Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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

VERIZON REFUND PLAN

Of Counsel
Michael E. Glover
Edward Shakin

Joseph DiBella
c/o Verizon
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3099

Attorney for the Verizon
telephone companies

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CONTENTS

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VERIZON[1] REFUND PLAN

Verizon hereby submits its refund plan in response to the Commission's July 30, 2004 *Order* in the above-referenced investigations.[2]

I. Introduction and Summary.

The data in the attached exhibits demonstrate that the Commission should not order Verizon to make any refunds as a result of applying add-back to its 1993 and 1994 annual access tariff filings. Although add-back increased the sharing obligations of the former Bell Atlantic companies by $6.3 million in 1993 and $6.9 million in 1994, the Commission should not order any refunds for these companies, because they had over $53 million of headroom during the two-year period. Even if the Commission looked at Bell Atlantic's headroom amounts separately for each year, less than $1 million of the increase in sharing increase due to add-back would not have been

[1] The Verizon telephone companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Inc. These companies are listed in Attachment A.

[2] *1993 Annual Access Tariff Filings, 1994 Annual Access Tariff Filings*, CC Docket Nos. 93-193, 94-65, Order, FCC 04-151 (rel. July 30, 2004) ("Order").

covered by the total amount of headroom in each year, and less than $2.4 million would not be covered by the amount of headroom each year if it were applied separately by basket. However, refunds based on the impact of add-back on separate tariff years or particular price cap baskets would not be justified, because access customers generally purchased services in both years and in all access categories and therefore benefited from Verizon's decision to keep rates well below the maximum allowed by price caps. For the former GTE companies, add-back actually would have *reduced* its net sharing obligation by approximately $3.8 million, because add-back would have increased GTE's lower formula adjustments more than it increased the sharing amounts. In addition, the GTE companies had over $690 million in headroom for this period, which far exceeded the impact of add-back on sharing alone. Either way, no refunds would be warranted for these companies.

II. Description of the Refund Plan

In the *Order*, the Commission found the 1993 and 1994 annual access tariffs of price cap local exchange carriers who had sharing or lower formula adjustments to be unreasonable to the extent that the carriers did not apply "add-back" in computing their 1992 and 1993 earnings and their resulting price cap indexes.[3] It required price cap local exchange carriers that implemented a sharing or lower formula adjustment and failed to apply add-back to (1) recalculate their 1992 and 1993 earnings and rates of return making the add-back adjustment; (2) determine the appropriate sharing or lower formula adjustments to their price cap indexes ("PCIs") for the subsequent tariff

[3] *See Order*, ¶¶ 12, 28. "Add-back" refers to the process that eliminates the effects on the current year's earnings of sharing or lower formula adjustments that were required by the prior year's earnings. It requires the carrier to add the sharing amount to, or subtract the lower formula adjustment amount from, the current year's earnings in calculating the rate of return and the sharing or lower formula adjustment for the next year. *See id.*, ¶ 9.

year; (3) compute the amount of any resulting access rate decrease; and (3) submit a plan for refunding the amounts owed to customers plus interest as a result of any such rate decrease. *Order*, ¶ 29. The *Order* also provided that if any carrier claims that refunds are not required because of the amount of "headroom" in their 1993 and 1994 tariffs, they should submit detailed calculations demonstrating this fact. *Id.*, ¶ 30.

The attached exhibits provide the information required by the *Order* on behalf of the Verizon telephone companies that did not include add-back in their 1993 and 1994 tariffs.[4] Exhibits 1 and 2 show the impact of add-back on earnings and rates of return for 1992 and 1993, including the impact on the final 1992 and 1993 rate of return reports.[5] Exhibit 1 summarizes the changes in the sharing and lower formula adjustments for the 1993 and 1994 annual access tariff filings resulting from the add-back adjustments. Exhibit 3 shows the changes in the PCIs resulting from the impact of add-back on sharing and lower formula adjustments. Exhibit 4 compares the changes in sharing or the lower formula adjustment caused by add-back to the headroom that

[4] These data only include the former Bell Atlantic and GTE companies. The former NYNEX companies already applied add-back in the 1993 and 1994 annual access tariff filings.

[5] Under the Commission's rules, carriers are required to file a final, amended rate of return report 15 months after the end of each calendar year incorporating all changes and corrections since the first rate of return report, which is filed three months after the close of the calendar year. *See* 47 C.F.R. § 65.600(d)(2) (carriers shall file a report within 15 months "reflecting any corrections or modifications" to the first report). Accordingly, Exhibit 1 includes the effect of add-back on the final 1992 rate of return reports in the 1994 annual access tariff filings as well as the add-back adjustments to the final 1993 rate of return reports in the 1995 annual access tariff filings. When Verizon implemented the Commission's add-back rule in the 1995 annual filings, it only applied add-back to the 1994 rate of return reports. Therefore, to fully implement add-back in this refund plan, Verizon must apply add-back to both the initial and final rate of return reports for 1992 and 1993.

actually existed in each price cap basket and in the access categories as a whole and provides the amount of any resulting rate decrease.[6]

If the Commission determined that Verizon had a refund liability, Verizon would make refunds in the following manner. First, Verizon would calculate the total refund liability by adding interest at the Internal Revenue Service ("IRS") large corporate overpayment interest rate, compounded daily, from the mid-point of each tariff year.[7] Verizon would use revenues billed by access customer name abbreviation ("ACNA") in each year to determine each carrier's share of the refund amount associated with access charges. Verizon would determine the proportion of switched and special access revenues paid by each carrier and use that proportion to determine

[6] These headroom calculations differ from those submitted previously, because Verizon has included mid-year tariff filings that had a significant impact on the price cap indexes and averaged the headroom over the tariff year. The previous filings only included the PCI and API changes in the annual access tariff filings due to the difficulty of reconstructing data from filings from ten years ago. With the additional time, Verizon has been able to develop data on the headroom changes that took place during each tariff year. The summary data show the total amount of headroom based on the amount of time that each mid-year filing was in effect. This is reasonable, because if Verizon had applied add-back at the time, it could have used this headroom to offset the add-back effect. Also, the calculations in Exhibit 4 do not reflect the effect of a filing Bell Atlantic made in 1997 to correct the "g" factor that Bell Atlantic had used in the 1993 annual tariff filing for the common line price cap formula. *See* Letter from Joseph J. Mulieri, Verizon, to William F. Caton, Secretary, FCC, Transmittal No. 977 (filed June 30, 1997). This correction eliminated $1 million of the common line headroom for the 1993 annual filing. *See* Letter from Joseph Mulieri, Verizon, to Marlene H. Dortch, Secretary, FCC, at p. 10 (filed Mar. 1, 2004). However, as is shown in Exhibit 4, Bell Atlantic had $19 million of headroom in the common line basket in 1993. Therefore, removal of $1 million still leaves far more headroom than the impact of add-back in the common line basket.

[7] Because the refund amount represents the annual refund for the tariff year, interest for the 1993-94 tariff year would be calculated from January 1, 1995, and interest for the 1994-95 tariff year would be calculated from January 1, 1996. As a result, if refunds were made today, Verizon would apply an interest factor of 1.7483 times the 1993 refund amount, and a factor of 1.6341 times the 1994 refund amount.

each carrier's share of the refund for each price cap basket.[8] Due to the passage of time, some of the ACNAs are no longer associated with a carrier account or with a successor carrier. Where Verizon could not determine which legal entity was associated with a particular ACNA, it would submit an industry notification requesting carriers to identify within 30 days any ACNAs to which they claimed ownership (such as through merger or acquisition). Verizon then would provide each carrier the data showing the calculations of its share of the refund amount, including the amounts allocated for unclaimed ACNAs. Actual refund payments would be subject to any previous legal settlements of claims that may exist between Verizon and the carriers.[9]

III. The Commission Should Not Order Refunds Because Ratepayers Were Not Harmed Regardless Of Whether Verizon Applied Add-Back.

The Commission should not order refunds for any of the Verizon companies as a result of applying the add-back adjustment to the 1993 and 1994 tariffs. As shown in the attached exhibits, for the 1993 and 1994 tariff periods as a whole, the Verizon telephone companies charged their customers far less than they could have even after add-back is taken into account.

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[8] Verizon would use the switched access data to distribute refunds associated with both the common line and the traffic sensitive baskets, because the distribution of revenues among carriers for common line and switched access rate elements is virtually identical. Both common line and traffic sensitive charges are applied based on switched access minutes of use. *See* 47 C.F.R. §§ 69.106(a), 69.154(a).

[9] For instance, as part of WorldCom's bankruptcy proceeding, Verizon and WorldCom entered into a settlement of their outstanding pre-bankruptcy claims against each other that, with certain exceptions not relevant here, covered all claims arising prior to the July 21, 2002, which would include the pending claims for these tariff investigations. Accordingly, MCI would not be entitled to refunds as a result of these investigations.

A. The Commission Cannot Order Refunds Where Verizon's Rates Would Have Been Below The Price Cap Limits Even After The Add-Back Adjustment.

The Commission has no legal authority to order refunds in these investigations where Verizon's PCIs would have been above its actual price cap indexes ("APIs") even after the PCIs were adjusted for the revised sharing amounts due to add-back. The Commission's authority to order refunds in a proceeding to investigate a tariff is limited to "such amounts [as] were paid" that were not lawful. 47 U.S.C. § 204(a); *see AT&T Co. v. FCC*, 836 F.2d 1386, 1394 (D.C. Cir. 1988) (FCC may order refunds at conclusion of § 204 proceeding only of "the portion of amounts paid that was not justified"). The Commission, therefore, cannot order refunds of amounts that were *not* paid, but that lawfully could have been charged, because a carrier elected to charge customers rates *lower than* those permitted under the price caps. As is shown in Exhibit 4, the rates in Verizon's tariff filings for the years at issue were *tens of millions of dollars below* the price caps. It would be unlawful for the Commission to order Verizon to refund these amounts, which it never collected, even though it was entitled to do so.

Under the price cap regime in effect at the time the relevant tariffs were filed, the PCIs for each basket set an upper limit on a carrier's rates, as measured by the APIs. With limited exceptions not relevant here, carriers had discretion to set rates below the PCIs. When a carrier did so, its tariffs had "headroom," which is the amount by which a carrier's APIs were lower than its PCIs. As the Commission has explained, headroom "represents charges that could have been, *but were not*, collected from customers." Memorandum Opinion and Order, *800 Data Base Access Tariffs and the 800 Service Management System Tariff and Provision of 800 Services*, 12 FCC Rcd 8396, ¶ 11 (1997) ("*800 Database Access Tariffs*") (emphasis added).

When the Commission disallows a portion of a price cap carrier's tariff filing, it is concluding that the carrier's *PCIs* — that is, the ceilings on its rates — were too high. But a determination that a carrier's PCIs should have been lower is not equivalent to a determination that a carrier's *rates* were too high and that customers paid too much. On the contrary, the carrier's rates — that is, its APIs — must be compared to its adjusted PCIs before determining whether customers paid rates that were unjust and unreasonable, and subject to refund. If the carrier's APIs remain *equal to or below* the adjusted PCIs, the carrier's rates were within the permissible limit and any refund order would be unlawful. Likewise, in the event the adjusted PCIs are below the carrier's APIs, any order requiring a refund for amounts below the level of the adjusted PCIs also would be unlawful. As the Commission has explained, "[t]here is no basis for 'refunding' . . . amounts [that] were never paid" because the carrier's rates were within the ceiling established by the PCIs. *Id.* More generally, as AT&T has conceded,[10] any lawful refund is limited to the amount by "which [a LEC's] API exceeded the PCI, as adjusted, as required by the Commission" — that is, after any exogenous costs that are disallowed by the Commission are removed from the PCI. *800 Database Access Tariffs*, ¶ 11.

In addition, as Verizon explains below, the Commission should not order refunds for equitable reasons even if the adjusted PCIs were above the APIs in certain price cap baskets for certain periods that the tariffs were in effect, because the overall amount of headroom in the two-year tariff period shows that customers were not harmed despite that fact that Verizon did not apply add-back prior to the Commission's rule change. The Commission's objective here is not to impose penalties, but to put the parties in the position that they would have been if the

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[10] *See* AT&T Ex Parte Letter at 3, CC Docket Nos. 93-193 *et al.* (FCC filed Aug. 19, 2003) ("AT&T Aug. 19, 2003 Ex Parte").

Commission had clearly informed the price cap carriers that add-back was required before they filed their tariffs. It is clear from the data that Verizon's rates were not unreasonable when viewed in this context. Accordingly, the Commission should apply the headroom analysis on an overall basis, rather than on a granular basis by basket or time period.

B. The Commission Should Not Order Refunds For The Bell Atlantic Companies, Which Had Far More Headroom Than The Impact Of Add-Back On Sharing.

There is no basis for ordering refunds for the former Bell Atlantic companies. Although add-back would have increased Bell Atlantic's sharing obligations by \$6.3 million in 1993 and \$6.9 million in 1994 (*see* Exhibit 1) these companies had over \$53 million of cumulative headroom for the 1993 and 1994 tariff periods. *See* Exhibit 4 East. Ratepayers were not harmed by Bell Atlantic's decision not to apply add-back, because Bell Atlantic's rates were well below the maximum it could have charged during this two-year period even if it had applied add-back. While most of the headroom was front-loaded (\$47 million was in the 1993 tariff year alone), the Commission should look at the overall savings that ratepayers enjoyed during this period net of add-back and decline to order any refunds.

As is explained above, there is no question that any potential refund amount must be reduced by the amount of headroom that was available during the tariff periods under investigation. Given that the amount of headroom available must be taken into account, the remaining question is how that headroom should be applied. In this case, the Commission should apply the total amount of headroom in the 1993 and 1994 tariffs to the total increase in sharing due to add-back, rather than do a more granular analysis that looks at individual tariff filings and individual price cap baskets within those filings.

Exhibit 4 shows that there was sufficient headroom in the 1993 access tariff filings to cover all of the increases in sharing due to add back.[11] It also shows that there was sufficient headroom in the 1994 access tariff filings across all baskets to cover all but about $1 million of add-back adjustments.[12] Moreover, there was enough headroom in each price cap basket in each tariff year to cover all add-back adjustments except for $2.4 million in 1994. *See id.* However, Exhibit 4 shows that the total amount of headroom in the two-year period far exceeds the total amount of increase in sharing by several-fold. The interexchange carriers generally obtained access services throughout Verizon's service area in both years and in all price cap baskets. They would be unjustly enriched if they were to receive refunds based on calculations that were limited to certain access categories while enjoying the benefit of rates that were below the price cap limits in other categories.

If the Commission applied headroom by basket or tariff year, it would not put the parties in the same position that they would have been if an add-back rule had existed at the time the tariffs were filed. As the Commission noted, it had not given the price cap carriers notice that add-back would be required prior to the 1995 rule change. *See Order*, ¶ 16 ("our price cap rules

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[11] These exhibits compare the original headroom in the annual access tariff filings and in each of the mid-year tariff filings to the total change in sharing due to add-back for each price cap basket and for all baskets, because it was not possible in the time available to calculate an adjusted PCI for add-back for each of the mid-year filings. However, the headroom analysis provides comparable data by showing the extent to which the headroom in the tariffs as filed, comparing the PCIs to the APIs, exceeds the increase in sharing due to add-back.

[12] *See id.* In Exhibit 4, Verizon has included mid-year tariff filings that created additional headroom. For instance, on February 14, 1995, Verizon revised its PCIs to recognize exogenous increases for OPEB costs. *See* Exhibit 4 1994 Backup (BATR). To take these filings into account, Verizon calculated the amount of headroom created by the filing for the time that it was in effect and included it as part of the total headroom against which the adjustment for add-back should be compared.

did not explicitly address add-back until 1995"). If the Bell Atlantic companies had known that add-back would be required, they could have used the headroom that was available at the time to compensate for the increased sharing obligation due to add-back. For instance, Bell Atlantic could have avoided leaving as much headroom in the 1993 tariffs if it had known that it would have increased sharing obligations for 1993 and 1994 as a result of add-back. The Commission cannot find that Bell Atlantic's rates were unreasonable if Bell Atlantic could have achieved the same overall revenues despite add-back. Giving refunds to the interexchange carriers based on add-back while ignoring the fact that Bell Atlantic could have filed higher rates even with the rule would provide a windfall to the interexchange carriers.

The Commission has no obligation to permit such a windfall. Broad application of headroom is consistent with the Commission's discretion in determining how to apply refunds in a tariff investigation. Refunds are "a matter of equity," and the Commission must "balance the interests of both the carrier and the customer in determining the public interest," with "each case . . . examined in light of its own particular circumstances." *American Television Relay*, 67 FCC 2d 703, ¶ 15 (1978); *see Public Service Comm'n v. Economic Regulatory Admin.*, 777 F.2d 31, 36 & n.5 (D.C. Cir. 1985). As the Commission has repeatedly recognized, the Commission "can exercise [its] discretion not to order refunds even when there is a finding of overearnings."[13] And the federal courts have held that an "agency need only show that it considered relevant factors and . . . struck a reasonable accommodation among them, and that its order granting *or denying* refunds was equitable in the circumstances of this litigation." *Towns of Concord, Norwood, & Wellesley v. FERC*, 955 F.2d 67, 76 (D.C. Cir. 1992) (citing *Las Cruces TV Cable v. FCC*, 645

[13] Order on Reconsideration, *800 Data Base Access Tariffs and the 800 Service Management System Tariff and Provision of 800 Services*, 12 FCC Rcd 5188, ¶ 18 (1997) (emphasis omitted).

F.2d 1041, 1047 (D.C. Cir. 1981)) (internal quotation marks omitted; emphasis added; alteration in original); *see also National Insulation Transp. Comm. v. ICC*, 683 F.2d 533, 541-44 (D.C. Cir. 1982) (holding that "the Commission did not abuse its discretion in declining to award refunds after finding the practice to be unreasonable").

In this case, equitable considerations compel the Commission to exercise its discretion and decide not to order refunds due to the lack of any ratepayer harm and the absence of any finding that Verizon violated the Commission's rules. As the Commission stated, the purpose of ordering refunds in this investigation is not to apply a penalty. *See Order*, ¶ 20. There is no basis for a penalty, as Verizon's tariffs violated no pre-existing Commission rule that addressed add-back. Rather, the Commission is adopting a policy on add-back in the context of this investigation for the sole purpose of determining the reasonableness of the carriers' 1993 and 1994 tariffs. *See id.*, ¶ 17. Refunds are necessary in this investigation "merely [to] return . . . revenues to which the LECs were not entitled in the first place." *Id.*, ¶ 20. As Verizon has shown, it was entitled to substantially more revenues than it received, even with the add-back adjustment to sharing.

C. The GTE Companies Are Not Liable For Refunds, Because Add-Back Increases Their Lower Formula Adjustments More Than It Increases Their Sharing Amounts And They Had Sufficient Headroom To Cover The Sharing Increases Alone.

For the GTE companies, Exhibit 1 shows no net increase in sharing obligations for either 1993 or 1994, because add-back increased the companies' lower formula adjustments more than it increased their sharing obligations. As required by the Commission's order, the calculations include changes to both sharing obligations and lower formula adjustments due to add-back. *See Order*, ¶ 29. While add-back increases the sharing obligations by adding back sharing revenues into the rate of return calculations, add-back also increases the lower formula adjustment, because it removes lower formula adjustment revenues from the rate of return calculations. *See id.*, ¶ 12. For this reason, GTE's price cap limits would have been over $3.8 million *higher* in 1993 and 1994 if it had applied add-back. *See* Exhibit 1. In addition, GTE had over $690 million in headroom over the two year period, which far exceeded the impact of add-back on sharing amounts alone.[14] During this period, GTE voluntarily reduced its rates, which were significantly higher at the time than the access charges of the BOCs, well below the price cap limits to discourage bypass. This provided the interexchange carriers the benefits of rate reductions far greater than those produced by the price cap sharing mechanism. There is no reason why the Commission should order additional refunds in this tariff investigation when the interexchange carriers already got more than was compelled by the price cap rules.

The Commission should not require the former GTE companies to provide refunds for study areas that would have had increased sharing obligations (and lower rates) without offsetting the amounts by which other study areas would have had larger lower formula adjustments (and higher rates). As is shown in Exhibit 1, the former GTE companies had twenty-six interstate tariff entities that reported separate rates of return.[15] In 1991, some of these tariff entities were in the sharing mode and some were in the lower formula adjustment mode. When GTE filed its access tariffs in 1993 and 1994, it did not apply add-back to any of its 1992 and 1993 revenues, regardless of whether the tariff entity was under sharing or lower formula adjustment. In other

[14] *See* Exhibit 4. At most, only $251,590 in 1993 and $571,659 in 1994 of the increase in sharing alone would not be covered by headroom in each price basket, including the interexchange basket.

[15] Exchanges in several of those tariff entities have been sold since the 1993-94 tariff period. If refunds are ordered in this investigation that are specific to sold exchanges, Verizon and the purchaser would determine which company was responsible for the refund based on the terms of the contract of sale.

words, it did not add the revenues in the sharing states or reduce revenues in the lower formula adjustment states. This was consistent with its view that the Commission's price cap rules did not incorporate the add-back mechanism that had been part of the previous rate-of-return enforcement mechanism. GTE pursued a consistent approach in all tariff entities, despite the fact that applying add-back in the lower-formula-adjustment entities would have increased the lower formula adjustment and allowed higher rates.

If the Commission required GTE to provide refunds to reflect the increased sharing obligations produced by add-back, it should allow GTE to offset its refunds by the amount of increased lower formula adjustment that it would have obtained through add-back. Fundamental fairness dictates that a carrier such as GTE, which had different tariff entities with different rates for different study areas, should not be treated differently than a carrier or group of carriers that had a single tariff for multiple study areas. Otherwise, a carrier with multiple tariff entities would be able to protect itself only by adopting the approach to add-back that maximized revenues in each study area (i.e., by applying add-back in lower formula adjustment states but not in sharing states), regardless of whether the approaches in different study areas would be inconsistent. Access customers, who generally obtained GTE services in all study areas, would be unjustly enriched if they were to receive refunds in the sharing areas without offset from the higher rates due to add-back in the lower formula adjustment areas. A carrier such as GTE should not be penalized for adopting a consistent position on add-back across all of its study areas. Nor should the Commission order refunds as a result of GTE's failure to apply add-back when, in fact, applying add-back would have resulted in even higher rates.

The D.C. Circuit's decision in *MCI Telecommunications Corp. v. FCC*, 59 F.3d 1407 (D.C. Cir. 1995) in no way constrains the Commission's ability to exercise its equitable discretion to offset refunds by the amount of an increased lower formula adjustment that the GTE entities, taken as a whole, could have obtained through add-back. The *MCI* case arose in an entirely different context – complaints for refunds based on violations of the Commission's category-specific rate of return prescriptions. In that context, the court explained that the Commission's hands were tied: unlike a Section 204 tariff investigation, where the Commission has permissive authority to determine refund liability, "[i]n the present cases … the Commission is responding to complaints brought by customers of the LECs under § 206 of the Act, which is phrased in mandatory terms. … Therefore, the factors that we set out in the *Virgin Islands* case do not apply where, as here, the Commission is adjudicating a damage claim made by a customer pursuant to § 206." *Id.* at 1414. Section 204 is written in permissive terms to give the Commission's discretion how to calculate refunds, or not to order refunds at all (the Commission "*may* . . . require the . . . carrier [ ] to refund . . . such portion of such charge . . . as by its decision shall be found not justified," (47 U.S.C. § 204(a)(1) (emphasis added)), while section 206 uses the mandatory "shall." The Commission's discretionary authority under § 204 is unconstrained – and, given that the Commission has discretion not to order refunds at all, it must have discretion to determine how much any refunds should be, taking into account the equitable factors discussed above.

In addition, the specific considerations relied on by the D.C. Circuit in invalidating the Commission's "limited offset" policy, which reduced damages for overearnings in one category by a LEC's underearnings in other access categories, do not apply here. The court held that the limited offset policy (1) was inconsistent with FCC precedent that prevented the Commission from using claims by carriers against customers to offset claims by customers against carriers, (2) amounted to an implicit determination that the defendant LEC was entitled to earn more than the amount that it actually earned from the rates it charged, even though there was no such entitlement under rate of return regulation, and (3) discriminated between those IXCs that filed complaints and those that did not. *MCI,* 59 F.3d at 1417-1420.

The Commission's precedent against using claims by carriers against customers as an offset in determining damages in the § 206 context is irrelevant here because this case arises under § 204, not § 206. There are no claims between carriers and customers in either direction; this is simply a tariff investigation. Nor would an equitable offset here violate rate of return regulation, for the simple reason that this case arises under price cap regulation. Indeed, while the Commission had stated that the authorized rate of return is only a maximum, not a minimum, the opposite holds true for the low-end adjustment. Here, LECs were entitled to earn at least 10.25 percent under price cap regulation; the failure to do so enabled them to claim a low-end adjustment. If local exchange carriers were forced to refund in sharing states but not to offset the amount of that reduction based on underearnings in low-end adjustment states, the very premise of the price cap framework would be violated. Finally, there is no discrimination among interexchange carriers here because, once again, this is a tariff investigation, not a complaint case. And, even apart from the different legal context, there is every reason to believe, as noted above, that interexchange carriers would have taken access services throughout GTE's service area, ameliorating any concern that some interexchange carriers would receive more than they should and some less.

In any event, GTE had enough headroom during the 1993 and 1994 tariff periods to more than compensate for the increases in sharing alone due to add-back. GTE voluntarily reduced its rates far below the maximums allowed under price caps, which provided the interexchange carriers with over $690 million of savings. Even if there was insufficient headroom in certain price cap baskets, in certain study areas, in certain years, to cover all of the effect of add-back, it is a trifle compared to the savings that GTE voluntarily provided to the interexchange carriers by keeping its rates so far below the price cap limits. The fundamental issue in this investigation is whether GTE's rates were reasonable during these tariff periods despite the lack of an add-back adjustment. The answer clearly is yes.

IV. Interest Should Be Computed At The IRS Large Corporate Overpayment Rates.

If the Commission orders refunds (which it should not), it should require Verizon to apply interest to the refund amounts at the IRS large corporate overpayment rate. This is the most appropriate interest rate that the interexchange carriers, which are large corporations, should receive if the Commission finds that they overpaid access charges in 1993 and 1994 due to the fact that Verizon did not apply add-back prior to the 1995 rule change.

In previous tariff investigations, the Commission has prescribed the IRS overpayment interest rate in ordering refunds to carriers who purchased access services at rates that the Commission later found to be unreasonable. *See, e.g., Investigation of Tariffs Filed by ACS of Anchorage, Inc.,* 17 FCC Rcd 10849, ¶ 31 (2002); *2001 Annual Access Tariff Filings*, 17 FCC Rcd 2110, ¶ 3 (2002). It also has used this interest rate for refunds in rate of return enforcement cases and in complaint proceedings. *See, e.g., Section 208 Complaints Alleging Violations of the Commission's Rate of Return Prescriptions,* 11 FCC Rcd 20104, ¶ 7 (1996); *Total Telecommunications Services, Inc., v. AT&T,* 16 FCC Rcd 5726, ¶ 40 fn. 89 (2001).

The Commission should not penalize Verizon by applying the higher IRS underpayment interest rate (the interest rate that applies when taxpayers underpay their taxes). The Commission applies the underpayment rate only when it finds that the carrier should be penalized for deliberately violating the Commission's rules. For example, in the investigation of long term number portability tariffs, the Commission required the carriers to submit refund plans applying the IRS overpayment rate, finding that "[w]e do not wish to penalize the carriers involved, as they filed their tariffs in good faith and are refunding money charged in excess of those rates that the Commission prescribed. End users overpaid carriers during the refund period, however, and we believe that carriers, who consequently had use of the end users' money during this period, should compensate them for this overpayment." *Long-Term Telephone Number Portability Tariff Filings*, 14 FCC Rcd 17339, ¶¶ 4-5 (1999). Similarly, there is no basis for a penalty here, because Verizon's failure to apply add-back was not in violation of any Commission rule, or even any clear direction from the Commission. As the Commission found in the *Order*, its price cap rules "did not explicitly address add-back until 1995," and requiring refunds in this investigation "does not amount to a penalty." *Order*, ¶¶ 16, 20. Verizon acted in good faith based on the limited guidance available at the time. Therefore, there is no basis for a finding of wrongdoing that would justify a penalty rate.

Although the IRS has several overpayment interest rates, the most appropriate rate in this case would be the large corporate overpayment rate. In the *Long-Term Telephone Number Portability Tariff Filings*, (¶¶ 4-5), the Commission applied the IRS overpayment rate for individuals, because end users had paid the number portability charges. However, in this investigation, the corporate rate is appropriate because carriers paid the access charges that will be refunded. In addition, the IRS large corporate overpayment rate (payments exceeding $10,000) is most appropriate, because the interexchange carriers are large corporations whose overpayments were well in excess of this amount. In *General Communication, Inc., v Alaska Communications Systems Holdings, Inc.*, 16 FCC Rcd 2834, ¶ 74 (2001), the Commission declined to require the carrier to apply the large corporate interest rate, because the defendant "acted in a manner that it at least should have known the Commission had already rejected as unlawful." In this case, the Commission had never found it was unlawful to fail to apply add-back under price caps prior to 1995, and there was considerable uncertainty at the time whether add-back was consistent with the price cap rules. *See Order*, ¶ 19. Accordingly, the Commission should allow Verizon to apply the large corporate overpayment interest rate in calculating any refund liability.

Conclusion

For the foregoing reasons, the Commission should find that Verizon is not required to make refunds in this investigation.

Respectfully submitted,

By: ______________________
Joseph DiBella
c/o Verizon
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3099

Attorney for the Verizon telephone companies

Of Counsel
Michael E. Glover
Edward Shakin

Dated: August 30, 2004

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Midwest Incorporated d/b/a Verizon Midwest
GTE Southwest Incorporated d/b/a Verizon Southwest
The Micronesian Telecommunications Corporation
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.