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October 5, 2004

EX PARTE

By Electronic Filing

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th St., SW
Washington, D.C. 20554

Re: Interest Rate To Be Applied To Refunds, CC Docket Nos. 93-193 & 94-65

Dear Ms. Dortch:

This *ex parte* responds to the letter submitted by SBC on September 23 (and similar letters submitted by BellSouth and Sprint on September 24) suggesting that the Commission should permit incumbent local exchange carriers ("ILECs") to apply a very low interest rate when computing refunds for overcharges associated with the ILECs' failure to apply add-back in their 1993 and 1994 interstate access tariffs.¹

As AT&T Corp. ("AT&T") has demonstrated, Commission precedent confirms that the correct interest rate for computing refund obligations in this proceeding is the IRS rate for corporate overpayments.² The FCC, in exercising its discretion to choose appropriate interest rates for computing refunds, adopted the following interest rates for refunds of tariffed

¹ Letter from Davida Grant (SBC) to Marlene H. Dortch (FCC), CC Docket Nos. 93-193 & 94-65 (Sep. 23, 2004) ("SBC Letter"). Letter from Richard M. Sbaratta (BellSouth) to Malrene H. Dortch (FCC), CC Docket Nos. 93-193 & 94-65 (Sep. 24, 2004) ("BellSouth Letter"); Letter from Craig T. Smith (Sprint) to Marlene H. Dortch (FCC), CC Docket Nos. 93-193 & 94-65 (Sep. 24, 2004) ("Sprint Letter").

² Reply Comments of AT&T Corp., *1993 Annual Access Tariff Filings; 1994 Annual Access Tariff Filings*, CC Docket Nos. 93-193, 94-65 (Sep. 13, 2004) ("AT&T Reply").

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overcharges: (1) the IRS interest rate for corporate underpayments, applied when there is “willful misconduct”; (2) the IRS interest rate for corporate overpayments, applied when the carrier had “constructive knowledge” – *i.e.*, “should have known” – that the tariff could be found unlawful; and (3) the IRS interest rate for corporate overpayments that exceed \$10,000, applied when the unlawful conduct was the result of a “miscalculat[ion]” resulting in rates that “accidentally exceed” lawful levels.³ AT&T does not seek the highest interest rate applicable to ILEC misconduct, but it is clear that the ILECs’ conduct was not a mere miscalculation resulting in accidental overcharges. Rather, this is a case where the ILECs should have known that what they were doing – applying add-back where it increased access charges and not applying add-back where it decreased access charges – would be found to be unlawful by the Commission. AT&T Reply at 4-5. Accordingly, Commission precedent requires the refunds to be computed using an interest rate equal to the IRS interest rate for corporate overcharges.

There is no merit to the ILECs’ contentions that they lacked “constructive knowledge” (*i.e.*, “should have known”) that their failure to apply add-back in their 1993 and 1994 tariffs was unlawful. In fact, in 1990, the Commission very clearly explained that sharing and low-end adjustments should “operate only as one-time adjustments to a single year’s rates, so a LEC would not risk affecting future earnings.”⁴ And, as the Commission has since demonstrated, basic mathematics confirms that add-back is necessary to ensure that sharing and low-end adjustments affect only a single year’s rates.⁵ The D.C. Circuit likewise has confirmed that “without add-back, the sharing adjustment . . . would continue to affect a carrier’s price caps year after year because the carrier’s earnings, rather than reflecting the carrier’s true productivity, would simply reflect the previous year’s sharing obligation.”⁶ Thus, unless the

³ Memorandum Opinion and Order, *GCI v. ACS*, 16 FCC Rcd. 2834, ¶ 74 (2001) (“*GCI v. ACS*”). These alternative interest rates and corresponding triggers have been upheld by the D.C. Circuit. *ACS v. FCC*, 290 F.3d 403, 414-15 (D.C. Cir. 2002).

⁴ Second Report and Order, *Policy and Rules Concerning Rates for Dominant Carriers*, 5 FCC Rcd. 6786, ¶ 136 (1990).

⁵ Report and Order, *Price Cap Regulation of Local Exchange Carriers Rate-of-Return Sharing and Lower Formula Adjustment*, 10 FCC Rcd. 5656, ¶ 28 (1995) (“*1995 Add-Back Order*”).

⁶ *Bell Atlantic Tel Cos. v. FCC*, 79 F.3d 1195, 1205 (D.C. Cir. 1996); *accord id.* at 1202 (the “add-back rule had been implicit in the sharing rules from the beginning”); *1995 Add-Back Order* ¶ 56 (“the add-back adjustment [wa]s essential if the sharing and low-end adjustments of the ILEC price cap plan [we]re to achieve their intended purpose”); *id.* ¶ 50 (“Without this adjustment . . . the sharing and low-end adjustments would not operate as [the price cap order] intended” and “add-back adjustments are *necessary* to achieve fully the purpose of the sharing and low-end adjustment mechanisms”) (emphasis added); *id.* ¶¶ 32, 56 (The Commission never “intended to eliminate the [add-back rules from the price cap system] for purposes of calculating current year earnings”). Even if the LECs could credibly claim that they lacked “constructive knowledge” that they were required to apply add-back *in 1993*, they can make no such claims *for*

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ILECs failed to grasp basic mathematics – and no ILEC suggests that is the case here – their assertions that “[i]t is absurd to suggest”⁷ that they should have known to apply add-back in their 1993 and 1994 tariffs must be rejected, and they should be required to compute refunds using the IRS interest rate for corporate overpayments.

Unable to legitimately contest that they are subject to the IRS interest rate for corporate overpayments under *GCI v. ACS*, the ILECs contend that the Commission should ignore that precedent because *GCI v. ACS* was a § 208 proceeding rather than a § 204 proceeding. But the Commission has never distinguished between such proceedings for purposes of assessing interest rates. On the contrary, the Commission has expressly adopted the same methods for computing interest in such proceedings. *See, e.g.*, Memorandum Opinion and Order, *Section 208 Complaints Alleging Violations of the Commission’s Rate of Return Prescription for the 1987-1988 Monitoring Period*, 8 FCC Rcd 5485, ¶ 42 (1993) (adopting the same methodology for computing “interest awarded in proceedings under Sections 204, 205, 224 and 208 of the Act”). That is because, the relevant issue in both types of proceedings is the proper measure of interest for ILEC overcharges; it makes no difference whether such overpayments were addressed by the Commission in a § 204 tariff investigation or whether the overpayments were addressed by the Commission following a § 208 complaint.

Even if the Commission could ignore the criteria for choosing an interest rate adopted by the Commission in *GCI v. ACS*, there is still no basis for adopting the very low interest rates proposed by the ILECs. The ILECs have failed to identify even a single case in which the Commission allowed an ILEC to use such a low interest rate for computing refunds for overcharges. *Accord GCI v. ACS*, ¶ 74 (noting the non-existence of any situation in which the Commission has awarded interest at “the rate for large corporate overpayments [those exceeding \$10,000]”). That is because the Commission has consistently held that the IRS interest rate for corporate overpayments, or even higher interest rates, should be used when computing such refunds.⁸

1994. By 1994, the Commission already had suspended the LECs’ 1993 tariffs on the grounds that the failure to apply add-back raised serious questions of lawfulness. In addition, by the time the LECs filed their tariffs in 1994, the Commission had already issued the Notice of Proposed Rulemaking, *Price Cap Regulation of Local Exchange Carriers Rate of Return Sharing And Lower Formula Adjustment*, 8 FCC Rcd. 4415 (1993), in which the Commission plainly noted that it believed the price cap rules required the application of add-back. *Id.* ¶ 4 (“we believe that ‘add-back’ is more consistent with the price cap plan as it was adopted”); *id.* ¶ 11 (“[we] believe that [add-back] continues to be an appropriate and indeed probably necessary component of the [price cap mechanism]”); *id.* ¶ 15 (“we tentatively conclude that the add-back adjustment should continue to be part of the rate of return calculations of LECs subject to price caps”).

⁷ *E.g.*, BellSouth Letter at 3.

⁸ *E.g.*, *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, 17 FCC Rcd. 2020, App. C (2002) (using IRS corporate

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The ILECs references to Commission statements that interest rates are not intended to “penalize” the ILECs are meaningless here. The Commission has expressly determined (in the two cases relied on by the ILECs) that the IRS interest rate for corporate overpayments – the interest rate required by Commission precedent and supported by AT&T here – is *not* a penalty. In the *LNP Order*, (¶¶ 4-5), the Commission made clear that it was not seeking to penalize the ILECs, and adopted the IRS *individual* overpayment rate, which is one percentage point *higher* than the IRS interest rate for corporate overpayments. Likewise, in *Western Union*, the Commission also stated that it was not attempting to penalize the ILECs, and adopted an interest rate equivalent to the current IRS interest rate for corporate overpayments (the federal rate plus 2 percentage points).

Finally, the ILECs’ claims that they should be permitted to apply the IRS interest rate for corporate overpayments exceeding \$10,000 merely because the amounts in question here exceed \$10,000 has been expressly rejected by the Commission. See *GCI v. ACS* ¶¶ 73-74 (rejecting the notion that the amount of refunds has any bearing on the proper IRS interest rate to use when computing refunds).

On this record, it is clear that consistent Commission precedent requires the ILECs to apply an interest rate at or above the IRS interest rate for corporate overpayments. The ILECs’ request to apply a much lower interest rate equal to the IRS interest rate for corporate overpayments exceeding \$10,000 should thus be rejected.

Respectfully submitted,

/s/ Christopher T. Shenk

cc: Julie Saulnier
Deena Shetler

interest rate to compute refunds, which is the federal rate plus 2 percentage points); *Section 208 Complaints Alleging Violations of the Commission’s Rate of Return Prescriptions*, 12 FCC Rcd. 4007, App. B (1997) (same); Memorandum Opinion and Order, *In Re Western Union Telegraph Co.*, 10 FCC Rcd. 1741, ¶¶ 38-39 (1995) (“*Western Union*”) (adopting the federal rate plus 2 percentage points); Memorandum Opinion and Order, *Long-Term Telephone Number Portability Tariff Filings of Ameritech et al.*, 14 FCC Rcd. 17339, ¶¶ 4-5 (1999) (“*LNP Order*”) (adopting the IRS interest rate for *individual* overpayments, which is 1 percentage point higher than the IRS interest rate for *corporate* overpayments).