiding onerous payment terms. **A** great deal has changed since the existing tariff language first went into affect. The most important changes are (1) the establishment price cap regulation, a regime

[1] *The Verizon Telephone Companies Tariff Nos 1, 11, 14 and 16, Transmittal No.* 226, Order, WC Docket No. 02-317, DA 02-2522, (rel. Oct. 7, 2002) ("Designation Order").

designed to "mirror[] the efficiency incentives found in competitive markets;"[2] and (2) the passage of the Telecommunications Act of 1996 as well as other initiatives designed to lower the entry barriers for competitive provision of interstate exchange access services (among other services). The basic question in this proceeding is whether, in light of the overall regulatory regime applicable to Verizon's interstate access services as well as the current market circumstances, regulators should grant Verizon substantially increased protection from the consequences of the downturn in the telecommunications market.

Verizon's Direct Case offers no basis for concluding that the changes proposed in Transmittal No. 226 are warranted. In particular, Verizon has failed to address adequately many of the salient concerns raised by the Commission in the Designation Order. First, and most fundamentally, Verizon has failed to explain why it believes its rates under price caps do not adequately compensate it for the risk of uncollectibles. Designation Order ¶ 12. Verizon asserts that the telecommunications marketplace has experienced a much more significant growth in uncollectibles than other parts of the economy. Since this dynamic is not fully reflected in the inflation factor (GDP-PI) or the X Factor used to adjust the normal price cap formula, Verizon asserts that price cap rates do not adequately reflect its risk of uncollectibles and therefore leave Verizon under-compensated. Direct Case at 12.

This assertion is unconvincing. Verizon's request for special protection from the consequences of the turmoil in the telecommunications market essentially amounts to a request

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*See Policy and **Rules** Concerning Rates for Dominant **Curriers,*** Second Report and Order, 5 FCC Rcd 6786, ¶ ***33*** (1990) ("Price Cap Order") for a rate increase.[3] But price caps are not designed to allow a rate increase every time an ILEC experiences cost increases that are not fully reflected in the applicable annual cap adjustments. In fact, the price cap rules generally are designed to limit rate increases to circumstances where the ILEC qualifies for an exogenous cost increase or where price caps result in confiscatory rates (thereby justifying **a** low end adjustment or an above-cap rate adjustment).[4] Verizon has of course not sought relief under either theory, but the FCC's approach to such requests is highly instructive. To begin with, exogenous cost adjustments are permitted only for "costs that are triggered by administrative, legislative or judicial action beyond the control of the carriers." Price Cap Order ¶ 166. When the Commission first established the ILEC price cap regime, it refused to allow ILECs to make exogenous adjustments to account for "extraordinary" costs that result from such unforeseeable events as "natural disasters." *Id.* ¶ 189. The Commission reasoned that granting relief from such events would diminish the ILECs' incentives to plan their businesses efficiently by taking measures (such as retaining adequate capital reserves) that other companies take to protect against the consequences of unforeseen hardship. *Id* **As** the Commission explained, "a carrier's ability to cope with unforeseen events, yet remain competitive. is in part a function of its engineering. investment and operational decisions." *Id.* The Commission concluded that excluding extraordinary costs, even those that disproportionately affect telecommunications carriers, was necessary to "avoid creating the wrong incentives by reducing the carrier's need to be efficient." *Id.* The downturn in the

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1 That is, Veriron's request would **allow** it to avoid losses associated with credit risks. Avoiding such losses would increase Veriron's revenue in rhe same way that a rate increase would.

4 *See Price Cup Order* ¶¶ 166-190 (exogenous adjustments); ¶¶ 127, 147-149 (low end adjustment); ¶¶ 300-302 (above-cap filings).

telecommunications market is an example of exactly such an unforeseen hardship for which efficient companies must plan. The logic of the exogenous cost rules therefore mandates that the ILECs not be given special relief from increased uncollectibles.

Nor could Verizon possibly argue that the increased level of uncollectibles has resulted in rates that arc confiscatory or a rate of return that is unreasonably low in light of the risks it faces. For example, in 2001, Verizon's special access rate of return was 2 1.7% (37.08% excluding NYNEX).[5] Verizon's aggregate interstate rate of return exceeded 17 percent.[6] This level of profit more than compensates Verizon for the risks associated with operating in the competitive and somewhat unpredictable environment created by the 1996 Act.

Not only has Verizon continued to profit handsomely under price caps and competition, but there is simply no indication that Verizon's uncollectibles are significant when considered in the context of its overall revenues. Based on ARMIS reports, Verizon's uncollectible interstate revenues increased from 0.55 percent in 2000 to only 1.53 percent in 2001.[7] This rate of uncollectibles appears to be substantially lower than those faced by Verizon's competitors. For

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5 **See** AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange carrier Rates for Interstate Special Access Services, WC Docket 02-___ at 8 (filed October 15, 2002).

6 *See* WorldCom Petition to Reject Or, In The Alternative. Suspend And Investigate Verizon Transmittal No. 226 at 18 (tiled Aug. 1, 2002) ("WorldCom Petition to Reject") (citing Verizon ARMIS 43-01, col. h, lines 1910. 1915).

7 *See* Petition to Reject Or Suspend And Investigate Proposed Tariff Revisions, Verizon Transmittal No. 226, of the Association of Communications Enterprises, BayRing Communications, Business Telecom, Inc., DSL.net, ATX Communications, CTC Communications, Focal Communications, Level 3 Communications, PaeTec Communications, Pac-West Telecomm, US LEC Corp., at 18 (filed Aug. 1, 2002) ("ASCENT Petition to Reject").

instance, TWTC currently experiences approximately a 5 percent uncollectible rate from end users.[8]

Second, even if it were eligible for regulatory relief from current market conditions (which it is not), Verizon has failed to demonstrate how the standards for creditworthiness proposed in Transmittal No. 226 would meet the requirements that tariffs be clear and unambiguous. ***See*** Designation Order ¶¶ 19-20. The risk of vague and amorphous standards for imposing deposits is obviously that they leave Verizon with complete discretion to impose deposit requirements in a discriminatory manner, such as by selectively targeting its competitors. Verizon says it is using "objective" criteria for requiring deposits/advance payments, but it never explains how it determines when the criteria would be met. Verizon merely states that it 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." Direct Case at 6. Such an open ended approach cannot be permitted for a firm with Verizon's incentives to engage in anticompetitive behavior.

Indeed, there is no basis for concluding that the proposed criteria would effectively target only high risk customers. It is quite obvious that virtually every carrier that purchases interstate

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[8] While not dispositive, it is also notable that there is no basis for concluding that uncollectible amounts will remain even at those modest levels. Verizon itself states that the trend in growing uncollectibles will slow as the economy recovers. Direct case at 15. Indeed, the available evidence indicates instead that the relative increase in uncollectibles likely reflects the normal business cycle. **For** example, the Precursor Group recently concluded that there are "emerging signs of improving fundamentals within the telecommunications sector" and a "directional shift away from further fall in the debt spiral towards an improved solvency position for companies." Scott Cleland, ***Pulling out of the Debt Spiral? Beginnings of on Improving Telecom Sector,*** November 1, 2002. It appears the worst of the economic turmoil is over, and it would be odd in the extreme for the Commission to step in at the eleventh hour to come to the aid of profitable carriers.

access from Verizon would be subject to deposit and advance payment requirements under the criteria that link creditworthiness to a customer's (or its parent's) senior debt ratings.[9] Yet there does not appear to be any basis for concluding that all firms with senior debt below investment grade will fail to pay their bills (especially those of their most important supplier of inputs). Statistics published by Moody's Investor Service show that the rate of default among speculative grade debt issuers is approximately ten percent. It seems reasonable to conclude from this statistic that some of the carrier customers of Verizon's interstate access service with below investment grade debt are more stable than others. It would be arbitrary and unreasonable to adopt criteria that would impose deposit and advance payment obligations on the more stable customers when those deposit and advance payments are only needed for the carrier customers that are truly *in extremis*

This is especially true since Verizon makes no attempt to explain why the criteria it proposes are more accurate predictors of whether a customer will pay than the more narrowly tailored criterion currently in its tariff that relies on a customer's payment history. Indeed, while the existing criterion may not capture all carriers that will fail to pay for service in the future, it seems likely that it is more accurately targeted than criteria that would apply to virtually all carrier customers.[10]

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[9] In fact, with few exceptions, CLECs (excluding large incumbent IXCs) would have been subject to deposit and advance payment requirements based on these criteria since their very creation.

[10] WorldCom Petition to Reject at 11. Verizon has argued that there is in fact a correlation between a carrier customer's S&P credit rating and the extent to which the customer's bills are 90 days or more in arrears. *See* Direct Case at 11. It is doubtful that Verizon's survey in fact includes enough companies to form the basis for reliable conclusions. Rut putting this issue aside, Verizon's survey proves too much. It shows that it can identify high risk customers by relying on its existing criterion of a history of late payments.

Furthermore, while Verizon states that it seeks only the same protections that "firms in other industries" are free to pursue, those protections are unavailable as a practical matter to competitors like TWTC. TWTC provides competitive special access service via contract. It does not have an FCC special access tariff. In order to obtain the changes sought by Verizon in Transmittal No. 226, TWTC would need to seek its amend its existing customer contracts. There is simply no way that existing customers would agree to such changes. Yet there is every reason to believe that TWTC is as exposed, if not more exposed, to **risk** associated with carrier bankruptcies as Verizon. For example, TWTC's preliminary analysis indicates that it stands to lose more money (measured as a percentage of overall company revenue) due to unrecoverable debts WorldCom accumulated as of the time it filed for bankruptcy than either Verizon or SBC. Thus, Verizon's plea for regulatory protection from business risks would turn the logic of the 1996 Act on its head by allowing regulation to become the vehicle for preserving the handsome profits of the incumbents while further jeopardizing the stability of competitors.

Verizon states that it would not have the incentive to impose security deposit requirements on rivals because Verizon must pay interest on those deposits and advance payment calculations must be performed manually, and updated periodically, at considerable cost and burden to Verizon. **See** Direct **Case at** 24. This point is utterly unpersuasive. Verizon can largely cover the cost of interest by placing security deposit money in a secure interest-bearing investment vehicle and by reducing the magnitude of any shortfall by deducting it from its taxable income. In any event, any scheme to raise rivals' costs requires that the dominant firm incur some costs of its own. **See,** *e.g.*, Steven C. Salop and David T. Scheffman, *Raising Rivals' Costs*, 73 American Economic Review 267 (1983).

Third. Verizon's explanation as to how disputed amounts are treated under Transmittal No. 226 only confirms the unreasonableness of that proposal. ***See*** Designation Order ¶ 13. The criteria to which disputed amounts relate state only that Verizon may impose deposits or advance payments if the customer is in arrears in any two months out of any consecutive twelve month period or if the customer owes $250,000 or more to Verizon that is 30 days or more past due.[11] In its Direct Case, however, Verizon states that it would not deduct disputed amounts from amounts billed for purposes of determining whether a carrier has complied with a deadline. ***See*** Direct Case, Exhibit **A** at **A-19.** This approach is unreasonable because it would effectively force most, possibly all, significant purchasers of interstate access service either to make an advance payment/deposit or to **pay** disputed charges in advance (which amounts to essentially the same thing as making an advance payment or a deposit).

To understand why this is so, it is necessary to understand ILEC, and in particular Verizon's, billing practices. Verizon has repeatedly failed to provide TWTC and other carrier customers with accurate bills in the past.[12] More generally, since 2001, TWTC has successfully disputed approximately $13 million in ILEC bills. Moreover, given the complexity of the bills

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11 Veriron argues that these provisions merely clarify circumstances in which Verizon already has the right to impose security deposits under the existing tariff. *See* Direct Case, Exhibit A at A-2. This assertion is implausible. The current Verizon tariff language allows Verizon to impose deposit requirements on customers with a "proven history of late payments." A single incident in which a customer is late in paying a bill for access that exceeds $250,000 cannot reasonably he construed to constitute a proven history of late payments. Moreover, the fact that a customer may have "fallen in arrears" for two months in a 12 month period because of billing disputes should not reasonably be construed to constitute a proven history of late payments. No doubt Verizon itselfreached these same conclusions. Otherwise, there would have been **no** need for it to seek the addition of new tariff language that establishes these criteria as separate bases for requiring deposits.

12 *See* ASCENT Petition to Reject at 4-9 (describing errors in Verizon interstate access bills to CoreComm/ATX, CTC, and BayRing).

Verizon sends carriers **like** TWTC for special access, it often takes more than a month to determine whether the charges billed accurately match the services ordered. TWTC receives approximately 1,700 ILEC invoices every month, most of which are for special access and collocation. Each such invoice requires significant time and resources to review. For example, **a** typical BOC special access invoice is approximately 500 pages long. Given the inaccuracy and complexity of Verizon's bills, it is not uncommon for carriers to dispute amounts in excess of $250.000 or to take Longer than 30 days to review Verizon's bills for accuracy. Yet the criteria proposed in 'Transmittal No. 226 would mandate that a carrier in such a position pay in advance, either by making an advance payment/deposit (while withholding disputed amounts) or by paying for services that it did not order (thus avoiding deposit/advance payments). This is unreasonable because there is no apparent connection between the extent to which **a** customer carefully reviews its bills and raises legitimate concerns regarding those bills and the customer's ultimate willingness or ability to pay undisputed amounts.

This aspect of Transmittal No. 226 is especially unreasonable in light of the notice period proposed therein, which is also subject to the instant investigation. ***See*** Designation Order ¶ 27. **As** mentioned, under Transmittal No. 226, if a customer fails to comply with either the deposit or advance payment requirement, Verizon may, upon seven day's written notice, refuse additional applications for service, refuse to complete any pending orders for service, or discontinue service entirely. ***See*** Direct Case at 20. This shortened period for notice of termination or embargo is in general too short to give carriers the opportunity to obtain alternative carrier arrangements. But it is especially onerous when considered in connection with Verizon's stated intent to include disputed amounts for purposes of its deposit/advance payment criteria. Considered together, these two aspects of Transmittal No. 226 give Verizon the right to disconnect a customer that has not completed its review of or has not paid substantial disputed amounts under Verizon's complex, lengthy and chronically inaccurate access bills within 37 days unless the customer pays in advance (either by making a deposit/advance payment or by paying disputed amounts) Amazingly, the only argument Verizon offers in support of the shorter notice period in Transmittal No. 226 is that it would not normally use it. Direct Case at 22. But, if this is the case, there is no need for the shortened time period.

Finally, for all of the reasons explained herein, the changes proposed by Verizon fail to meet the "substantial cause" test. Under Commission precedent, which has now been discussed at length in the tariff proceedings addressing the various ILEC filings related to deposits and advance payments. a dominant carrier may not make a material change to tariff provisions governing long-term service arrangements absent "substantial cause."[13] As several parties have explained, the significant changes in the deposit, advance payment, and notice provisions contained in Transmittal No. 226 would result in a material change to just the type of long-term service arrangements to which the Commission has applied the substantial cause test. **See,** *e.g.*, WorldCom Petition to Reject at 15-16.

There should also be little question that Verizon lacks "substantial cause" for adopting the proposed changes. As the Commission has explained, customers have "legitimate expectations" that their long-term arrangements will remain stable and unchanged. **See** ***RCA American Communication*** ¶ 13. **A** carrier seeking to materially alter such long-term

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[13] *See HCA American Communications, Inc.*, Memorandum Opinion and Order, 86 FCC 2d 1197 (1981) ("*RCA American Communications*").

arrangements must therefore bear the burden of demonstrating that it has experienced unexpected changes that have resulted in losses so significant that the tariff revisions proposed outweigh the customers' legitimate expectations of stability in their long-term arrangements. Indeed, that burden should be especially heavy in this case, since Verizon has proposed highly over-inclusive protective measures. Those measures burden carrier customers that pose little or no threat to Verizon just as much as they burden higher risk carrier customers. Moreover, the proposed measures would be affirmatively harmful, as explained, because they would create an arbitrary competitive advantage for Verizon. When these very significant costs are compared with the relatively small cost that uncollectible interstate revenues have imposed on Verizon, it is clear that no substantial cause exists for adopting the proposed tariff changes

111. Conclusion

In sum, there is no basis for concluding that Transmittal No. 226 is lawful. There is also no basis for concluding that the existing criteria for requiring deposits are somehow inadequate. Veriron cannot be sheltered from every possible consequence of the current market turmoil. The proposed Verizon tariff provisions should not be allowed to go into effect.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 12th day of November, 2002, I served copies of the foregoing Opposition in WC Docket No. 02-317 electronically (*) or by first-class U.S. mail postage prepaid, or by hand on the following parties:

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