**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20544**

| | |
|---|---|
| In the Matter of<br><br>National Exchange Carrier Association, Inc.'s Proposed 2007 Modification of Average Schedule Formulas | WC Docket No. 06-223 |

# COMMENTS OF VERIZON


Of Counsel:

Michael E. Glover

Scott H. Angstreich
KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
(202) 326-7959

Karen Zacharia
Amy P. Rosenthal
VERIZON
1515 North Courthouse Road, Suite 500
Arlington, VA 22201-2909
(703) 351-3175

*Counsel for Verizon*


February 13, 2007

# TABLE OF CONTENTS

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20544**

| | |
|---|---|
| In the Matter of<br><br>National Exchange Carrier Association, Inc.'s Proposed 2007 Modification of Average Schedule Formulas | WC Docket No. 06-223 |

## COMMENTS OF VERIZON[1]

## INTRODUCTION AND SUMMARY

The members of the National Exchange Carrier Association ("NECA") charge unreasonably high access charge rates that fail to reflect today's competitive market and that fail to comply with the Commission's rate-of-return prescription. Rather than continuing to allow NECA members to levy unreasonable and noncompetitive access charges, the Commission should require NECA's access charge rates to be brought into line with rates charged by price cap carriers under the CALLS regime. The rates for price cap LECs implemented in the *CALLS I Order*[2] were established through a market-based mechanism — namely, negotiations between carriers with equivalent bargaining power — and submitted to the Commission as part of the CALLS process. The CALLS rates therefore already reflect market-based rates. Under that regime, the targeted switched access rates for large price cap carriers is $0.0055 per minute, or *less than one third* of the average rate of $0.0199 per minute that NECA's members charge, even

[1] The Verizon companies participating in this filing ("Verizon") are the regulated, wholly owned subsidiaries of Verizon Communications Inc.

[2] Sixth Report and Order in CC Docket Nos. 96-262 and 94-1; Report and Order in CC Docket No. 99-249; Eleventh Report and Order in CC Docket No. 96-45, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service*, 15 FCC Rcd 12962 (2000) ("*CALLS I Order*"), *aff'd in part, remanded in part, Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313 (5th Cir. 2001).

though there is little (if any) difference in the work performed by price cap and rate-of-return carriers. Even the targeted switched access rate for rural price cap carriers under CALLS is $0.0095 per minute, or *less than half* of the average rate of $0.0199 per minute that NECA's members charge. There is no justification for insulating NECA members from the effects of competition by requiring long-distance carriers and their customers to continue subsidizing NECA's members through payment of these unjust and unreasonable access charges.

NECA's most recent tariff-related filings highlight the noncompetitive access rates charged by its members and the need for this reform. Although NECA's members are subject to the Commission's rate-of-return regulations, its members have flouted those regulations for over a decade, at the expense of competition and ultimately, consumers. Indeed, NECA itself has conceded that, for *every* two-year monitoring period from 1993 though 2004, its members have violated the Commission's rate-of-return prescription; nothing NECA has filed since proves matters are different from 2005 through the present. And NECA has *increased* access charge rates — by nearly 6 percent in its June 2006 tariff filing — even as its own calculations of members' costs continue to *decrease*. Indeed, NECA's current filing shows that increased efficiencies and the resulting cost reductions should lead to average settlement reductions of about 7.27 percent, *on top of* the average reduction of about 1.7 percent in NECA's filing last year.

Yet, as it did last year, NECA proposes to insulate its members from the consequences of these reductions under rate-of-return regulation, by slow-rolling the reductions of settlements over a period of two years. Thus, the cost reductions calculated by NECA from 2004 and 2005 would not be fully reflected in reduced settlements until June *2009*. NECA estimates that this transition will provide more than $33.6 million in subsidies to its members over the two-year transition; this is in addition to the more than $18.8 million in subsidies NECA members will receive this year and next year under the transition plan NECA proposed last year. The Commission should reject this transition, because approving these subsidies would allow NECA's members — through June 2009 — to receive subsidized revenues that will necessarily exceed the Commission's rate-of-return prescription, and therefore violate 47 U.S.C. § 201(b) as implemented by the Commission. That is true even without considering NECA's demonstrated history of proposing access charges and other rates that insulate NECA's members from the effects of competition and that consistently result in revenues in excess of the Commission's rate-of-return prescription. None of the reasons NECA gives for its transition this year — which is significantly larger in size and scope than last year's transition — justifies ignoring the Commission's clear rate-of-return prescription for the more than 85 percent of average schedule companies who would benefit from the subsidies in this transition.

Finally, although NECA's filing is voluminous and packed with numbers and mathematical symbols, our preliminary review shows NECA has failed to provide the information needed for "the Commission and interested parties to verify NECA's Study results."[3] The Commission should require NECA to provide further substantiation for its claims and calculations before ruling on its submission.

[3] 2007 Modification of Average Schedules, National Exchange Carrier Association, Inc., *2007 Modification of Average Schedules*, WC Docket No. 06-223, at I-4 (Dec. 21, 2006) ("*2007 Modification of Average Schedules*").

## DISCUSSION

## I. THE COMMISSION SHOULD REJECT NECA'S PROPOSED TRANSITION AND SHOULD REDUCE NECA'S ACCESS CHARGE RATES TO CALLS LEVELS

### A. NECA Consistently Flouts the Commission's Rate-of-Return Regulation and Should Be Required To Reduce Its Access Charge Rates to CALLS Levels

The Communications Act requires that all "charges, practices, classifications, and regulations for and in connection with" communications services subject to Section 201(a) "shall be just and reasonable." 47 U.S.C. § 201(b). In implementing this statutory mandate, the Commission has repeatedly found that "competition is the *most effective* means of ensuring that . . . charges, practices, classifications, and regulations . . . are just and reasonable, and not unreasonably discriminatory."[4] In the *Access Charge Reform Order*,[5] the Commission explained why market forces, such as those that would later be brought to bear in arriving at the CALLS proposal, are the best basis for switched access rate-setting. A "market-based approach" will result in "a better combination of prices, choices, and innovation than can be achieved through rate prescription." *Access Charge Reform Order* ¶ 289; *see id.* ¶ 263. This is because "competitive markets are far better than regulatory agencies at allocating resources and services efficiently for the maximum benefit of consumers." *Id.* ¶ 42. The Commission therefore concluded "that competition or, in the event that competition fails to develop, rates that approximate the prices that a competitive market would produce, best serve the public interest."

[4] Memorandum Opinion and Order, *Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c)*, 19 FCC Rcd 21496, ¶ 24 (2004) ("*Broadband Forbearance Order*") (internal quotation marks omitted; omissions in original; emphasis added), *aff'd, EarthLink, Inc. v. FCC*, 462 F.3d 1 (D.C. Cir. 2006).

[5] First Report and Order, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Transport Rate Structure and Pricing; End User Common Line Charges*, 12 FCC Rcd 15982 (1997) (subsequent history omitted) ("*Access Charge Reform Order*").

*Id.* ¶ 42; *see id.* ¶¶ 262, 263. Applying these principles, the Commission's *CALLS I Order* implemented rates for price cap LECs that were established through a market-based mechanism— namely, negotiations between carriers with equivalent bargaining power – and submitted by those carriers to the Commission.

The Commission should therefore be moving *all* carriers' interstate access rates toward the market-based rates charged by price cap LECs under the CALLS regime. The Commission can do so in two steps, first by requiring NECA and its members to reduce their interstate access rates to the levels currently maintained by the rural carriers subject to the *CALLS I Order*. CALLS brought about substantial reductions in the interstate access charge rates of the carriers subject to that plan, and it would be appropriate to create a more level playing field by extending that plan to all carriers' interstate access rates. Indeed, there is little (if any) difference in the work performed by rural price cap and rural rate-of-return carriers; there is no justification for non-price cap carriers to charge more than twice as much for that work. Second, all carriers' interstate access charge rates should be brought down to the lowest CALLS target level. This, in turn, would put all carriers on an equal footing, enabling a smoother transition to a regime of voluntarily negotiated rates.

The market-based rates of the CALLS regime stand in stark contrast to NECA's noncompetitive access charges. In contrast to the market-based rates that were *reduced* under CALLS, NECA has recently *increased* its tariffed switched access rates. In July 2006, NECA increased its averaged access rate to \$0.0199 per minute, a six percent increase from the \$0.0188 per minute averaged rate under the July 2005 tariff filing.[6] This rate is *more than double* the

[6] *See* NECA, Access Service Tariff FCC No. 5, Transmittal No. 1129, Vol. 1, at 10 (filed June 16, 2006).

target rate of $0.0095 per minute established under the CALLS regime for rural price cap LECs. *See CALLS I Order* ¶ 142. And the rate is *more than triple* the target rates established for the Bell operating companies and GTE ($0.0055 per minute) and for all other price cap LECs ($0.0065 per minute). *See id.*

NECA members have imposed these noncompetitive rates under the guise of – but in violation of – the Commission's comprehensive regulatory scheme governing rate-of-return carriers. Under the Commission's rate-of-return regulation, carriers may not charge rates that will generate a return exceeding 11.25 percent.[7] This prescription is applicable to all rate-of-return carriers, regardless of whether they file tariffs individually or as part of an association such as NECA.

NECA, however, has consistently violated the Commission's rate-of-return prescription. Indeed, NECA violates the basic procedural requirements designed to ensure compliance with that prescription, like the obligation to file a report (Form 492) by September 30 of the year following the close of a two-year review period — that is, every odd-numbered year — containing any "*[f]inal* adjustments to the enforcement period report." 47 C.F.R. § 65.600(b) (emphasis added). As the Commission found in 2004, the Forms 492 that NECA files pursuant to § 65.600(b) "do not represent final earnings," and NECA did "not . . . subsequently file a revised Form 492 to disclose the final data." *NECA Access Tariff Order*[8] ¶¶ 10-11.

As part of that proceeding, NECA informed the Commission "for the first time . . . of its 'final' rates of return for traffic sensitive switched access services." *Id.* ¶ 25 n.70. According to

---

[7] *See, e.g.*, Order, *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, 5 FCC Rcd 7507, ¶ 216 (1990).

[8] Memorandum Opinion and Order, *July 1, 2004 Annual Access Charge Tariff Filings*, 19 FCC Rcd 23877 (2004) ("*NECA Access Tariff Order*").

NECA, those returns were 12.93 percent for the 1993–1994 monitoring period, 12.11 percent for 1995–1996, 13.46 percent for 1997–1998, 12.17 percent for 1999–2000, and 13.14 percent for 2001–2002. *Id.* The Commission noted that NECA's "final" rate-of-return report for 2003–2004 "would not be available until January 2007." *Id.* That report just became available, and it shows a return of 13.77 percent[9] — the *highest* return during any of the monitoring periods from 1993 through 2004. In other words, *according to NECA's own calculations*, NECA's members have exceeded the prescribed rate-of-return in *each and every* monitoring period from 1993 through 2004. On September 29, 2006, NECA submitted a Form 492 for the first year of the 2005–2006 monitoring period. That form showed returns of 13.15 percent in 2005 for participants in the NECA Traffic Sensitive and Common Line Pool.[10]

Despite this clear record of violating the Commission's rate-of-return prescription, the Commission has been hampered in enforcing that prescription by NECA's own failure to provide the Commission with sufficient data to review NECA's filings. Thus, in reviewing NECA's 2004 tariff filing, the Commission repeatedly found that NECA "did not provide . . . substantial data that we require"; that it gave "unsatisfactory and inadequate" explanations for its failure to provide that data; that the "data that NECA d[id] provide are inadequate to provide the level of detailed information necessary to complete [the Commission's] investigation"; that the data contained adjustments that were "not adequately identif[ied]" and for which "NECA's explanations are inadequate." *E.g.*, *NECA Access Tariff Order* ¶¶ 16-20. All told, these failures on NECA's part "d[id] not allow [the Commission] to determine the validity of NECA's 24-month rate of returns." *Id.* ¶ 23. Indeed, the Commission found that the absence of "sufficient

[9] NECA Form 492 (filed Jan. 31, 2007).

[10] NECA Form 492 (filed Sept. 29, 2006).

and reliable data" rendered it "unable to ensure that [any] prescription [of switched access rates] would result in just and reasonable rates." *Id.* ¶ 25.

Even though it has been reporting consistent violations of the Commission's rate-of-return prescription, NECA has recently *increased* its tariffed switched access rates. In July 2006, NECA increased its averaged access rate to $0.0199 per minute, a six percent increase from the $0.0188 per minute averaged rate under the July 2005 tariff filing.[11] The Commission should not allow NECA to continue to flout its rate-of-return regulations to impose such noncompetitive access rates on long-distance carriers and their customers, and should instead require NECA's access charge rates to be brought into line with the rates charged under the CALLS regime.

### B. NECA's Proposed Transition Should Be Rejected

The unjustness and unreasonableness of NECA's extremely high access charge rates is shown not only by its Forms 492, but also by its recent filing to revise the formulas used for average schedule interstate settlement disbursements and to provide a "transition" mechanism to protect revenues for those members with declining costs and decreasing settlement disbursements. Even if the Commission does not shift NECA members' access rates to CALLS levels in the immediate term, the Commission should reject NECA's average settlements "transition" proposal.

NECA asserts that its members are experiencing significant declines in their costs, due to what NECA describes as a "marked decline in costs of some line haul facilities" resulting from "cost economies in fiber and copper networks equipped for ever increasing broadband demand," as well as "continued depreciation" of older network investments. *2007 Modification of Average*

[11] *See* NECA, Access Service Tariff FCC No. 5, Transmittal No. 1129, Vol. 1, at 10 (filed June 16, 2006).

*Schedules* at I-5. Because NECA's proposal for the year starting in July 2007 is based on data from 2004 and 2005, *see id.* at III-4–III-5, it does not capture more recent investments in more efficient broadband facilities. And this downward cost trend is likely to continue into the future, as NECA members — like all other incumbent telephone companies — "continue to improve their networks to provide their customers with the broadband services they want."[12]

The settlement reductions that should follow from these changes are (on NECA's calculation) about 7.27 percent on average. *2007 Modification of Average Schedules* at I-6. That average masks the fact that some members have seen even greater cost decreases: NECA reports that 23 study areas would see a reduction of more than 20 percent of settlements, and another 51 would see a reduction of more than 10 percent of settlements, if their reduced costs were reflected fully in their settlements starting in July 2007. *See id.*

NECA, however, proposes to insulate its members from these reductions by slow-rolling the reductions over a two-year period, so the reductions based on data from 2004 and 2005 are not fully implemented until June 2009. *See id.* at VII-67–VII-68. At the same time, it proposes that its members in the approximately 15 percent of study areas that would see an increase in their settlements — in some cases, an increase of more than 10 percent — immediately receive the full amount of their increased settlements. *See id.* at VII-68, E-14. This is similar to what NECA proposed for the year starting July 2006. NECA then proposed formula changes that would reduce overall settlement rates by about 1.7 percent, but with "most companies . . . expected to experience small increases in settlements," and some increasing by more than 10

[12] Technology Planning & Implementation Group, NECA, *Trends 2006: Making Progress with Broadband* at 9 (Sept. 18, 2006), *available at* http://www.neca.org/media/trends_brochure_website.pdf.

percent.[13] While those companies received the full amount of their increased settlements immediately, those that had reduced costs that warranted reduced settlements benefited from a two-year transition.[14] Indeed, even though the formula adjustments were based on data from 2003 and 2004,[15] that transition will not be completed until June 2008.

Although the Wireline Competition Bureau approved NECA's proposed transition plan in 2006,[16] the Commission should *reject* the proposed transition this year. As the Bureau recognized last year, the general rule is that "changes in average schedule settlements normally should parallel changes in cost company settlements."[17] That is because a failure to follow this rule conflicts with the Commission's goal of "remov[ing] . . . implicit subsidies from the rate structure of rate-of-return carriers," as the transition plan is an unambiguous $33.6 million subsidy to NECA members.[18] A failure to follow the general rule also ensures that companies that benefit from the transition will necessarily experience returns that violate the Commission's rate-of-return prescription and, therefore, violate 47 U.S.C. § 201(b), as applied to rate-of-return carriers.

---

[13] 2006 Modification of Average Schedules, National Exchange Carrier Association, Inc., *2006 Modification of Average Schedules*, WC Docket No. 05-347, at I-5–I-6 (Dec. 29, 2005) ("*2006 Modification of Average Schedules*").

[14] *See id.* at VII-70–VII-71.

[15] *See id.* at III-3.

[16] Order, *National Exchange Carrier Association, Inc., 2006 Modification of Average Schedules*, 21 FCC Rcd 6220 (May 30, 2006) ("*2006 Bureau Order*").

[17] *Id.* ¶ 4.

[18] Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45 and Report and Order in CC Docket Nos. 98-77 and 98-166, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, 16 FCC Rcd 19613, ¶ 83 (2001).

When the additional settlements NECA proposes are added to the demonstrated history of NECA's violation of the rate-of-return prescription as shown in its Forms 492, it is clear that NECA's proposed transition ensures that its members will not comply with the rate-of-return prescription through at least 2009. These effects will be exacerbated when NECA, next year, proposes yet another transition to further insulate its members from the necessary consequences of their own declining costs. The Commission should put a stop to this and should reject the transition plan to ensure that NECA's members abide by the Commission's rate-of-return prescription.

The transition NECA proposes this year, moreover, is significantly different from the one approved last year. First, the proposed transition is nearly double the size of last year's transition.[19] Second, while last year's transition did not apply to "most" companies, this year's would apply to more than 85 percent of average schedule companies, some of which are also benefiting the transition approved last year (and will benefit from that next year as well). Despite these differences, NECA provides the Commission with the same justification, *word-for-word,* as last year — namely, that some members are concerned that immediate implementation of the settlement reductions could cause:

> the delay of broadband service deployment plans, or difficulty meeting a 2008 broadband deployment deadline mandated by one state, restrictions on future business plans if impacts on a company's cash flow causes a lender to modify

[19] *Compare 2006 Modification of Average Schedules* at VII-71 (estimating that the transition will result in $13.92 million in additional transition payments in the year beginning July 2006, and $4.89 million in additional payments in the following year, for a total of $18.81 million) *with 2007 Modification of Average Schedules* at VII-68 (estimating that the transition will result in $24.89 million in further additional transition payments in the year beginning July 2007, and $8.74 million in additional payments in the following year, for a total of $33.63 million).

> terms of a loan according to an existing loan covenant, and the possible inability of a carrier to meet existing loan commitments.[20]

Therefore, even assuming the Bureau were justified in finding, without further elaboration, that "the . . . circumstances [last year] do justify [the] transition plan,"[21] that finding cannot apply this year, where NECA has proposed a much bigger transition, but cannot identify even one additional effect that concerns its members. Nor has NECA substantiated these purported concerns or quantified the alleged effects on each of its member companies. As noted above, last year, *most* companies were *not* covered by the transition; this year, more than *85 percent* of NECA's average schedule companies would be covered.

In short, NECA has given no justification for departing from the general rule that NECA members should immediately incur the reductions in settlements that result from reductions in costs. And NECA's own history in violating the rate-of-return prescription and refusing to give the Commission sufficient data with which to assess NECA's claims, both counsel strongly against adopting a transition that ensures that more than 85 percent of average schedule companies will have returns that violate the Commission's rules until June 2009.

## II. THE COMMISSION SHOULD REQUIRE NECA TO SUBMIT ADDITIONAL INFORMATION TO SUBSTANTIATE ITS CALCULATIONS

NECA's filing is lengthy, and is replete with numbers and mathematical symbols. But despite this veneer of substantiation, basic details of NECA's calculations are missing from its filing. As a result, NECA has failed to provide the information needed for the Commission or Verizon to verify NECA's Study results. Verizon cannot yet detail all of these issues —

---

[20] *2007 Modification of Average Schedules* at VII-67; *accord 2006 Modification of Average Schedules* at VII-68.

[21] *2006 Bureau Order* ¶ 4.

NECA's filing tops six hundred pages, and Verizon has had limited time to review it. But at least some issues are readily apparent.

First, NECA fails to provide all of the "explanatory variables" that it used to develop the models presented in Section IV of the *2007 Modification of Average Schedules*. For example, NECA does not provide data for "Adjusted Special Access Revenues per Line with Wideband" and "Adjusted Special Access Revenues per Line without Wideband," two of the variables used in its "COE Category 4.2 – Interexchange Circuit" model.[22] Similarly, NECA does not provide the "variance weights" for any of the models discussed in Section IV of the *2007 Modification of Average Schedules*.

Second, NECA fails to provide information it used to "project" access minutes in the future. In particular, NECA's discussion in Section V shows that NECA's estimate of the decline in access minutes expected for the twelve months ending June 2008 relies on NECA's estimates of the consumer price index, disposable income, a price index for cellular services, and employment in the twelve months ending June 2008.[23] However, NECA does not explain how it estimates these variables for future periods, and does not provide its estimates.

Third, NECA fails to provide the "dependent variables" for its 11 settlement formulas. For example, the dependent variable for NECA's settlement formula for "Central Office Formula – Local Switching Only" is "central office revenue requirements."[24] NECA does not, however, present its estimate of central office revenue requirements for each sample "average schedule"

[22] *See 2007 Modification of Average Schedules* at IV-23.

[23] *See id.* at V-15–V-19.

[24] *See id.* at VII-20.

company in its analysis. Indeed, NECA does not provide its definition of "central office revenue requirements."

To allow the Commission and other parties to evaluate its analysis, NECA should provide all of the intermediate data sets it used in its analysis (*e.g.*, data files that contain dependent variables, all explanatory variables, and all "weights" for every regression model), and all the computer programs used to estimate all models and adjustments that NECA relies on to develop its settlement formulas.

## CONCLUSION

For the foregoing reasons, the Commission should reject NECA's proposed transition.

Respectfully submitted,

Scott Angstreich / APR

Scott H. Angstreich
KELLOGG, HUBER, HANSEN, TODD,
EVANS & FIGEL, P.L.L.C.
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
(202) 326-7959

Karen Zacharia
Amy P. Rosenthal
VERIZON
1515 North Courthouse Road, Suite 500
Arlington, VA 22201-2909
(703) 351-3175

*Counsel for Verizon*

Of Counsel:

Michael E. Glover

February 13, 2007