

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the matter of)	
)	
National Exchange Carrier Association, Inc.)	WC Docket No. 02-356
Tariff FCC No. 5, Transmittal No. 952)	
)	

**DIRECT CASE OF THE
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.**

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December 2, 2002

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DIRECT CASE

The National Exchange Carrier Association, Inc. (NECA) hereby submits its response to the issues set for investigation in the FCC's *Designation Order*¹ associated with NECA's Transmittal No. 952. Herein, NECA provides additional evidence that NECA's proposed tariff revisions are just and reasonable and should be permitted to take effect.

I. INTRODUCTION AND SUMMARY

NECA believes that the proposed tariff revisions are necessary to safeguard the pooling companies' interests going forward. Approval of these revisions will help provide the revenues necessary to achieve the authorized rate of return for the remainder of the 2002/2003 Test Period.

In this response to the *Designation Order*, NECA addresses each issue raised by the Commission and provides additional evidence that the proposed tariff changes are just and reasonable. NECA addresses each individual issue in detail below.

¹ National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 952, WC Docket No. 02-356, *Order*, DA 02-3100 (rel. November 8, 2002) (*Designation Order*).

Many of the issues raised by the Commission are similar or identical to those raised in the Commission's Designation Order on Transmittal No. 951² (*Customer Deposit Designation Order*). NECA filed its Direct Case on the *Customer Deposit Designation Order* on November 21 (*Customer Deposit Direct Case*). Where applicable, NECA refers to the *Customer Deposit Direct Case* included as Exhibit A.

II. ISSUES DESIGNATED FOR INVESTIGATION

A. Reasonableness of the Proposed Increased Allowance for Uncollectibles

The issue designated for investigation is whether the increased allowance for uncollectibles and the resulting increases in interstate access rates are just and reasonable within the meaning of section 201(b) of the Act.³ Below, NECA responds to the specific questions posed by the Commission related to this issue and demonstrates that its proposed increases in the interstate access charges are just and reasonable.

- 1. The increased security deposits proposed in Transmittal No. 951 appear to address the same risk as the proposed increase in traffic-sensitive and special access rates proposed in Transmittal No. 952 to reflect a higher allowance for uncollectibles. NECA shall address why both forms of relief are necessary, or what modifications to either form of relief could be made if the other proposed tariff revision were allowed to take effect.*

Both forms of relief are necessary and no modifications are necessary to either form of relief if the proposed tariff revisions are allowed to take effect. Please refer to the response to this identical issue addressed in the *Customer Deposit Direct Case*.⁴

- 2. As part of its direct case, NECA shall explain the derivation of the \$15 million*

² National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 951, WC Docket No. 02-340, *Order*, DA 02-2948 (rel. October 31, 2002) (*Transmittal 951 Designation Order*).

³ *Designation Order* at ¶1.

⁴ Exhibit A, *Customer Deposit Direct Case* at 3 (Issue No. 1).

projection of uncollectible interstate access revenues for the NECA traffic-sensitive pool for the current tariff period. NECA shall provide a quantitative economic analysis of uncollectible amounts from an historical perspective, as well as an analysis of current telecommunications market conditions. NECA shall provide all internal and external studies created or relied upon to make the estimates or evaluation of risk assessment. NECA should explain its analysis of the risk of default among its customers – is the \$15 million designed to cover the default of several smaller customers or one or two bigger ones? NECA should also address the factors that lead it to believe that \$15 million is the appropriate allowance for uncollectibles for the current tariff period. NECA shall, in particular, explain how the two bankruptcies it cites, Global Crossing and WorldCom, can provide a basis for determining any future uncollectible levels.

In response to Commission staff questions, prior to the *Designation Order*, NECA submitted a detailed description of the development of the \$15 million projection in uncollectibles.⁵ This response is attached as Exhibit B. The \$15 million cannot be attributed to any specific customers, or class of customers. It is based on a projected bankruptcy default rate for long distance carriers in general, and this default is then applied to projected carrier revenue.

3. *NECA shall also provide the totals of each of the individual defaults grouped into the following ranges: less than \$100,000; \$100,001-250,000; \$250,001-\$500,000; \$500,001-\$1,000,000; and more than \$1,000,000. For each range, NECA shall indicate the number of defaulting entities. NECA shall then address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks anticipated in the 11.25 percent authorized rate of return, or whether it reflects some long term trend that warrants increasing the allowance for uncollectibles in the calculation of NECA's interstate revenue requirement.*

NECA demonstrated in its *Customer Deposit Direct Case* that there has been a substantial increase in uncollectible revenue since the 1990s.⁶ Uncollectible revenues,

⁵ Letter to Marlene H. Dortch, Secretary, FCC from Regina McNeil, Director, NECA at Attachment 2 (October 11, 2002).

⁶ Exhibit A, *Customer Deposit Direct Case* at 4 (Issue No. 2).

which were relatively constant and predictable during the 1990s, have increased significantly. For 2002, they are about 1,000% higher than the levels experienced in 1998, and are expected to be over 2,300% higher once all companies have reported their uncollectibles to the pool.

In addition to demonstrating that there has been a significant increase in uncollectibles, NECA also provided evidence in its *Customer Deposit Direct Case* that indicates this trend is not just a normal business fluctuation primarily attributed to bankruptcy filings by Global Crossing Ltd. (Global Crossing) and WorldCom, Inc. (WorldCom), but a symptom of long-term financial weakness in the interstate access marketplace. NECA showed how all of the largest long-distance providers' financial positions have deteriorated recently, and referenced several independent economic reports as evidence of the trend. NECA provided this information in response to an issue raised in the *Customer Deposit Direct Case* on whether the risk of uncollectible debt has increased permanently.⁷

4. *NECA shall also indicate the total dollar amount of security deposits held by its carrier participants that are attributable to interstate access services and the percentage relationship of that amount to average monthly interstate access billings.*

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.⁸

5. *NECA shall provide the following data on the distribution of its revenues for*

⁷ *Id.* at 14-17 (Issue No. 14). Unlike Price Cap carriers, rate-of-return carriers target their rates to 11.25%, regardless of business fluctuations. Uncollectible revenues from tariff rates are required to represent what is expected. When uncollectibles revenues are low, a smaller proportion of the rates are attributable to the recovery of uncollectibles. When they are higher, rate-of-return carriers are permitted to increase their rates accordingly.

⁸ Exhibit A, *Customer Deposit Direct Case* at 7 (Issue No. 4).

calendar year 2001. NECA shall indicate the share of its revenues that come from each of the following types of customers: IXCs, competitive LECs, other incumbent LECs through arrangements such as meet-point billing, and businesses.

NECA does not have access to all the requested information for the over 1,000 companies that participate in its tariff, but can make some reasonable assumptions based on its 2001 Annual Filing support⁹ regarding shares of revenue from IXCs and businesses. For the 2001/2002 Test Period, there was \$1.518 billion in revenue associated with carriers (non-end-users) and end-user businesses.¹⁰ Of this amount, 17% (\$264 million) is from end-user businesses and 83% (\$1.254 billion) is from non-end users, including IXCs and CLECs. CLEC shares of switched access revenue are believed to be negligible because the UNEs they purchase are not part of access. A portion of the non-end user special access revenue may be attributable to CLECs. Because special access revenue data is not categorized by customer type, NECA cannot determine the exact share. Regarding revenue that is billed other incumbent LECs on behalf of pool members through arrangements such as meet-point billing, this would be included in the total revenues, but cannot be separately identified.

6. *NECA shall also indicate the extent to which carriers participating in the NECA tariff have a debtor relationship with their customers and how that may affect those carriers' credit risk, e.g., through offset in a bankruptcy proceeding.*

⁹ National Exchange Carrier Association, Inc., Transmittal No. 901, Volume 1 (June 18, 2001).

¹⁰ The only interstate access revenue not included in the \$1.5 billion is \$397 million from residential subscriber line charges.

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.¹¹

7. *Because uncollectibles can be affected by whether services are billed in advance or in arrears, NECA shall indicate which services in its interstate access tariff, including the subscriber line charge and other common line services, are billed in advance and those that are billed in arrears.*

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.¹²

8. *Indicate the percentage of interstate billings that are billed in advance, how this level has changed over the past five years, and how this change has affected the risk faced by carriers participating in the NECA tariff.*

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.¹³

9. *NECA shall also provide data covering the period from January 1, 2001, through June 30, 2002, on the percentage of revenues in default that are attributable to services billed in arrears and the percentage attributable to special access services.*

NECA estimates total uncollectibles for the period January 1, 2001 to June 30, 2002 will be approximately \$78 million. Of this amount, 90%, or \$70 million is billed in arrears. Special Access uncollectibles are approximately six percent of the total, or \$5 million.

10. *Using its current tariff provisions, NECA shall describe the number of days of billings that would be at risk when a NECA carrier terminates service for failure to pay for services that are billed in arrears and for services that are billed in advance.*

¹¹ Exhibit A, *Customer Deposit Direct Case* at 13 (Issue No. 12).

¹² *Id.* at 11 (Issue No. 10).

¹³ *Id.* at 12 (Issue No. 11).

Exhibit C shows a timeline illustrating a non-payment situation for both usage charges (billed in arrears) and non-usage charges (billed in advance). This timeline assumes the minimum times allowed by the existing tariff are followed to discontinue service for a non-payment situation involving a customer without a late history record. Using the minimum time allowed by the tariff to discontinue service, for charges billed in arrears, 97 days of outstanding charges would exist on the day service can be discontinued. For charges billed in advance, the number of days' worth of outstanding charges is reduced to 67 days. The timeline represents ideal situations. Negotiations between the access customer and telephone company can significantly increase the number of days of outstanding charges before a discontinuance occurs. Therefore, whether charges are billed in arrears or advance, there would be more than two months of outstanding charges in a non-payment situation.

11. NECA should indicate the amount of unpaid bills of defaulting customers that have gone into bankruptcy since January 2000 and the percentage of that amount that has been recovered through bankruptcy proceedings.

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.¹⁴

¹⁴ *Id.* at 14 (Issue No. 13).

12. *If NECA believes that the risk of uncollectible debts has increased permanently, it should explain what accounts for this change, e.g., the general economic climate or some structural change in the market. If the change is a structural one, are there methods other than the NECA proposal to increase the allowance for uncollectibles that would adequately address this additional risk, e.g., is there a subset of carriers that can be identified that are the major cause of the increased risk?*

NECA provided this information in response to an identical issue raised in the *Customer Deposit Direct Case*.¹⁵

13. *NECA should also discuss any other steps, other than those proposed in Transmittal Nos. 951 and 952, it might take to mitigate the risk. For example, could it adopt some form of advance payment for services currently billed in arrears and, if so, what modifications to its tariff and billing programs would be necessary? How difficult would it be to implement such changes?*

NECA provided this information in response to a similar issue raised in the *Customer Deposit Direct Case*.¹⁶

14. *Finally, we direct NECA to address whether there are means other than including an allowance for uncollectibles in its revenue requirement calculation that might address the concern that NECA might overearn because its realized rate of return would increase by the difference between the allowance and the amount of the actual uncollectibles if the uncollectibles do not occur.*

In response to Commission staff questions, prior to the Designation Order, NECA outlined two possible solutions to the uncollectible reimbursement issue that could be accomplished outside of the normal pool recovery process.¹⁷ Both depend on setting up an interest-bearing escrow account that would not be reflected in monthly pool reporting unless uncollectibles are incurred. This escrow account would be used to reimburse

¹⁵ *Id.* (Issue No. 14).

¹⁶ *Id.* at 17 (Issue No. 15).

¹⁷ Letter to Marlene H. Dortch, Secretary, FCC from Regina McNeil, Director, NECA (October 18, 2002).

uncollectibles to the extent funds are available. These proposals are described in Exhibit D.

15. We direct NECA to describe how the timing of reporting uncollectibles to the pool is handled, especially in light of the two-year window within which a participating LEC may file revised cost data with the pool.

For NECA pool settlement purposes, past due revenue is not classified as uncollectible until all reasonable collection efforts have been exhausted. A company only reports to the pool the realized uncollectible revenues that have been written off its books.¹⁸ The company then receives full reimbursement of the reported uncollectible from the pool. If revenue previously reported to the pool as uncollectible is subsequently collected, the original write-off entry is reversed. The recovered amount should then be recorded in the usual manner (i.e., debit “Cash” and credit “Accounts Receivable”). According to NECA’s pooling procedures, uncollectible revenue may be reported in the data month in which the write-off occurred.¹⁹

A company may report bankruptcy-related interstate access uncollectibles to the pool in the month these amounts are recorded on the company’s books as uncollectible. NECA pool companies still must take reasonable measures to collect revenues owed by access customers as permitted by law, including, at a minimum, filing a Proof-of-Claim or other similar documents necessary to register a claim with the bankruptcy court and/or the trustee. Any portion of bankruptcy-related uncollectibles that are subsequently

¹⁸ Companies charge Account 5300, Uncollectible Revenue, and credit Account 1171, Allowance for Doubtful Accounts.

¹⁹ Companies are also permitted to report the uncollectible in the month the corresponding billed revenue was reported to the pool.

collected (e.g., through court proceedings or settlement negotiations) must be reported to the pool as a deduction (i.e., report as a negative) to uncollectibles in the month collected.

16. NECA shall describe how it addresses defaults occurring before the effectiveness of any tariff to ensure that any tariff revisions are not designed to recover retroactively losses due to earlier nonpayment events (i.e., how does NECA avoid retroactive ratemaking?).

Prior to the bankruptcies of Global Crossing and WorldCom, defaults had no impact on ratemaking because they were *de minimis*.²⁰ Based on the recent bankruptcy experiences, and the deteriorated financial situation of all of the other large access customers, this is no longer true. NECA proposed in Transmittal No. 952 to revise its uncollectibles estimate to reflect additional uncollectible losses based on recent experiences with bankruptcies. These forecasts do not include losses from Global Crossing or WorldCom.

Tariff rate setting and pool recovery of uncollectibles are exclusive of one another: rates include a projected uncollectible component based on historical trends and proposed estimates, while the actual uncollectibles reported to the NECA pool are included in the earnings calculations (i.e., a reduction to pool rate of return). For ratemaking purposes prior to Transmittal No. 952, NECA projected the amount of revenues that it anticipated would ultimately be uncollectible resulting from the rates to be included in the tariff.

Transmittal No 952 represents a modification of the methodology used to develop uncollectibles reflected in prior tariff filings. In addition to an approach based on recent historical trends, NECA incorporated the financial uncertainty of the telecommunications

²⁰ See Exhibit A, *Customer Deposit Direct Case* at 4 (Issue No. 2) for uncollectible history.

industry into its uncollectibles estimate. NECA's methodology for projecting uncollectibles for tariff rate setting purposes, which has been typically based on historical uncollectible levels, was revised to exclude the bankruptcy-related amounts that have already occurred and to include projections of future bankruptcy claims.

III. CONCLUSION

In this *Direct Case*, NECA demonstrates that its proposed tariff revisions are reasonable. NECA has provided sufficient cost support for its proposed rate increases and satisfied the requirements of 61.38 of the Commission's rules. These revisions are necessary for NECA to maintain the authorized rate of return for the remainder of the current July 1, 2002 through June 30, 2003, tariff Test Period. The Commission should find that the proposed tariff revisions are just and reasonable and should be permitted to take effect.

Respectfully submitted,

NATIONAL EXCHANGE CARRIER
ASSOCIATION, INC.

By: /s/ Richard A. Askoff
Richard A. Askoff
Its Attorney

December 2, 2002

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the Direct Case was served on this 2nd day of December 2002 by electronic delivery and by first-class mail to the persons listed below.

By : /s/ Shawn O'Brien
Shawn O'Brien

The following parties were served:

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NECA DIRECT CASE

WC DOCKET NO. 02-356

EXHIBIT A

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the matter of)	
)	
National Exchange Carrier Association, Inc.)	WC Docket No. 02-340
Tariff FCC No. 5, Transmittal No. 951)	
)	

**DIRECT CASE OF THE
NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.**

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November 21, 2002

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Exhibit C	Access Bill Timeline
Exhibit D	Document 1: "Distressed Assets Could Pose a Threat to IXCs" Document 2: "Telecom's Debt Spiral: Why Some Will Survive – The Game Will Change" NECA Transmittal No. 952 Support

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

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National Exchange Carrier Association, Inc.)	WC Docket No. 02-340
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DIRECT CASE

The National Exchange Carrier Association, Inc. (NECA), hereby submits its response to the issues set for investigation in the FCC's *Designation Order*¹ associated with NECA's Transmittal No. 951. Herein, NECA provides additional evidence that NECA's proposed tariff revisions are just and reasonable and should be permitted to take effect.

I. INTRODUCTION AND SUMMARY

NECA believes that its proposed tariff revisions, aimed at addressing the risks associated with customers who are likely to default on their payments, are warranted, objective, and clearly defined. They are targeted to address those instances posing the most significant risk of loss to the NECA pooling companies participating in NECA Tariff FCC No. 5.

¹ National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 951, WC Docket No. 02-340, *Order*, DA 02-2948 (released October 31, 2002) (*Designation Order*).

In this response to the *Designation Order*, NECA addresses each issue raised by the Commission and provides additional evidence that the proposed tariff changes are just and reasonable. The telecommunications market has changed and NECA is merely conforming its tariff to this changed market. NECA addresses each individual issue in detail below.

Many of the issues raised by the Commission relate to billing practices. Since NECA only files tariffs on behalf of its pooling companies and does not do the actual billing or provisioning of interstate access service, NECA requested its tariff participating companies to assist NECA in meeting the requirements of the *Designation Order*. The NECA Common Line (CL) and Traffic Sensitive (TS) pools are comprised of over 1,000 telephone companies. To develop characteristics representative of these pools and to facilitate the gathering of billing information, the Rate Development Task Force (RDTF)² consisting of selected tariff participants was utilized. RDTF participants were asked to complete a customer deposit data request (CDDR). The thirty-five respondents completing the CDDR represent approximately one-third of the access lines in the CL pool. This CDDR is included as Exhibit A.

II. ISSUES DESIGNATED FOR INVESTIGATION

A. Basis for Requiring a Deposit from a Customer

The first issue for investigation is whether NECA's proposed security deposit revisions are reasonable and not so vague as to permit carriers participating in the NECA

² The RDTF assists NECA in a number of special studies required for tariff filings. See NECA Transmittal No. 939 at Volume 5, Section 1, page 1, (June 17, 2002), describing the RDTF. See Exhibit 1 of that same volume for a list of NECA Rate Development Task Force participants.

tariff to discriminate unreasonably among their interstate access customers. Below, NECA responds to the specific questions posed by the Commission related to this issue and demonstrates that its tariff revisions are reasonable, clear, and do not permit a carrier participating in the NECA tariff to discriminate among its interstate access customers.

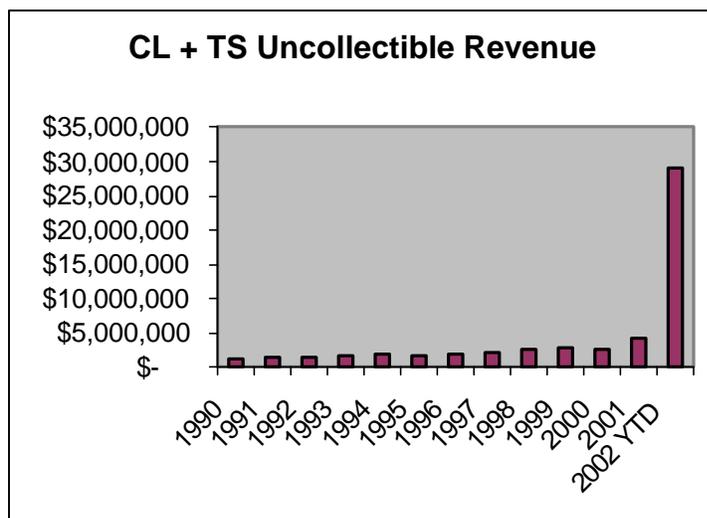
- 1. The increased security deposits proposed in Transmittal No. 951 appear to address the same risk as the proposed increase in traffic-sensitive and special access rates proposed in Transmittal No. 952 to reflect a higher allowance for uncollectibles. NECA shall address why both forms of relief are necessary, or what modifications to either form of relief could be made if the other proposed tariff revision were allowed to take effect.*

Transmittal No. 951 proposes longer-term solutions to reduce the amount of uncollectible revenue for NECA pooling companies. Its focus is on identifying specific customers that are likely to default and requiring deposits from them to help limit losses from nonpayment. Transmittal No. 952, on the other hand, addresses an unexpected shortfall in the uncollectible reserve for the current Test Period beginning July 1, 2002 to June 30, 2003. Even with the additional safeguards requested in Transmittal No. 951 for securing deposits, NECA projects uncollectible revenues of \$15 million greater than the amount originally included in the current Test Period. Furthermore, as will be shown in the responses below to the specific issues in the *Designation Order*, the ability to demand deposits from customers deemed to have high credit risks and the shortening of notice periods do not eliminate uncollectibles but only reduce the amount that may otherwise occur.

- 2. NECA shall explain why it believes its rates do not adequately compensate its carrier participants for the risk of uncollectibles. NECA is directed to submit the level of uncollectible debts from interstate access services and the actual return on investment for the years 1990 to the present.*

The table and chart below display reported uncollectible revenue for the period 1990 through October of 2002 for the Common Line (CL) and Traffic Sensitive (TS) Pools. The data demonstrate that the level of uncollectible revenue has increased dramatically beginning in 2001, and the sharp spike in 2002 clearly shows that the relatively steady, slow, and predictable growth in uncollectibles that existed during the 1990s no longer reflects the profound increase in risk associated with interexchange carrier accounts.

NECA Pool Uncollectible Revenue		
Year	CL	TS
1990	\$988,915	\$275,175
1991	\$1,160,037	\$375,678
1992	\$1,252,109	\$341,955
1993	\$1,430,625	\$171,932
1994	\$1,575,792	\$315,867
1995	\$1,657,761	\$139,694
1996	\$1,807,360	\$97,984
1997	\$1,973,747	\$110,048
1998	\$2,377,962	\$247,517
1999	\$2,829,865	\$158,341
2000	\$2,369,405	\$303,769
2001	\$3,444,427	\$905,122
2002 YTD	\$11,946,519	\$17,131,802



The picture would look far bleaker in 2002 if all of NECA's pooling companies had reported their expected losses to the pool. NECA's experiences with Global Crossing Ltd. (Global Crossing) demonstrated that the bulk of uncollectibles are reported to the pool months after proof of claims are filed. For WorldCom, Inc. (WorldCom), this would mean that the bulk of uncollectibles are yet to be reported. NECA estimates the total CL and TS uncollectible revenue for 2002 will be greater than \$70 million for

WorldCom and Global Crossing alone, when all companies have fully reported.³ Tariff changes are needed to mitigate the impact on telephone companies and on their customers that pay their bills on time.

Historical rates of return shown in the following table do not reflect this new and highly risky environment.

Return on Investment		
	CL	TS
1990	11.54%	11.35%
1991	12.00%	10.83%
1992	13.29%	13.39%
1993	12.60%	13.74%
1994	11.01%	12.06%
1995	9.73%	11.98%
1996	10.42%	12.12%
1997	10.83%	11.85%
1998	11.39%	14.05%
1999	10.98%	12.49%
2000	11.72%	11.37%
2001	11.70%	12.80%

The 2001 return data are still preliminary and subject to true-ups that will reduce the return levels. Returns in 2002 are expected to be considerably below historical levels because the defaults of Global Crossing and WorldCom were not anticipated.

3. *For the period from January 2000 to July 31, 2002, NECA shall also provide the totals of each of the individual defaults grouped into the following ranges: less than \$250,000; \$250,001-\$500,000; \$500,001-\$1,000,000; and more than \$1,000,000. For each range, NECA shall indicate the number of defaulting entities. NECA shall then address whether the variation in uncollectible levels for 2000 and 2001 is merely a normal fluctuation in uncollectibles, which would be covered by the business risks anticipated in the 11.25 percent authorized rate of return, or whether it reflects some long term trend that warrants expanded security deposits from customers meeting NECA's proposed standards.*

³ Exhibit B shows the methodology used by NECA to estimate the uncollectibles caused by the bankruptcies of Global Crossing and WorldCom.

NECA files Tariff FCC No. 5 on behalf of more than 1,000 companies. Since each company has its own accounting system, billing cycles, and methods for tracking customer accounts, collecting this level of detail from the NECA pooling companies and analyzing the results in the three weeks NECA was provided to respond to this data request were not possible. Nevertheless, based on the uncollectible revenues shown in the table above for Issue No. 2, where the highest annual TS uncollectible revenue between 1999 and 2000 was \$375,678, it is extremely unlikely that there were any individual carrier customers with uncollectible revenue greater than \$250 thousand during this period. The CL uncollectible revenue prior to 2002 was composed mostly of end user uncollectible revenue and would be even more difficult to group into the defined default categories.

However, nothing experienced during the period from 1990 to 2001 would come close to matching the uncollectible revenues experienced thus far in 2002. NECA estimates that the total impact for 2002 of the Global Crossing bankruptcy on interstate access revenue will be about \$14 million, while for WorldCom the amount will be about \$60 million.⁴

NECA does not believe this is just a normal fluctuation in the uncollectibles. Uncollectibles for 2002 far exceed any prior year. As will be discussed below in response to Issue No. 14 of this section, the financial weakness of the telecommunications sector is pervasive, and there are several other companies still teetering on the brink of bankruptcy.

⁴ *Id.*

4. *NECA shall also indicate the total dollar amount of security deposits held by its carrier participants that are attributable to interstate access services and the percentage relationship of that amount to average monthly interstate access billings. The changes in the security deposit provisions of NECA's interstate access tariff would increase customer-supplied funding as well as reduce the exposure of carriers participating in the NECA tariff to defaults. NECA should accordingly address what modifications should be made to its authorized rate of return to account for these changes to the capital and risk parameters.*

NECA asked RDTF members to identify two types of interstate security deposits: those held for end user customers and those held for carrier customers. Most companies indicated that they do not keep separate records on end user security deposits that are solely attributable to interstate access services. Security deposits are typically based on the total end user bill, including local services and end user access services. Therefore, in determining the interstate portion of the end user security deposits, most companies developed a factor equal to the interstate end user revenue divided by total end user revenue and applied this factor to their total end user security deposits. Interstate security deposits for carriers were generally available. Responses to the CDDR identified \$218 thousand in interstate end user security deposits and \$13 thousand in interstate carrier security deposits currently being held for the responding companies. Based on these representative data, NECA estimates the total pool security deposits are \$600 thousand for end user customers and \$40 thousand for carrier customers.

The low security deposits from carriers indicate most companies have not requested security deposits from their carrier customers. As evidenced by the relatively low amounts of carrier uncollectible revenue reported to the pool between 1990 and 2001, carrier customers did not generally have histories of late payments, which under

the current tariff provisions is the only reason a telephone company may require a deposit from an existing customer.

No changes should be made in the authorized rate of return to account for changes in tariff deposit policy provisions. In 2002, telephone companies have watched the credit ratings of most of their largest access customers fall to either junk bond status, or just above it. The impact of the bankruptcies of just two of these customers⁵ have caused shortfalls in interstate access charges alone that are estimated in excess of \$70 million. Telephone companies are facing greater financial risks than at any period since 1984, when access charges were introduced. The measures proposed in Transmittal No. 951 will not eliminate risk but merely reduce risk to more manageable levels. In addition, the changes in capital will be reflected in the pooling companies' rate bases and any additional earnings on this capital will be totally offset by the deposit interest paid by the telephone companies to their customers on held deposits.

5. *NECA should describe the billing and collection procedures used by carriers participating in the NECA tariff and explain any changes in those billing and collection procedures or the accounting treatment of disputed amounts on bills within the past two years that could have affected the levels of uncollectibles.*

All RDTF sample companies indicated they follow the billing and collection procedures described in the NECA tariff, including sending certified letters and working with customers on outstanding and disputed amounts. There were thirty-five respondents completing the NECA CDDR, representing about 4.4 million access lines, or approximately 1/3 of the access lines in the Common Line pool. Several of these companies indicated that, based on the current financial conditions of their largest access

customers, they have instituted increased reviews of their customer accounts resulting in timelier notices to customers that have been delinquent in bill payments.

6. *NECA shall, to the extent it has the data, indicate the average length of time from the bill date until the bill is sent to the carrier customer and what percentage of those bills, by number of entities and by billed amount, is sent electronically.*

Twenty-six of the thirty-five respondents to the CDDR indicated the average length of time from bill date until the bill is sent is five days or less. No company took longer than eleven days to send the bill. Twenty-three of the respondents do not have any electronic billing. Of the twelve companies that have electronic billing, these companies had from five to fifty percent of their bills sent electronically and from ten to sixty-nine percent of their billed amount sent electronically. Based on these representative data, NECA estimates the total pool would have about 700 of its 1062 participating companies not performing any electronic billing.

7. *NECA shall provide the Commission, to the extent it has the data, with the number of customers that have been sent non-payment, discontinuance of service, or refusal of new orders letters in the past year and the average length of time from a bill's being delinquent until the letter was sent.*

The respondents to the CDDR indicated about 3379 letters of non-payment had been sent, and the average length of time from a bill being delinquent until the letter was sent was 69 days.⁶ For discontinuance of service, there were 409 letters, and the average length of time to send the letter from the time a bill was delinquent was 16 days. For refusal of new orders, there were 190 letters and the average letter was sent 13 days after

⁵ Global Crossing and WorldCom.

⁶ Several companies indicated they were reviewing their customer payment procedures to improve the timeliness of the notices.

the time of the delinquent bill. Based on these representative data, NECA estimates the total pool would have 9600, 1160, and 540 letters sent for non-payment, discontinuance of service, and refusal of new orders in the past year, respectively.

8. *NECA shall provide the Commission with the percent of carrier bills disputed, the percent of carrier-billed revenues disputed, and the percentage of the disputed amounts that were successfully disputed by the carrier for billing periods beginning with January 2000 to the present.*

Of the thirty-five respondents to the CDDR, fifteen had no disputed carrier bills, and the remaining companies had five percent or less of their bills under dispute. All companies indicated the disputed amounts represented five percent or less of the total billed charges. Regarding disputed amounts that were successfully disputed, twenty-four companies said zero percent, nine had less than ten percent, and two had amounts that were over ten percent.

9. *NECA should also indicate if its carrier participants deduct disputed amounts from amounts billed for purposes of determining whether a carrier has complied with a deadline.*

Twenty-four of the respondents indicated they would deduct disputed amounts from billed amounts for purposes of determining whether a carrier has complied with a payment deadline. Nine responded that they do not deduct disputed amounts. Finally, the remaining two respondents stated the question was not applicable because they did not have any disputed amounts.

10. NECA shall indicate which services in its interstate access tariff, including the subscriber line charge and other common line services, are billed in advance and those that are billed in arrears.

The table below lists the tariff services billed in advance and arrears.

NECA Tariff FCC No. 5 Interstate Access Services
Billed in Advance and Arrears⁷

<u>Service</u>	<u>Billed in Advance</u> ⁸	<u>Billed in Arrears</u>
Carrier Common Line		Usage based charges
End User Common Line	Monthly recurring charges	
Federal Universal Service Charge	Monthly recurring charges	
ISDN Line Ports	Monthly recurring charges	
Switched & Directory Assistance Access Services	Monthly recurring charges	Usage based, installation and nonrecurring charges
Special Access Services	Monthly recurring charges	Installation and nonrecurring charges
Public Packet Data Network Services	Monthly recurring charges	Installation and nonrecurring charges
Digital Subscriber Line Access Services	Monthly recurring charges	Installation and nonrecurring charges
Miscellaneous Services	Monthly recurring charges	Installation and nonrecurring charges

11. Indicate the percentage of interstate billings that are billed in advance, how this level has changed over the past five years, and how this change has affected the risk carriers participating in the NECA tariff face. In this connection, NECA should discuss whether different security deposit provisions should apply depending upon whether the service is billed in advance or billed in arrears.

⁷ Excludes consideration of partial month prorating of monthly recurring charges for installation or removal of service during the billing cycle.

⁸ Except for services billed to the Federal Government, which are always billed in arrears. See NECA Tariff FCC No. 5, Section 2.4.1(B).

The table below displays the revenue billed in advance and arrears and the percent of revenue that is billed in advance.

Total CL + TS Pools			
Year	Advance	Arrears	% Advance
1998	\$511,089,937	\$870,374,398	37%
1999	\$588,354,325	\$929,267,400	39%
2000	\$665,564,547	\$1,012,075,876	40%
2001	\$782,252,219	\$1,076,664,580	42%
2002	\$1,223,194,865 ⁹	\$455,720,479	73%

While the table shows a significant shift over time from revenue billed in arrears to revenue billed in advance, there is still a substantial amount of revenue associated with billing in arrears. Most carrier revenue, including over 90% of switched access revenue, is still billed in arrears. The majority of the 2002 \$1.2 billion in revenue billed in advance is from subscriber line charge revenue. Moreover, “billing in advance” does not eliminate the risk of non-payment, it only reduces the maximum number of outstanding days a customer could be in default. Even for services that are billed in advance, the actual payment is not due from the customer until after the service has been rendered.

Exhibit C shows a timeline illustrating a non-payment situation for both usage charges (billed in arrears) and non-usage charges (billed in advance). This timeline assumes the minimum times allowed by the existing tariff are followed to discontinue service for a non-payment situation involving a customer without a late history record. Using the minimum time allowed by the tariff to discontinue service, for charges billed in arrears, 97 days of outstanding charges would exist on the day service can be

⁹ The total revenue billed in advance for carrier and special access customers is only \$320 million.

discontinued. For charges billed in advance, the number of days worth of outstanding charges is reduced to 67 days. The timeline represents ideal situations and negotiations between the access customer and telephone company can significantly increase the number of days of outstanding charges before a discontinuance occurs. Therefore, whether charges are billed in arrears or advance, there would be more than two months of outstanding charges in a non-payment situation. Applying NECA's assumed 11% default rate¹⁰ to the current Test Period's CCL, TS Switched, and TS Special revenue yields \$20 million in potential losses from uncollectibles. This is a measure of substantial risk still overhanging NECA's pool members despite the shift toward advanced billing of access services. Requiring a two-month deposit for either type of billing is justified and reasonable. If anything, the deposit on charges billed in arrears could be increased from the current two months to three months of billing if NECA were attempting to eliminate most risk.

12. NECA shall also discuss the extent to which carriers participating in the NECA tariff have a debtor relationship with their customers and how that may affect those carriers' credit risk.

The CDDR results indicated twenty-one of the thirty-five respondents had debtor relationships with their customers. The remaining fourteen had no debtor relationships with their customers. The companies' responses on how the debtor relationship may affect their own credit risk were varied but generally indicated the relationship does not impact the credit risk.

13. NECA should indicate the amount of unpaid bills of defaulting customers that have gone into bankruptcy since January 2000 and the percentage of that

¹⁰ The development of the \$15 million in Test Period uncollectible traffic sensitive revenue and an explanation on the 11% default rate are displayed in Exhibit B.

amount that has been recovered through bankruptcy proceedings.

For the CDDR respondents, defaulting carriers that have gone into bankruptcy since January 2000 had \$54 million in unpaid bills. The amount from end users was \$355 thousand. Twenty-six of the respondents said that zero percent has been recovered to date through the bankruptcy proceedings, six recovered less than five percent, one recovered five to ten percent, and two recovered amounts in excess of ten percent. Based on these representative data, NECA estimates all of its tariff participants would have about \$150 million¹¹ from defaulting carriers and \$1.0 million from defaulting end users.

14. If NECA believes that the risk of uncollectible debts has increased permanently, it should explain what accounts for this change, e.g., the general economic climate or some structural change in the market. If the change is a structural one, are there methods other than the NECA proposal that would adequately address this additional risk, e.g., is there a subset of carriers that can be identified that are the major cause of the increased risk?

NECA believes the risk of uncollectibles has increased permanently with respect to interstate access services. Access customers are experiencing decreasing demand for interstate switched access, decreasing long distance revenue, and have been impacted by the general downturn of the economy, particularly in telecommunications. While the general economy may recover, the embedded IXCs in the traditional long distance market will continue to face lower profit margins and decreasing revenue caused by the intense competition they face from cellular carriers, Voice-Over-IP networks, and from RBOCs entering the long distance market.

¹¹ The \$150 million includes defaults from CL pool members that file their own TS tariffs, so it is not directly comparable to the estimate provided by NECA of over \$70 million in defaults for the CL and TS pool. However, it does illustrate that the \$70 million is a conservative estimate.

Financial experts in the measurement of financial risk have clearly noticed this change. For example, Merrill Lynch has this projection for AT&T:

We expect AT&T's 3Q consumer revenues to fall 24.0% YoY on our estimates, contributing to the lowest estimated EBITDA margin among the large cap telecoms, at 26.8%. We estimate total revenues to be \$12.0B, down 7.2% YoY, and EBITDA to be \$10.9B, down 1.8% YoY.¹²

Further support for the deteriorating position of IXC's in today's market is contained in two documents, included in Exhibit D, which discuss the current financial problems plaguing the telecommunications industry.

The first document, "Distressed Assets Could Pose a Threat to IXC's"¹³ shows how the reduced value of the assets of companies that have gone bankrupt in 2001 and 2002 may negatively impact the current IXC's as the newly reformed emerging IXC's are able to "significantly underprice the commodity long-haul transport market." This will put further pressure on IXC prices, margins, and cash flow and continue the downward spiral.

The second document, "Telecom's Debt Spiral: Why Some Will Survive—The Game Will Change"¹⁴ demonstrates how many telecommunications companies are clearly at risk of bankruptcy and how this situation has significantly deteriorated from the first quarter to the second quarter of 2002.

¹² Adam Quinton, Merrill Lynch, The Telecommunicator, *Telecom 2002: Nightmare on Wall Street*, at 2 (October 21, 2002).

¹³ Daniel Hanover and Melanie Swan, RHK Telecommunications Industry Analysis, *Distressed Assets Could Pose a Threat to IXC's*, <<http://www.rhk.com/pressrelease.asp?id=367>>.

¹⁴ Scott Cleland, Precursor Group, *Telecom's Debt Spiral: Why Some Will Survive- The Game Will Change* (September 5, 2002).

In addition to the above evidence of a deeply troubled telecommunications economy, NECA submitted in its Transmittal No. 952 a list of the largest access customers and how the financial credit ratings have recently decreased for every customer. The supporting information filed for that Transmittal is also reproduced in Exhibit D.

NECA believes its proposed changes in deposit regulations are targeted to the subset of customers that are the major cause of increased risk. In its *Reply Comments*,¹⁵ NECA stated that a “Moody's Investor Service report shows that ‘over 90% of all rated companies that have defaulted since 1983 were rated Ba3 or lower at the beginning of the year in which they defaulted.’ The Moody’s Ba rating is equivalent to the S&P rating of BB, the proposed trigger for which a customer deposit may be required.” In addition, in this same reply, NECA also referenced a Verizon Communications Inc. (Verizon) study¹⁶ that demonstrated a clear correlation between Standard & Poor’s (S&P) credit ratings and customers with outstanding receivables for 90 days or more.¹⁷ Requiring deposits from financially troubled access customers is not unreasonable and targets the major cause of increased risk.

Unless incumbent local exchange carriers (ILECs) are given increased latitude to lessen the impact of the business failures of their customers, such as being able to request

¹⁵ See National Exchange Carrier Association, Inc., Tariff FCC No. 5, Transmittal No. 951, *Reply to Petitions* (Sept. 3, 2002) (*Reply Comments*).

¹⁶ *Id.* at 4.

¹⁷ Since NECA’s tariff represents over 1,000 companies, with many different type of customer account systems, gathering this type of customer information contained in the Verizon report would be too difficult for the NECA companies. However, the Verizon report should be indicative of ILECs in general.

adequate assurance of payment or promptly terminate service to non-paying customers, the uncollectible problem will continue unchecked for ILECs. In addition, in that uncollectibles become an increasing component of the interstate revenue requirement, it will force access customers with good payment histories and in sound financial condition to pay for costs caused by those riskier access customers.

15. Alternatively, is there some means of accelerated billing that could, if there were a nonpayment, trigger the existing security deposit provisions and thus offer some additional protection to carriers participating in the NECA tariff? NECA should also discuss any other steps, other than requiring additional security deposits, it might take to mitigate the risk. For example, could it adopt some form of advance payment for services currently billed in arrears and, if so, what modifications to its tariff and billing programs would be necessary? How difficult would such changes be to implement? NECA's tariff revisions increasing the security deposits would impose additional costs on carriers that may also be competitors of carriers participating in the NECA tariff at a time when access to capital markets is extremely limited. This could adversely affect the competitiveness of telecommunications markets. Thus, if some measures are necessary, an approach that has the fewest adverse effects on the competitive market while protecting the interests of carriers participating in the NECA tariff would be preferred.

NECA believes its tariff proposals strike the best balance between protecting its pooling companies from defaulting customers without over burdening them. Prior to filing Transmittal No. 951, NECA evaluated several alternatives, both internally and with its pooling companies. Regarding advance payment, several companies indicated their billing systems were not capable of rendering these types of bills.¹⁸ Other pooling companies said they would be able to do advance billing with only minor modifications to their systems. NECA is willing to consider advance payments as an option for

¹⁸ Modifying billing systems for advance billing can be complex depending on the system. The changes include, averaging the previous three months of customer bills, true-ups of the actual billing month to the previous estimate, and adjusting for rate changes.

companies with the capability to perform this type of billing; however, it believes the remedies proposed in Transmittal No. 951 would best meet the needs of all small rural companies participating in NECA's Tariff FCC No. 5.

16. NECA's proposed security deposit revisions also raise questions about whether they are sufficiently clear and unambiguous to preclude discriminatory or anticompetitive application. Section 61.54(j) of the Commission's rules provides that "[t]he general rules (including definitions), regulations, exceptions, and conditions which govern the tariff must be stated clearly and definitely." Presently, Section 2.4.1(A) of the tariff allows NECA to obtain a deposit for a period of no more than two months estimated billings. Proposed Section 2.4.1(A)(1) would allow NECA to obtain a deposit for new service for a two month period due to a customer's late payments or lack of established credit. In addition, proposed Section 2.4.1(A)(2) would allow NECA to obtain a deposit or an additional deposit after service is established for no more than two months actual billings based on an average of the customer's most recent three months billing. How does the proposed Section 2.4.1(A)(1) work with the proposed Section 2.4.1(A)(2)? Could NECA collect more than two months' deposit?

The total amount of the deposit from proposed Section 2.4.1(A)(1) plus Section 2.4.1(A)(2) cannot exceed two months. NECA would not object to modifying its proposed tariff regulations to further clarify this if the Commission deems it necessary.

17. The revisions in proposed Section 2.4.1(A)(2) state that, "[a] deposit or an additional deposit may be required from a customer at any time following establishment of service when...." The term "may" gives NECA considerable discretion to enforce these provisions. Without definitive criteria in the tariff, what would prevent NECA companies from collecting a deposit from one customer and nothing from another customer given that both meet one of the criteria for deposits?

The proposed language is similar to other tariff provisions that have been in effect for years. For example, in the current tariff at Section 2.1.8(A), it states:

[T]he Telephone Company may, on thirty (30) days written notice to the customer by Certified U.S. Mail, take the following actions:

- refuse additional applications for service and/or refuse to complete any pending orders for service, and/or

- discontinue the provision of service to the customer.¹⁹

Although the “may” language in this provision has existed in the tariff since 1985, NECA is not aware of any customer complaint alleging disparate application of the tariff. Each NECA company is expected to apply the tariff regulations consistently to all of its access customers in compliance with FCC rules. Over 1,000 ILECs participate in NECA Tariff FCC No. 5, and as such, some flexibility is necessary for the individual company to allow it to adapt the tariff to its individual business practices.

18. Proposed Section 2.4.1(A)(2) defines the type of funds for a deposit as “U.S. Federal Reserve Bank wire transfers, U.S. Federal Reserve notes (i.e., paper cash), and/or U.S. Postal Money Orders.” Many customers may not be able to make these types of payments, but would be able to obtain irrevocable letters of credit from a financial institution. NECA should explain why it limited the type of funds it would accept for a deposit. Why would an irrevocable letter of credit from a financial institution be unacceptable for a deposit?

While irrevocable letters of credit from financial institutions may be more easily obtainable for customer transactions with larger ILECs, such as Verizon or SBC, NECA does not believe this would be practical for the over 1,000 companies participating in its tariff. However, NECA has no objection to adding irrevocable letters of credit from a financial institution as an acceptable type of payment, if the Commission deems it necessary.

19. NECA’s proposed tariff revisions provide that a security deposit may be required when the company becomes aware that the customer’s credit worthiness is below a commercially acceptable level. A commercially acceptable level of credit worthiness for a customer or its parent company is defined as having a corporate debt securities rating with respect to any outstanding general debt obligations of at least BBB according to Standard and Poor’s or an equivalent rating from other debt rating agencies. For a

¹⁹ NECA Tariff FCC No. 5, Section 2.1.8(A) (emphasis added).

customer that does not issue debt securities, a commercially acceptable credit worthiness is defined as having a composite credit appraisal rating published by Dun & Bradstreet of at least "good" or a Paydex score as published by Dun & Bradstreet of at least "average." NECA has not shown that these factors are valid predictors of the likelihood of a customer paying its access bill, or that they are better predictors of whether a customer will pay its bills in the future than the customer's past payment history. As part of its direct case, NECA shall explain how each of these factors is a valid predictor of whether the carrier will pay its interstate access bill. NECA shall also explain how the provisions can be applied in a manner that will not produce arbitrary and/or discriminatory results.

The issue should not be whether late payment histories or financial debt ratings are better predictors of the likelihood of a customer paying its access bill. Both are necessary. The existing security deposit provisions are inadequate because they fail to protect the telephone company in instances where a customer with a prompt payment history suddenly ceases to pay its bill two or three months prior to filing for bankruptcy. When a customer receives a credit rating that is below commercially acceptable standards, it is indicative that the company's financial situation has changed and a past history of good payments is no longer a good predictor of future payment.

NECA's proposed revision does target those companies that are most likely to default. Over 90% of all rated companies that have defaulted since 1983 would have received ratings of commercially unacceptable based on the proposed tariff standards. Also, as stated previously in Issue No. 14 of this section, Verizon provided its own internal analysis that demonstrated a clear correlation between S&P credit ratings and customers with outstanding receivables for 90 days or more. Requiring deposits from financially troubled access customers is not unreasonable.

The tariff provides the same treatment for all access customers. The security deposit provisions can only be applied if there is evidence of a lack of customer

creditworthiness. In addition, there is not an incentive to require a deposit unless an ILEC believes one is absolutely necessary since, pursuant to the tariff, the ILEC must pay significant interest of 11.25% to the customer on security deposits.

20. NECA shall provide the Commission with information concerning the security deposits that carriers participating in the NECA tariff have required of any long-distance or competitive LEC affiliate. NECA shall also indicate how those affiliates would score under its proposed credit-rating procedures and what actions it anticipates carrier participants in the NECA tariff would take in response to that rating. NECA shall also indicate how its carrier participants would score under its credit-rating methodology. We note that most of these criteria relate to ratings for carriers and large businesses. NECA should discuss its intentions, if any, with respect to residential end users.

The NECA pooling companies responding to the CDDR, to date, have not required deposits from their affiliates. To the extent any of their affiliates triggers a deposit requirement, the NECA pooling company will administer the deposit provisions of the tariff in the same way that it does for all of its access customers. Based on the results of the CDDR, all of the respondents indicated the credit rating of their telephone company and affiliates were commercially acceptable based on the proposed tariff language, with one exception. One company indicated a less than commercially acceptable rating for its affiliated CLEC. If the proposed tariff revisions were approved, the telephone company would be required to apply the same treatment to its affiliated company as it would to any other access customer.

For residential end users and small businesses without an S&P or Dun & Bradstreet financial rating, only late payment histories will be used in determining if a security deposit is required. NECA will add tariff language to clarify these intentions.

21. NECA shall provide the Commission with data on the payment characteristics of defaulting interstate access customers during the year prior to the time the account was 90 days overdue from January 1, 2000, to the present. NECA

shall present the data in terms that will enable the Commission to identify patterns that may exist in a customer's payment practices prior to default that may permit alternatives to security deposits to be identified and evaluated.

To respond to this question, NECA asked the RDTF to identify the total number of interstate access customers that had filed for bankruptcy and had an overdue account more than 90 days old at the time of bankruptcy. In addition, they were asked to show the number of late payments the customers had during the year prior to the time the account became ninety days overdue. Seventeen of the respondents had no customer that filed for bankruptcy with overdue accounts more than 90 days old. Twelve respondents indicated they had customers in this category, and they identified the number of late payments prior to the 90 days as ranging from zero to ten, with the average being four. The remaining six respondents were not able to complete this question.

22. Finally, we ask NECA to provide data, to the extent available, on the level of uncollectibles of other regulated utilities, or in the broader marketplace. It should also discuss the means those businesses use to address the risks of default, especially how they manage bad credit risks while continuing to provide goods or services to the customer.

NECA does not have access to data regarding the level of uncollectibles of other regulated utilities or their methods of managing bad credit risk.

B. Application of Revised Deposit Requirements to Term Plan Customers

The second issue designated by the FCC for investigation is whether the imposition of revised security deposit provisions constitutes a material change to NECA's term contracts, and if so, whether it is reasonable for NECA to apply the revised deposit provisions to term plans. Below, NECA responds to specific questions related to this issue and demonstrates that its tariff revisions are reasonable and do not constitute changes to NECA's term contracts.

- 1. NECA shall explain in its direct case the reasons increased security deposits should be required of customers with existing term plans and how that is consistent with the Commission's decision in RCA Communications, Inc.*

The Commission's decision in RCA Communications outlines a "substantial cause" test for changes in term arrangements. There is "substantial cause" for making these tariff changes.

It is reasonable to apply security deposits to term plan customers for the same reasons they are applied to other customers, namely, for late payment histories and unacceptable commercial credit ratings, since these traits are indicative of a higher level of payment risk.

Tariff provisions regarding term plans contain information related to pricing and length of agreements, but do not govern the payment of bills and security deposits related to the plans. The overall terms and conditions that apply to the term plans and to all of the services offered under the tariff are those contained in Section 2, General Regulations.

Term plans do not state that the tariff's General Regulations will not change during the length of the plan. Transmittal No. 951 does not alter the operative conditions of any term plans (i.e., discounts or commitment lengths). In fact, the only way that the proposed revisions would affect term plans would be to provide a waiver of any applicable termination charges in cases where a customer refuses to pay a deposit and subsequently service is discontinued under the term plan.

The imposition of revised security deposit provisions does not constitute a material change for NECA's term plan customers. Even if the revisions proposed in

Transmittal No. 951 could be considered “material” from the point of view of a term plan customer (which they are not), “substantial cause” has been shown.

2. *NECA shall provide the Commission with data on the share of interstate access revenues that are received from services subject to term plans and, of that amount, what portion is attributable to services that are paid in advance.*

NECA’s tariff has provisions for term plans for DS1, DS3, SONET, Frame Relay, and DSL services. The term plan only applies to revenue that is paid in advance. For the current Test Period,²⁰ \$25 million in term plan revenue represents 1½ percent of the total Common Line and Traffic Sensitive billed revenue.

C. Shortened Termination Period

The third issue for investigation is whether NECA’s proposal to reduce the notice required before termination of a service, or refusal to process an order, may occur from 30 day to 10 days is just and reasonable. Below, NECA responds to specific questions related to this issue and demonstrates its changes in its notice periods are just and reasonable.

1. *NECA shall explain why it believes that the increased security deposit provisions it proposes are inadequate and why it needs shortened notice periods as well; or, conversely, why a shortened notice period would not be adequate by itself.*

As previously stated, at least 97 days of outstanding charges for those billed in arrears, and 67 days of charges for those billed in advance would exist before a customer could be disconnected under the existing tariff provisions. By the time a bill is late, there are already one to two months of charges for services the customer has not paid.

Requiring another 30 day notice to terminate the service just increases the amount of

²⁰ July 1, 2002 through June 30, 2003.

unpaid charges the telephone company will accumulate and causes the outstanding charges to exceed the security deposit. NECA estimates that even with two months of security deposits and a reduced notice period, pool members would still be at risk for at least \$1.5 million²¹ from carrier uncollectibles. Keeping in mind that the 67 and 97 days are the most optimistic time frames under the tariff to terminate service in a non-payment situation, the changes to the security deposit provisions and notice periods are very conservative. Shortened notice periods and increased security deposit provisions are both necessary to contain the spread of the insolvency virus, so that it does not pass on to other IXC's or ILEC's.

2. *NECA shall also submit information for the most recent twelve months, to the extent it possesses such data, as to the timeliness of the billings of carriers participating in the NECA tariff. In this connection, it shall address the relationship of the billing date to the delivery date (indicating the percentage of bills and billed amounts that were delivered electronically).*

In response to Issue No. 6, in Section A, above, NECA provided data on the time between the billing date and the date the bill is sent. NECA does not have data on the amount of time it takes to deliver non-electronic bills to the customer. This would vary based on the method of delivery and other factors such as US Mail delivery times. Of the thirty-five respondents to the CDDR, twelve companies have electronic billing, and these companies had from five to fifty percent of their bills sent electronically and from ten to sixty-nine percent of their billed amount sent electronically.

3. *Also discuss the appropriateness of prescribing the time within which a bill must be presented to the customer if a shortened notice period were to be allowed in order to permit the customer sufficient time to review the bill and*

²¹ As noted earlier, the 11% default rate yields \$20 million in projected Test Period uncollectibles. Increasing the security deposit reduces this risk to \$6.1 million. Reducing the termination period from 30 to 10 days further reduces the risk to \$1.5 million.

pursue its dispute rights under the tariff. In particular, NECA should address whether the carriers participating in its tariff could meet the three-day requirement the Commission adopted in 1987.

NECA pooling companies are committed to sending customer bills on a timely basis and most have indicated it takes five or less day from the billing date to the date they send the bill (see Issue No. 6 response in Section A.). However, telephone companies cannot guarantee that a customer will receive a bill within three days of 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. Therefore, the Commission should not prescribe a specific time limit, and in particular should not prescribe a three-day time limit.

III. CONCLUSION

In this *Direct Case*, NECA demonstrates that its proposed security deposit and shortened notice revisions are reasonable. The proposed provisions will not eliminate risk but merely reduce it to a more manageable level and are targeted to the subset of customers that are the major cause of increased risk. The Commission should find that the proposed tariff revisions are just and reasonable and should be permitted to take effect.

Respectfully submitted,

NATIONAL EXCHANGE CARRIER
ASSOCIATION, INC.

By: /s/ Richard A. Askoff
Richard A. Askoff
Its Attorney

November 21, 2002

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the Direct Case was served on this 21st day of November 2002 by electronic delivery and by first-class mail to the persons listed below.

By : /s/ Shawn O'Brien
Shawn O'Brien

The following parties were served:

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street SW
TW-A325
Washington, DC 20554
(electronically filed)

Qualex International
Portals II
445 12th Street SW
Room CY-B402
Washington, DC 20554
(delivered by U.S. Mail)

Julie Saulnier
Pricing Policy Division
Wireline Competition Bureau
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NECA DIRECT CASE

WC DOCKET NO. 02-356

EXHIBIT B

Projected Uncollectibles for the 2002/2003 Test Period

This write-up explains NECA's estimate of the additional \$15 million in uncollectibles forecast for the 2002/2003 Test Period, as referenced in the August 30, 2002, rate revision filing (See Transmittal 952).

According to Moody's, 2001 resulted in one of the most intense years of credit pressure around the globe¹. The default rate was more than two standard deviations from the mean for only the second time since 1980.² The two largest defaulting industry categories by dollar volume were deregulated in recent years. They were the telecommunications and energy industries.³ The big defaulter in telecommunications was PSINet Inc. at \$3.1 billion.⁴ Moody's concluded the fallout from the disintegration of the New Economy is likely to continue and be acutely felt, but said that the default rate for speculative grade bond issuers should decline from 10.2 per cent in 2001 to 6.8 percent in 2002.⁵ Then in January, Global Crossing declared bankruptcy and WorldCom followed suit in July.

We are clearly operating in a new, highly volatile environment, especially in the telecommunications industry. Long distance carriers have built huge speculative networks with enormous capacity without having enough customers to fill even a fraction of their fiber pipelines. The Precursor Group's document shown in Appendix 1 displays the significant financial deterioration in the Telecommunications sector between 1Q02 and 2Q02. The "Bankruptcy possible" category includes virtually every IXC and many ILECs.

NECA has already shown the sharp decline in the bond ratings for AT&T, Global Crossing, Qwest Communications, Sprint, and WorldCom. Between April and July 2002, WorldCom's bond rating dropped from BBB to D.⁶ Then the company defaulted. Qwest's ratings are dropping almost as fast. It is not inconceivable that companies will be forced to declare bankruptcy in response to the competitive advantage that companies already in Chapter 11 have. They have effectively reduced their debt structure, which allows them to charge lower retail rates.

With all these risks looming, NECA has selected a default rate of about 11 percent, roughly the default rate prediction for speculative bond issuers in 2001, as a reasonable prediction for the 2002/2003 test period. Multiplying this projected default rate by \$712 million, the projected total interstate traffic sensitive access revenues for the test period, then by 19.2 %, which translates into 70 days⁷ of lost revenue due to defaults, yields NECA's \$15 million uncollectibles estimate.⁸

¹ *Default and Recovery Rates of Corporate Bond Issuers: A Statistical Review of Moody's Rating Performance 1970-2001*. Moody's Investor Services. p.4.

² *Ibid.*, p. 6.

³ *Ibid.*, pp. 6-7.

⁴ *Ibid.*, p. 5.

⁵ *Ibid.*, p. 7.

⁶ NECA's Transmittal No. 952, August 30, 2002, p. 2 of 4.

⁷ Approximately 70 days of outstanding payments were due to NECA pooling companies providing data for the WorldCom bankruptcies.

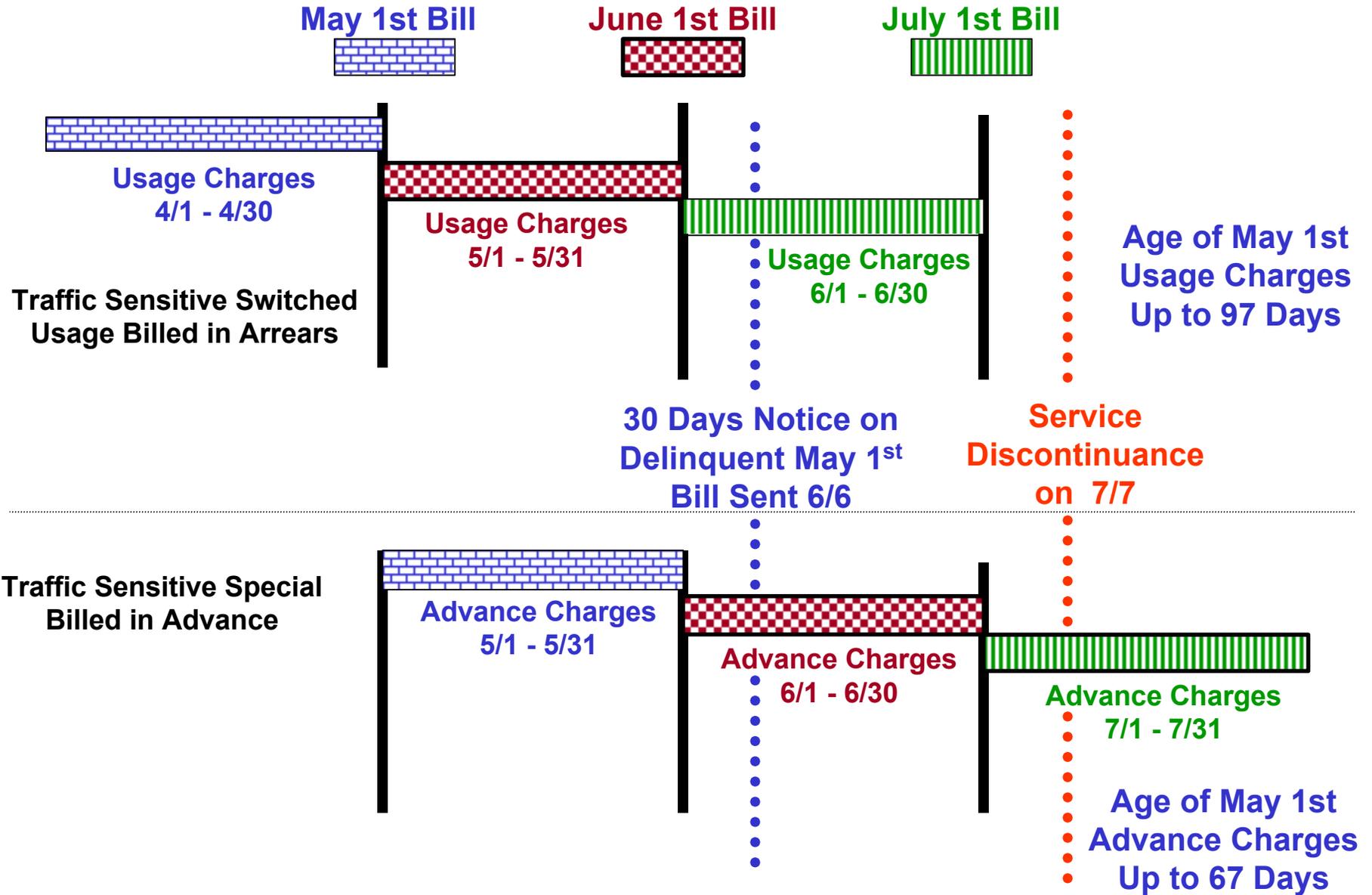
⁸ The \$712 million projection includes Traffic Sensitive access elements only.

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EXHIBIT C

Access Bill Timeline



Switched Access Usage Bill Illustration (Billed in arrears):

- April's usage bill preparation begins on May 1.
- Bill received by customer on or about May 10.
- Payment due by June 1, for usage back to April 1 (Age of charges – 60 days).
- If payment not received by June 1, balance shows an overdue amount.
- 30 day notice of refusal/discontinuance mailed on 6/6.
- On 7/7, the thirty notice period has elapsed. Service terminated if payment not received.
- Bills for May usage (billed June 1) and June usage (billed July 1) also outstanding on 7/7.
- Total of 97 outstanding usage days (April 1 through July 7).

Special Access Bill Illustration (Recurring charges billed in advance):

- Bill preparation for May's charges begins on May 1.
- Bill received by customer on or about May 10.
- Payment due by June 1, for May's service (Age of charges – 30 days).
- If payment not received by June 1, balance shows an overdue amount.
- 30 day notice of refusal/discontinuance mailed on 6/6.
- On 7/7, the thirty notice period has elapsed. Service terminated if payment not received.
- Bills for June service (billed June 1) and July service (billed July 1) also outstanding on 7/7.
- Total of 67 outstanding days (May 1 through July 7).

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EXHIBIT D

UNCOLLECTIBLES ESCROW ALTERNATIVES

Background:

In its August 30, 2002 midcourse filing (Transmittal No. 952), NECA proposed to increase traffic sensitive (TS) rates by approximately 2.13% to recover an additional projected test period TS uncollectible amount of \$15 million. Uncollectible revenue is interstate revenue applicable to the NECA pool that the exchange carrier was lawfully entitled to receive but which it was not able to collect. In response to issues raised in discussion with FCC staff, NECA is outlining two possible solutions to the uncollectible reimbursement issue that are outside of the normal pool recovery process. Both depend on setting up an interest-bearing escrow account and would not be reflected in monthly pool reporting unless uncollectibles are incurred. This escrow account would be used to reimburse uncollectibles to the extent funds are available.

Under Option #1, a study area would be reimbursed based on actual uncollectibles reported to the pool. Option #2 provides for recovery based on estimated uncollectibles associated with specific bankruptcy filings. The unused portion of the escrow account, if any, from one rate period offsets the next period's access rates. As a result, access customers receive a full refund of unused funds, including interest, but NECA pool members absorb the losses if actual realized uncollectibles exceed estimates included in rates.

This paper outlines the current treatment of uncollectibles and the two escrow alternatives.

Current Treatment of Uncollectibles in NECA Pool Settlements:

- The company reports the realized uncollectible revenue that was written off its books to the NECA pool.
 - Uncollectible revenue may be reported in the data month in which the write-off occurred.
 - The company receives full reimbursement of the reported uncollectible from the pool.
 - Companies charge Account 5300, Uncollectible Revenue, and credit Account 1171, Allowance for doubtful accounts.
- When revenue previously reported to the pool as uncollectible is subsequently collected, the original write-off entry is reversed.
- When bankruptcy occurs, a member company must take reasonable measures to collect revenues owed by access customers as permitted by law, including, at a minimum, filing a Proof-of-Claim or other similar documents necessary to register a claim with the bankruptcy court and/or the trustee.
 - A member company may report bankruptcy-related interstate access uncollectibles to the pool in the month these amounts are recorded on the company's books as uncollectible.
 - Any portion of bankruptcy-related uncollectibles that are subsequently collected (*e.g.*, through court proceedings or settlement negotiations) must be reported to the pool as a deduction (report as a negative) to Net Realized Uncollectibles in the month collected.

Alternative Treatment of Uncollectibles:

NECA anticipates that the currently applicable uncollectible procedures described above for pool reporting would remain in place. The only difference between the current pool settlement process and the options described below is in the method for compensating NECA TS pool companies for uncollectibles they incur and report to NECA for reimbursement.

Option #1:

- The revenues generated as a result of the increased rates proposed in Transmittal No. 952 will be held in an escrow account by NECA prior to processing pool settlements.
 - Since the increase in TS rates for uncollectibles was approximately 2.13%, this same percentage of monthly reported TS revenues for all study areas would be removed from monthly pool distributions and placed in an interest-bearing escrow account.
 - Money would be held in a separate account outside of the pool settlements process.
 - Escrow account will build gradually through the test period (*i.e.*, approximately 1/12 per month).

UNCOLLECTIBLES ESCROW ALTERNATIVES

- As actual TS uncollectibles are reported to NECA in the monthly settlements process, payment would come from the escrow account.
 - TS uncollectibles are reimbursed from the escrow account by releasing escrow funds to the pool equal to the actual uncollectibles reported.
- If uncollectibles were reported during the period that exceed the current balance of the escrow account, the account would be used to pay uncollectibles only to the extent there are funds available.
- If uncollectibles were reported during the period that are less than the balance of the escrow account, any unused portion of the uncollectible escrow will be “refunded” in TS rates from one test period to the next through a reversing of accrual process.
 - For example, assume that of \$15 million accrued for uncollectibles for the test period, only \$10 million from the escrow account is paid out. The remaining \$5 million, plus any interest earned, will be used to reduce the projected revenue requirement for the next test period.
- As necessary, a new estimate of uncollectibles will be included in rates for the future test period. This new uncollectible accrual will be treated in the same manner as the previous uncollectible accrual.
 - The change in escrow funding would be reflected as a net adjustment between the prior test period refund and future test period accrual. For example, if the prior test period refund was \$5 million (as in the previous example) and the future test period accrual is projected to be \$12 million, the net increase in the rates due to uncollectibles is \$7 million.
 - If there were no new uncollectible expectations for the test period, any unused funds held in escrow from the prior period would result in reductions to revenue requirements used in calculating TS rates.
 - If the total amount of uncollectible escrow for the current test period was insufficient to meet the levels of uncollectibles reported during the period, the pool would not be reimbursed from future test period accruals for the underfunding. For example, if NECA has projected an uncollectible reserve requirement of \$15 million and the actual uncollectible requirement is \$20 million, the \$5 million difference would not be carried forward to the next test period.

Option #2:

- Similar processes as Option #1, with the exception that estimated uncollectibles for the current rate period would be reimbursed from the escrow account.
 - Funds would flow to the escrow account similar to Option #1.
 - If a bankruptcy were to occur, NECA would estimate the amount of uncollectibles that would be attributable to that bankruptcy:
 - ✓ Gather uncollectibles estimates and access lines from a sample of NECA pool companies related to the company declaring bankruptcy.
 - ✓ Develop an uncollectibles estimate per access line based on sample data.
 - ✓ Multiply the uncollectibles per line estimate by total pool access lines.
 - Based on that estimate, NECA would make funds available to the pool from the escrow account to compensate companies for uncollectibles corresponding to that bankruptcy.