

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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Federal Communications Commission
Office of the Secretary

In the matter of

Request for Review by Centennial
Communications Corp. of Decision of the
Universal Service Administrator

CC Docket No. 96-45
CC Docket No. 00-256

**REQUEST FOR REVIEW AND,
IN THE ALTERNATIVE, REQUEST FOR WAIVER, AND REQUEST TO SUSPEND
RECOVERY**

Pursuant to 47 C.F.R. §§ 54.719(c) and 54.722(a), Centennial Communications Corp. ("Centennial")¹ hereby requests review and reversal of a decision of the Universal Service Administrative Company ("USAC") on March 28, 2007 regarding the "true-up" of Interstate Common Line Support ("ICLS") payments for Puerto Rico for 2004.² This request is timely filed within 60 days of the issuance of USAC's decision, as required by 47 C.F.R. § 54.720(a). In the alternative, Centennial requests that the Commission waive the application of the true-up rule, and related rules, to permit Centennial to retain the universal service funds it received for Puerto Rico in 2004.

I. Introduction and Summary.

This request for review arises out of USAC's application of the true-up rules applicable to the ICLS program (47 C.F.R. §§ 54.903(a)(4), (b)(3)) to the two Puerto Rico Telephone Company ("PRTC") study areas in Puerto Rico, for calendar year 2004. Based on its

¹ The specific Centennial entity certified as an eligible telecommunications carrier ("ETC"), and receiving support relevant to this appeal, is Centennial Puerto Rico Operations Corp.

² A copy of USAC's March 28, 2007 decision ("*USAC Decision*") is attached hereto as Exhibit 1. Centennial's principal filing with USAC below was a letter (with attachments) dated September 25, 2006, attached hereto as Exhibit 2. Centennial supplemented that original package with a letter dated March 13, 2007. That letter is attached hereto as Exhibit 3.

interpretation of the true-up rules, USAC concluded that Centennial had been overpaid by \$5,381,641, out of an initial payment of \$9,185,973 – a “true-up” of nearly 60%.³ Under a proper application of those rules, however, only a very modest true-up is appropriate.⁴

The Commission’s review of USAC’s determination is *de novo*, see 47 C.F.R. § 54.723, so Centennial could, theoretically, simply present its views here, without regard to USAC’s explanation of its actions. That said, while Centennial believes that USAC applied the ICLS and LTS rules erroneously, we recognize that USAC considered the matter in some detail and put a great deal of effort into reaching its conclusions. For this reason, we discuss not only our affirmative views regarding the proper interpretation and application of the rules, but also address USAC’s approach and why we believe that approach is mistaken.⁵

USAC misapplied the ICLS true-up rule in two specific ways. The first relates to the treatment of Long Term Support (“LTS”) payments during the first half of 2004. The rule calls for true-ups to be conducted once a year, but does not contemplate that the true-up calculations themselves must be based on an undifferentiated, unitary “annual” analysis. To the contrary, the rule recognizes that ICLS disbursements are made on a monthly basis, and the underlying rules

³ See *USAC Decision* at 22. These figures reflect USAC’s agreement with Centennial that USAC had originally overstated the amount that Centennial had been paid in 2004, which led USAC to demand an even larger recoupment. See *id.* at 18-21.

⁴ Centennial presented USAC with its analysis of the proper true-up amount for 2004, and believes that a relatively minor true-up relating to that year is appropriate. See Exhibit 2 hereto, at Attachment 1 (showing total true-up for 2004 of \$110,247). However, USAC initially began recovery in August 2006, and in that month alone recovered more than the entire correct true-up amount. So, looking at the 2004 true-up in isolation, a small payment back to USAC is appropriate. Taking account of the amounts that USAC has already recovered, however, USAC should actually refund substantial amounts to Centennial. Centennial believes that it will not be difficult to reconcile the appropriate specific amounts with USAC, once the substantive issues raised in this request have been resolved.

⁵ USAC had the matter under consideration for six months from the time Centennial submitted its initial detailed intra-USAC appeal in late September 2006. USAC’s ultimate decision runs to 22 single-spaced pages, with nearly that much additional material in the form of charts and attachments. While we obviously disagree with USAC’s conclusions in this matter, we appreciate the time, attention and courtesy with which it was handled.

for determining ICLS in the first place contemplate the use of monthly, quarterly, and annual data as appropriate. Moreover, the ICLS program operates on the basis of July 1 – June 30 funding year, so each calendar year will encompass the end of one funding year and the beginning of another. If there are significant differences in the ICLS program from one funding year to the next, true-up calculations will need to be made in a manner that reflects those differences. All of these factors affect the “relevant period” to which the details of a given year’s true-up calculation must apply.⁶

USAC apparently failed to appreciate this aspect of the true-up process, and took the position that the only appropriate way to calculate a true-up is by using a unitary, annual calendar-year calculation that ignores all distinctions between different periods within a year. That was a mistake with respect to 2004, because it violates the substantive requirements of § 54.901(a) to consider the LTS payments received in the first half of 2004 – the end of ICLS funding year 2003-2004 – as relevant to ICLS payments in the second half of that year – the beginning of ICLS funding year 2004-2005. LTS payments cannot properly be considered relevant to any period after July 1, 2004 because that is the date on which the Commission declared the LTS program to be fully and finally terminated.⁷ The rules for calculating the appropriate ICLS amounts for the 2004-2005 funding year, therefore, literally prohibit consideration of any LTS amounts at all. However, USAC’s approach attributes LTS revenue from the first half of 2004 to the second half, and uses that mis-attributed revenue to offset ICLS payments attributable to the second half.

⁶ See 47 C.F.R. § 54.903(a)(4).

⁷ See *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122 (2004) (“*LTS Order*”) at ¶ 67; 47 C.F.R. § 54.303(a)(1) (“Beginning July 1, 2004, no carrier shall receive Long Term Support”).

It appears that USAC interpreted the true-up rule in this way out of concern that if it did not, then PRTC would over-recover its costs.⁸ It is not at all clear that this is actually correct. But even if it were, enforcing the Commission's rate-of-return prescription against PRTC is not within USAC's delegated authority. *See* 47 C.F.R. § 54.702. If PRTC over-earned for 2004, whether as a result of the LTS program or any other reason, the Commission or PRTC's customers may bring an action to enforce the rate-of-return prescription. And, if the Commission were to become concerned that PRTC's universal-service-related receipts for 2004 were inflated because of an intentional effort to "game" the LTS system, it may, among other things, impose forfeitures on PRTC for a failure to be candid with the Commission.⁹

The second issue relates to the calculations that convert PRTC's LTS and ICLS revenues into per-line amounts, and then use those amounts to derive Centennial's "equal support" payments. Both the ICLS true-up rule (47 C.F.R. § 54.903(b)(4)) and the equal support rules (47 C.F.R. §§ 54.307(a) and 54.901(b)) entitle Centennial to the same per-line support that the PRTC ultimately receives for any given period. USAC, however, calculated final 2004 per-line support using line counts from prior periods.¹⁰ As a factual matter, PRTC is shedding lines, and Centennial is gaining them. This makes the line-count error a "double-whammy." It first understates PRTC's per-line support (by dividing its 2004 costs by an artificially high, out-of-period number of lines). Then it uses this erroneously low per-line amount to an artificially reduced number of Centennial lines (lower line counts from periods before 2004). This is

⁸ *See, e.g., USAC Decision* at 5 & n.33, 9, 11, 12.

⁹ *See In the Matter of Business Options, Inc.; Order to Show Cause and Notice of Opportunity for Hearing*, 18 FCC Rcd 6881 (2003) at ¶ 15 ("The duty of absolute truth and candor is a fundamental requirement for those appearing before the Commission").

¹⁰ Based on the *USAC Decision*, it appears that the line counts it used were lagged by approximately twelve months. *See USAC Decision* at 13 (chart) (compare column 2, "Time Frame of Reported Data" with column 5, "Affects Payments for").

completely inconsistent with the Commissions rules, which require a true-up to be based on “actual” data.

Centennial requests that the Commission correct the two errors. However, if the Commission concludes that USAC applied the rules as intended, then Centennial respectfully requests that the Commission waive the true-up and associated rules to permit Centennial to retain the universal service support payments for Puerto Rico that it actually received and spent in 2004. As noted above, the “true-up” amounts to a nearly 60% reduction in the amounts originally provided. This is not a meaningful “true-up” at all. To the contrary, an adjustment of this magnitude violates the command of 47 U.S.C. §§ 254(b)(5) and (d) that universal service funding be “predictable.” Moreover, Centennial has already used the money to expand its Puerto Rico wireless network in ways that would not be economically reasonable based on purely commercial considerations. Centennial cannot “un-invest” or “un-spend” this money; as a result, the massive “true-up” is effectively a punitive action against Centennial, which reasonably relied on the approximate accuracy of the funds it was receiving from USAC. Furthermore, the unique situation in Puerto Rico – very low wireline penetration, with unusually high penetration of wireless – also supports giving special consideration to funding robust wireless ETC services there. As a result, a waiver of the true-up and associated rules is particularly appropriate in this specific situation.

Finally, Centennial requests that the Commission direct USAC to stay its recovery of the amounts USAC asserts to be due while this request for review is pending. USAC voluntarily suspended recovery while it considered Centennial’s intra-USAC appeal, for which Centennial is grateful. As Centennial understands it, however, USAC does not view itself to be free to continue that suspension at this juncture. On the merits, Centennial believes that the arguments

asserted in this request are sufficiently substantial that it is fair and equitable to prevent further disruption in Centennial's cash flow – of which universal service support is a non-trivial portion – while this matter is pending.

Centennial discusses each of these points in more detail below.

II. Argument.

A. Misapplication Of The ICLS True-Up Rules.

1. Introduction.

The root cause of this dispute is the fact that PRTC significantly over-estimated its common line costs for the first six months of 2004. In the last few years of the operation of the LTS program, a carrier's LTS disbursement was based on the lower of (a) carrier-projected costs, or (b) prior year LTS amounts adjusted upward for inflation. *See* 47 C.F.R. § 54.303(b)(5)(i). PRTC's projected costs were lower than the inflation-adjusted amount, but turned out to be far above its actual costs.¹¹ Both Centennial and PRTC received LTS payments for the first half of 2004 – that is, the last six months of the 2003-2004 ICLS funding year – based on PRTC's projections. However, neither carrier received any ICLS revenues for that period, because the LTS payments largely covered estimated common line costs. *See* 47 C.F.R. § 54.901(a). By contrast, during the second half of 2004 – that is, the first six months of the 2004-2005 ICLS funding year – both Centennial and PRTC received ICLS disbursements – again based on PRTC's projections – but no LTS revenues (since the LTS program had terminated as of July 1, 2004).

When USAC examined PRTC's actual data, PRTC's over-estimation became evident. Based on its written ruling, it appears that USAC may have been motivated to find a way to get

¹¹ Using USAC's data for 2004, PRTC estimated its cost-based support requirements for 2004 as \$31,928,856, when after-the-fact data showed those amounts to actually be only \$13,982,571. *See USAC Decision* at 8 (chart). This is an over-estimate of more than 125%.

the money back – that is, to impose an effective true-up on the LTS payments. We emphasize that we do not question USAC’s motives in this matter. In the abstract, avoiding a situation in which a rate-of-return carrier might exceed its prescribed level of earnings is surely a worthy goal. We do, however, question USAC’s authority, and its application of the governing universal service rules. USAC’s authority is limited to faithfully and logically applying the rules that the Commission has established for the universal service system. As described below, some of those rules act to prevent over-earnings in some situations; others do not. Where, as here, the relevant universal service rules – those applicable to the LTS program – do not include true-ups or other mechanisms to avoid over-earnings, other tools – such as the ability of the Commission or customers to enforce a rate-of-return prescription¹² – come into play. As described below, in this case USAC should have allowed the LTS payments for the first half of 2004 to stand, but referred the question of PRTC’s overall earnings to the Commission for possible enforcement action.¹³

2. The LTS and ICLS Programs.

In order to understand how these issues should have been handled, it is necessary to briefly present the background and operation of the LTS and the ICLS programs. The key issue is how to handle the transition between those two programs, which occurred as of July 1, 2004.

The LTS program was established in 1987 to allow carriers participating in the NECA common line pool to maintain carrier common line rates near the national average. It was funded by payments from non-pooling carriers.¹⁴ In 1997 the Commission modified the LTS

¹² See, e.g., *MCI Telecommunications Corp. v. FCC*, 59 F.3d 1407 (D.C. Cir. 1995).

¹³ If USAC’s view led it to be concerned that PRTC’s LTS projections reflected a lack of good faith on PRTC’s part, rather than a mere over-estimation, it could have pointed that out to the Commission as well. See generally *Comprehensive Review of Universal Service Fund Management*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, 20 FCC Rcd 11308 (2005) at ¶¶ 67-99.

¹⁴ *LTS Order* at ¶¶ 55-56.

program in two ways. First, LTS would be funded by the universal service mechanisms established under newly-enacted Section 254, rather than by contributions from non-pooling carriers. Second, beginning in 1998, disbursements from the LTS program would be determined based on prior year disbursements, adjusted upwards for inflation.¹⁵

In early 2002, at least for some carriers, inflation-based LTS payments would have resulted in significant over-earnings. NECA and USAC brought this situation to the Commission's attention and, in response, the Commission modified the LTS rules so that a carrier would receive the lesser of (a) the original, inflation-based amount, or (b) a carrier's own projected common line revenue requirement, less applicable revenues such as subscriber line charge receipts, etc.¹⁶

The Commission undoubtedly expected carriers to try to project their common line costs in good faith and with reasonable accuracy. The Commission did not, however, establish a true-up mechanism for LTS in the event that the projections were not entirely accurate. The projections were to establish a *cap*. This absence of a true-up mechanism is all the more striking given that, by the time of the *Projected LTS Order* (June 2002), the Commission had already established the ICLS program, which *does* contain an explicit true-up mechanism. See 47 C.F.R. §§ 54.903(a)(4), (b)(3). The lack of a true-up mechanism for LTS payments, therefore, cannot be viewed as an oversight or a mistake. True-ups of LTS payments were simply not part of what the Commission contemplated when it established the LTS system originally; when it modified that system in 1997; or when it further modified that system in 2002.

¹⁵ *Id.* See also 47 C.F.R. § 54.303(b). From 1998 to 2000 the inflation adjustment was keyed to changes in reported costs of certain carriers; from 2000 on it was keyed to a specific Department of Commerce inflation measure.

¹⁶ *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, Order and Second Order on Reconsideration, 17 FCC Rcd 11593 (2002) ("*Projected LTS Order*").

Meanwhile, in 2001, the Commission had established the ICLS program.¹⁷ The purpose of the ICLS program was to eliminate the per-minute carrier common line charge, and replace the revenues from that charge with an explicit universal service support mechanism. The ICLS program became operational on July 1, 2002.

The ICLS rules contemplate the calculation of ICLS amounts, depending on the context, on monthly, quarterly, and annual bases. The basic ICLS calculation is laid out in 47 C.F.R. § 54.901. The calculations in § 54.901(a) generally refer to annual figures. However, the per-line calculations called for by § 54.901(b) plainly entail the use of *monthly* amounts.¹⁸ Moreover, these monthly calculations require ILEC line counts as an input.¹⁹ These line-count data, in turn, are submitted on a *quarterly* schedule.²⁰ In accordance with these rules, USAC calculates monthly ICLS amounts, which it then multiplies by three to generate quarterly figures.²¹ As described below, this multiplicity of time periods applicable to ICLS calculations undermines any claim that one must, or even should, use a unitary annualized calculation to determine the ICLS true-up for any given year.

In any event, the Commission recognized that ICLS rendered LTS obsolete. With the elimination of the carrier common line charge, LTS – a support program designed to keep that

¹⁷ *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, 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, 16 FCC Rcd 19613 (2001) (“MAG Order”) at ¶¶ 120-76.

¹⁸ Specifically, the formula laid out in 47 C.F.R. § 54.901(b)(3) makes specific reference to the \$2.70 amount by which *monthly* multi-line business maximum subscriber line charges exceed *monthly* residence/single-line business subscriber line charges. As a result, the required calculations must be performed using *monthly* data.

¹⁹ *See id.*

²⁰ *See* 47 C.F.R. § 54.903(a)(2). This rule requires submission of line count data on the schedule laid out in 47 C.F.R. § 36.612 which, in turn, requires quarterly submission of data.

²¹ *See USAC Decision* at Attachment D for an illustration of the use of both quarterly and monthly figures in developing a purportedly “annual” ICLS calculation.

charge at reasonable levels – was unnecessary. As a result, in the *MAG Order*, the Commission proposed to eliminate LTS as of July 1, 2003.²² As events developed, the Commission actually terminated LTS as of July 1, 2004. *See* 47 C.F.R. § 54.303(a)(1). In the interim, ICLS and LTS were both in effect for a two-year period, from July 1, 2002 through July 1, 2004.

To handle this overlap, the Commission defined ICLS in a way that made LTS “primary” for those carriers that were eligible to receive it. Specifically, during this period, LTS continued to be available to pooling carriers under 47 C.F.R. § 54.303. ICLS was theoretically available to these carriers as well, but ICLS amounts were expressly reduced not only by the amount of LTS a carrier *actually* received, but by the amount of LTS that the carrier *would have* received if it taken advantage of all available LTS funding. 47 C.F.R. § 54.901(a)(5). This created an overwhelming incentive for a carrier entitled to receive LTS to be sure that it actually received all the LTS to which it was entitled.²³

As noted above, the LTS program does not contain any mechanism for truing up LTS payments to correct either over- or under-recovery of common line costs. ICLS, by contrast, expressly calls for true-ups. *See* 47 C.F.R. §§ 54.903(a)(4), (b)(3). Section 54.903(a)(4) states (emphasis added):

Each rate-of-return carrier shall submit to the Administrator on December 31st of each year the data necessary to calculate a carrier’s Interstate Common Line Support, including common line cost and revenue data, for *the prior calendar year*. Such data shall be used by the Administrator to make adjustments to *monthly* per-line Interstate Common Line Support amounts in the final two *quarters* of the following calendar year to the extent of any differences between the carrier’s ICLS received based on projected common line cost and revenue data and the ICLS for which the carrier is ultimately eligible based on its actual common line cost and revenue data *during the relevant period*.

²² *MAG Order* at ¶¶ 139-41.

²³ The Commission set up this incentive in order to motivate carriers participating in the NECA common line pool as of the date of the creation of the ICLS program to remain in that pool until the LTS program was terminated. *See LTS Order* at ¶¶ 62-63; *MAG Order* at ¶ 141.

The emphasized language is central to understanding USAC's error below. While the rule contemplates submission of data for "the prior calendar year," it does not state that the true-up itself must be *calculated* for "the prior calendar year," for "the calendar year for which the true-up is being made," or any similar language. Instead, the rule recognizes that ICLS amounts are calculated and paid on a "monthly" basis, and indicates that the true-up is to be calculated by determining the ICLS "for which the carrier is ultimately eligible ... during the relevant period" – whatever that turns out to be.

This flexibility in determining the "relevant period" makes sense, for several good reasons. First, the "funding year" for ICLS runs from July 1 through June 30.²⁴ As a result, any given calendar year necessarily contains two different ICLS funding years. To the extent that different regulatory or financial conditions obtain during different funding years (which in fact occurred here), that can affect the calculation of a true-up.²⁵

Second, even though ICLS is calculated under § 54.901(a)(5) to reflect a carrier's entitlement to LTS revenues, LTS entitlements were not calculated on a "funding year" basis. Instead, LTS was based on calendar year cost and inflation information – information that significantly lags the two ICLS funding years spanned by the affected LTS calendar year. *See* 47 C.F.R. § 54.303. As a result, LTS amounts will never exactly correspond to ICLS funding years.

Third, by requiring true-ups to be calculated on the basis of a "relevant period" rather than a calendar year, the Commission ensured that USAC had the flexibility to calculate true-ups

²⁴ *See* 47 C.F.R. § 54.903(a)(3) (stating, *inter alia*, that "the funding year [for ICLS] shall be July 1st of the current year through June 30th of the next year").

²⁵ In this regard, precisely because ICLS began in the middle of a calendar year, it was necessary to make a number of adjustments and assumptions to properly assign costs to that initial six-month period in calculating ICLS support. *See* Letter from C. Matthey (Wireline Competition Bureau) to I. Flannery (USAC), dated March 2, 2004 ("*Matthey Letter*"). In that letter, the Bureau confirmed that when relevant revenues relate only to half of a year, spreading them across the entire year "would not provide an accurate calculation of the final ICLS amount that carriers require to meet their common line revenue requirements.

that reflected meaningful changes in actual data that occur in, and apply to, periods shorter than a calendar year. In this regard, the most obvious data that will change over the course of a year is carrier line counts. In fact, USAC calculates both current-period and true-up ICLS payments not on an annual basis, but instead on a *quarterly* basis – based in part on *monthly* figures – in order to take account of changing line counts and interim distribution adjustments. *See, e.g., USAC Decision* at Attachment D (showing quarterly “actual” ICLS amounts based on quarterly line counts).²⁶ As a result, the “relevant period” for purposes of a true-up might turn out to be an entire year, but could well be a month or a quarter, depending on the particular circumstances.

3. Application Of The True-Up Rule To 2004.

The ICLS funding year runs from July 1 of one calendar year to June 30 of the following calendar year. 47 C.F.R. § 54.903(a)(3). July 1, 2004, therefore, represented the beginning of a new ICLS funding year. By contrast, LTS funding was provided on a calendar year basis. *See* 47 C.F.R. § 54.303, *passim* (defining LTS amounts for calendar years). Also, as noted above, the Commission declared that the LTS program would completely terminate as of June 30, 2004. As a result, effective with the July 1, 2004 ICLS funding year, there would be no further interplay between the LTS program and the ICLS program.

It made sense for the Commission to terminate the LTS program as of June 30, 2004, in light of the way ICLS is calculated. Under 47 C.F.R. § 54.901(a)(5), any LTS for which a carrier is eligible during a particular ICLS funding year is counted as an offset against the ICLS “revenue requirement” for that year. By terminating LTS as of June 30, 2004, the Commission ensured that the 2004-2005 ICLS funding year would be “clean.” That is, the amount of LTS to

²⁶ As described below, USAC used the *wrong* line counts for this purpose. But USAC was perfectly correct to make separate quarterly calculations to reflect changing conditions in each quarter.

which a carrier was entitled for the July 1, 2004 ICLS funding year would necessarily be zero, thereby simplifying ICLS calculations for that funding year.

Given the termination of LTS as of June 30, 2004, it would have been a plain error – indeed, a violation of § 54.901(a) – for any carrier to have included any LTS amounts as an offset when calculating projected ICLS entitlement for the 2004-2005 funding year.

The purpose of the ICLS true-up rule is not to modify the substantive requirements of the ICLS funding formula. To the contrary, it is simply to reconcile the amount of ICLS a carrier actually received based on projected data for the funding year, with the amount it turns out to have been “ultimately *eligible*” to receive, based on the actual data, available after the fact. 47 C.F.R. §§ 54.903(a)(4), (b)(3). Because true-ups are calculated once each calendar year, any given true-up analysis will necessarily cover two different ICLS funding years. As a result, if there are changes in relevant conditions between the two consecutive ICLS funding years embraced by a single calendar year, those changes will affect the amount of ICLS for which a carrier is “ultimately eligible” in each funding year differently. In that case, it will be necessary to make separate true-up calculations for the two funding years embraced by a single calendar year, in order to accurately reflect the ICLS for which a carrier was “ultimately eligible” during that calendar year. Failing to do this will result in a retroactive miscalculation of the amount of ICLS to which a carrier was entitled, resulting in a substantive violation of § 54.901(a).

That is exactly what happened in our case for calendar year 2004, which embraced the 2003-2004 and 2004-2005 ICLS funding years. During the 2003-2004 ICLS funding year – which included the first half of 2004 – the LTS program was operational, and § 54.901(a)(5) required deduction of any LTS to which PRTC was eligible from the amount of ICLS otherwise due. However, during the 2004-2005 ICLS funding year – which included the second half of

2004 – the LTS program was gone, so the calculation of the amount of ICLS to which PRTC was entitled literally could not be affected by LTS amounts from the first half of the year. Any effort to take those amounts into account when projecting ICLS for the 2004-2005 ICLS funding year would have been a violation of § 54.901(a).

In this regard, it is significant that the amount of ICLS to which a carrier is entitled is not affected by how much LTS the carrier might *receive*. Instead, § 54.901(a)(5) clearly and intentionally adjusts ICLS entitlements downwards based on the amount of LTS for which a carrier is *eligible*.²⁷ Since, as a matter of law, no carrier was “eligible” for any LTS whatsoever for any period after June 30, 2004, it is flatly inconsistent with the rules to adjust ICLS downward for the 2004-2005 funding year based on any LTS amounts whatsoever.

From this perspective, it is easy to see where USAC’s analysis went astray. USAC apparently believed that the “relevant period” for purposes of calculating the ICLS true-up for 2004 was necessarily the entire 2004 calendar year, viewed as an integrated whole.²⁸ But the true-up rule does not change the underlying fact that as a substantive matter of the calculation of ICLS entitlement, the ICLS program runs on a July 1 – June 30 funding year. *See* § 54.903(a)(3). Nor does it change the fact that ICLS in any given funding year is offset by LTS for which the carrier was eligible *in that year*. *See* § 54.901(a)(5). As a result, it was inconsistent with the substantive rules governing the calculation of PRTC’s ICLS to offset its ICLS amounts for the 2004-2005 funding year (that is, the second half of 2004) with LTS amounts that only existed during the 2003-2004 funding year (that is, the first half of 2004).

²⁷ The only carriers eligible to receive LTS at all were carriers that participated in the NECA common line pool. As noted above, the Commission established the rule reducing ICLS entitlements based on the amount of LTS for which a carrier was “eligible,” instead of amounts actually received, in order to provide a strong financial incentive for pooling carriers to remain in the pool until the termination of the LTS program. *See LTS Order* at ¶¶ 62-63; *MAG Order* at ¶ 141.

²⁸ *See USAC Decision* at 5, 8.

Unfortunately, that is what USAC did – its approach offsets *2004-2005 program year* ICLS amounts with LTS from the *2003-2004 program year*. This directly violates § 54.901(a)(5).²⁹

Recognizing that the Commission’s review of this matter is *de novo*, it is nonetheless significant that USAC offers no substantive explanation, based on the language or purpose of the ICLS rules, as to why its integrated calendar year true-up calculation is required, or even appropriate. Instead, USAC simply equates the “relevant period” under § 54.903(a)(4) with a calendar year 2004, as though the supposed equivalence of the two were obvious and required no explanation. *See USAC Decision* at 5, 8. In fact, for the reasons discussed above, the “relevant period” for making true-up calculations may or may not correspond to a single, unified calendar year, depending on the circumstances.

Attributing first-half-2004 LTS amounts to the second half of 2004 is not only inconsistent with the ICLS rules; it is also inconsistent with the Commission’s rules regarding LTS itself. Specifically, LTS revenues ceased – both in fact and as a matter of law – as of July 1, 2004. This abrupt end to LTS revenues occurred because, in the *LTS Order*, the Commission directly ordered that result:

In order to effectuate this decision, we amend our rules to provide that ***LTS shall not be provided to any carrier beginning July 1, 2004***. We note that overall support ***will not be reduced*** because our existing rules will operate to ***automatically increase ICLS by an amount to match any LTS reduction***. For that reason, no further action by the Commission is necessary to implement the merger of LTS into ICLS.

²⁹ The logical implication of lowering ICLS payments in the second half of 2004 – that is, for ICLS funding year 2004-2005 – on the basis of LTS received in the first half of 2004 is that when PRTC was projecting its ICLS amounts for funding year 2004-2005, it should have reduced those amounts by some portion of the LTS payments that it was entitled to receive from January through June of 2004 – that is, during ***ICLS funding year 2003-2004***. That, obviously, would have been impermissible under § 54.901(a)(5), since PRTC was “eligible” for exactly zero LTS payments for ICLS funding year 2004-2005. USAC’s approach to the true-up rule, therefore, has the effect of requiring a retroactive violation of § 54.901(a)(5), or, at a minimum, applying a different interpretation of the rule retrospectively than the rule would permit initially. This is inconsistent with the notion of a “true up” calculation.

LTS Order at ¶ 67 (emphasis added).

By ruling that no LTS shall exist beginning July 1, 2004, this order clearly draws a line in the sand between the first two quarters of 2004 and the second two quarters of that year. LTS revenue existed to offset any ICLS revenue requirement during the first two quarters. LTS revenue did not exist during the second two quarters. Given PRTC's 2004 level of projected common line costs for LTS purposes, the LTS revenue it received offset any potential ICLS revenue during the first two quarters. *See* 47 C.F.R. § 54.901(a)(5). On the other hand, since PRTC did not project or receive any LTS revenues in the second half of 2004, there was no offset to ICLS revenue requirement during the second two quarters.

In this regard, the emphasized language in the second sentence of the quotation above is directly relevant. That language makes clear that the phase-out of LTS should normally occur in such a way that the loss of LTS payments as of July 1, 2004, will result in a dollar-for-dollar increase in ICLS payments. That can only be accomplished if the LTS payments are treated as confined to the first half of 2004. Attributing LTS revenues from before the LTS "drop-dead" date to the period after that date – which USAC did – necessarily, dollar-for-dollar, *prevents* the "automatic increase" in ICLS that the Commission contemplated.

Simple fealty to the Commission's rules about when to terminate the LTS program compels the conclusion that the ICLS true-up for 2004 must treat these two very different periods as separately "relevant" under 47 C.F.R. § 54.903(a)(4).

As we explained to USAC below, a March 2004 letter from the Wireline Competition Bureau to USAC relating to the ICLS true-up applicable to 2002 (the year ICLS first took effect) confirms that stopping LTS as of July 1, 2004, is the correct way to apply the true-up. Just as LTS *ended* on July 1, 2004, ICLS *began* on July 1, 2002. The Commission had specified that

for these purposes, carrier costs relevant to ICLS should be split 50-50 between the first and second halves of that year. Even so, an issue remained because, with the various changes in access charges and universal-service related payments that also took effect that year, the 2002 revenues relevant to ICLS were “lumpy” in nature. This meant that simply taking half the yearly revenues and attributing them to the second half of the year would produce inaccurate results. In these circumstances, the Bureau directed that USAC use data from NECA to determine reasonable industry-wide factors for allocating revenues to the first versus second halves of 2002, and to use the appropriate second-half figures – not spread-out “actual” annual figures – to calculate the 2002 true up. As the Bureau succinctly noted, simply spreading 2002 revenues across the entire year “would not provide an accurate calculation of the final ICLS amount that carriers require to meet their common line revenue requirements.” *See Matthey Letter, supra.*

The same sound reasoning applies here. First, ICLS true-up calculations should avoid a methodology that “would not provide an accurate calculation.” Second, when a relevant event takes effect at mid-year, it is necessary to make half-year calculations to accurately determine true-up amounts.³⁰

As noted above, 47 C.F.R. § 54.903(a)(4) does not require that the cost and revenue items used in calculating a true-up must be annual amounts, applied unthinkingly to a unitary annual calculation. To the contrary, the rule recognizes that relevant ICLS calculations involve monthly

³⁰ In this regard, an order issued in March 2007 confirms this understanding of the applicable rules. Puerto Rico regulators had asked the Commission to clarify the application of 47 C.F.R. §54.311, as opposed to § 54.315, in light of the 2004 transition from LTS to ICLS. The Wireline Competition Bureau stated that, “**Effective July 1, 2004, the Commission consolidated LTS into Interstate Common Line Support (ICLS) and eliminated LTS as a distinct mechanism.**” *Federal-State Joint Board on Universal Service Telecommunications Regulatory Board of Puerto Rico Petition for Clarification, or in the Alternative, Waiver of Section 54.311(b) of the Commission’s Rules*, Order, CC Docket No. 96-45, DA 07-1235 (rel. March 13, 2007) at ¶ 2 (emphasis added, footnote omitted). This confirms the elimination of LTS as of July 1, 2004. It follows that USAC’s true-up calculation, which mathematically attributes substantial amounts of LTS revenue prior to that date to the second half of calendar year 2004, is wrong. USAC’s decision acknowledged this ruling, *see USAC Decision* at 11, but did not accept its implications.

and quarterly amounts as well, so that a period other than an entire year will be appropriate in some cases. The radical shift in funding mechanisms as of mid-year 2004 – that is, the total elimination of LTS funding – necessarily requires treating the first and second half of 2004 as separate “relevant periods” in calculating the true-up. Centennial submits that it flatly violates § 54.903(a)(4) to try to determine the “ICLS for which [Centennial] is ultimately eligible” in 2004 using a calculation that attributes any LTS revenue to the second half of 2004. For LTS revenue, the second half of 2004 is not, and by law cannot be, a “relevant period.”

The true-up rule requires a reasoned consideration of what period is “relevant” based on the circumstances of each year. It may well be that for some years (such as 2003, or 2005), the “relevant period” for cost and revenue purposes is, indeed, the entire calendar year, because no significant cost or revenue changes occurred mid-year. On the other hand, for other years (such as 2002, when the ICLS program began mid-year, or 2004, when the LTS program ended mid-year), the “relevant period” cannot possibly be an entire calendar year. Moreover, as noted above, USAC *never* calculates ICLS on a purely calendar year basis. To the contrary, because ICLS is determined on a per-line basis, and line counts are updated quarterly, USAC always makes *quarterly* calculations of both projected and retroactive (trued-up) ICLS amounts. Given that USAC (properly) makes quarterly calculations in any case, Centennial submits that it is unreasonable to treat revenues that *as a matter of law* are attributable only to the first two quarters of 2004 as, in fact, attributable to the entire year.

In this regard, the *MAG Order* clearly contemplates *quarterly* calculations based on changes in line counts. That order states, at paragraph 149 (emphasis added):

[A] competitive eligible telecommunications carrier’s per-line support amounts will be based on the incumbent carrier’s then-current total support levels, lines, disaggregated support relationships, and customer classes. Finally, the per-line support amounts available to a competitive eligible telecommunications carrier

for each zone *will be recalculated whenever an incumbent's total annual support or line counts, as indicated by its filings*, have changed.

This shows that both ongoing ICLS support amounts, as well as true-ups, should be calculated on a quarterly basis to conform to quarterly updates in both ILEC and competitive ETC line counts. Given that USAC will necessarily be re-calculating ICLS payments on a quarterly basis in order to reflect line count changes, there is no basis for its claim that true-up calculations should, or must, be made on an integrated, full-year basis.

For all these reasons, it is an error – and amounts to a substantive violation of § 54.901(a) – to calculate true-up 2004 amounts by spreading out PRTC's LTS revenues from the first two quarters of 2004 over the complete year. Not only is such a “yearly” calculation not required by ICLS rules, it is inconsistent with those rules because it fails to distinguish between the two very different “relevant periods” that occurred in 2004. Moreover, it is inconsistent with the longstanding (and correct) practice of calculating ICLS – both on a current and true-up basis – for each calendar quarter of each year, to reflect quarterly changes in line counts.³¹

4. USAC's Error Appears To Have Been Motivated By Concerns Which May Be Legitimate As A Policy Matter But Which Are Not Properly Effectuated Via The Universal Service Process.

Based on the text of its March 28 decision, USAC developed its interpretation of the true-up rule in order to effectuate a policy of preventing PRTC from receiving revenues that would

³¹ Centennial has been unable to estimate the potential overall impact of correcting USAC's calculation of true-ups for 2004 as described above, assuming *arguendo* that this result would to all study areas. If the Commission views an estimate of that impact to be a significant matter, Centennial will attempt to obtain the data from USAC necessary to make such an estimate. However, Centennial submits that there is no legal requirement to extend any correction of USAC's calculation of the 2004 true-up applicable to Centennial to any other carrier. By making its true-up determination for Centennial, USAC applied the Commission's rules to Centennial's specific situation. In administrative law terms, this is an “adjudication” that affected Centennial's specific rights. If other affected carriers have chosen not to exercise their rights to appeal specific adjudications as to them for the periods in question, that constitutes, in effect, a waiver of any claim they might have to correct these errors. Consequently, there is no reason to believe that correcting them with regard to Centennial would have any general or wide-reaching impact on the total universal service fund.

lead it to exceed its authorized rate of return.³² Since PRTC's data for 2004 showed that its actual common line costs were below the projected costs on which the first-half LTS payments had been based, USAC concluded that letting PRTC retain those payments would result in over-earnings. Spreading first-half 2004 LTS payments over the entire year allows more ICLS revenues to be offset by the portion of those earlier LTS payments that exceeded PRTC's actual common line costs for the earlier period, thus lowering PRTC's earnings.³³

Centennial does not dispute that in the abstract, public policy frowns on allowing a rate of return carrier to earn more than its prescribed return. However, that does not justify distorting the operation of universal service programs to achieve that result. This is so for many reasons, of which three are particularly relevant here. First, because universal service is available to rate-of-return ILECs and competitive ETCs alike, using the universal service rules to enforce rate-of-return prescriptions can create severe "collateral damage" for competitive ETCs, which is what happened to Centennial here.

Second, although enforcing rate-of-return prescriptions informs some universal service rules, it does not inform others.³⁴ As a result, making over-earnings a touchstone for interpreting universal service rules in general will inevitably distort the operation of some of those rules.

³² Its March 28 decision is replete with references to the supposed need to apply universal service rules so as to prevent PRTC from over-earning. *See, e.g., id.* at 5, 9, 11, 12.

³³ The Commission made clear in 2002 that there would never be any "negative ICLS" amounts. *See LTS Projection Order* at ¶ 7 n.22, ¶ 8. As a result, to the extent that the calculation required by § 54.901(a) (common line revenue requirements minus various offsets, including LTS) results in a negative number, that simply means that the affected carrier will receive no ICLS at all for the period in question. The mathematical effect of USAC's whole-year true-up calculation was to increase the total "base" of common line costs from which the expected LTS payments would be subtracted, leading to a low, but positive, ICLS amount for the year as a whole. This calculation, therefore, had the effect of nullifying the ban on "negative ICLS" for the first half of 2004.

³⁴ For example, with respect to ICLS payments, the true-up rule in 47 C.F.R. § 54.903(a)(4) ensures that ICLS payments, after true-up, do not exceed the common line costs that those payments are intended to recover. On the other hand, with regard to LTS, the Commission's decision to cap payments at the lower of the traditional inflation-adjusted amount and projections of costs, *see* 47 C.F.R. § 54.303(b)(5),

Third, there are separate regulatory mechanisms, not within the purview of universal service programs, for dealing with over-earnings by rate-of-return carriers. As the Commission noted when it modified the LTS program in 2002, rate of return carriers are subject to a *prescribed* earnings level: “Rate-of-return carriers ... are *limited* to recovery of their costs plus a *prescribed rate of return*.”³⁵ Long-standing Commission and court precedent establishes that if a carrier violates a rate of return prescription by earning too much, the carrier can be required, in a case brought by the Commission or an affected customer, to disgorge the excessive earnings in the form of refunds.³⁶ As a result, if it turns out that PRTC’s LTS payments for 2004 caused PRTC to exceed its authorized rate of return, existing Commission rules and applicable precedent establish a clear and direct way to correct that situation. There was, therefore, no need to interpret the *ICLS* true-up rules in a manner that prevents over-earnings based on *LTS* payments (which, as noted above, are not subject to true-up).

In other words, while it is hard to quarrel, in the abstract, with a desire to prevent PRTC from over-earning, that is not what the *LTS* or *ICLS* rules contemplate. Other mechanisms exist to correct that problem.

In fact, interpreting the *ICLS* rules to allow for a true-up of PRTC’s “excess” *LTS* revenue creates a situation in which USAC’s core mission – administration of universal service –

will tend to minimize over-earnings attributable to *LTS* revenues, as long as carriers do not significantly over-estimate their costs, but – since there is no *LTS* true-up mechanism – if a carrier does so, the *LTS* program does not have a mechanism to correct that situation. As another example, also with regard to *LTS*, prior to the imposition of the cap just described, carriers would receive their inflation-adjusted *LTS* payments without regard to actual costs. In this regard, the entire purpose of price cap regulation is to decouple carrier rates and earnings; price cap regulation, in other words, inherently tolerates a certain degree of over-earning by carriers subject to it.

³⁵ *Projected LTS Order* at ¶ 10.

³⁶ *See, e.g., MCI Telecommunications Corp. v. FCC*, 59 F.3d 1407 (D.C. Cir. 1995). *Cf. Projected LTS Order* at ¶ 10 (“If NECA files a tariff that on its face permits excessive recovery, any ratepayer—end users or interexchange carriers subject to CCL charges—could request that the Commission suspend the tariff to prevent over-recovery”).

is compromised. As discussed below in connection with Centennial's alternative request for a waiver, Section 254 – on which the entire modern universal service program is based – specifically requires that universal service distributions be “predictable.” The practical impact of USAC's interpretation of the true-up rules is to make Centennial's universal service support for 2004 utterly *unpredictable* by implementing a “true-up” that retroactively reduces support by almost 60%.

5. Conclusion.

For the reasons set out above, the Commission should reverse USAC's calculation of Centennial's ICLS true-up for 2004. The first and second halves of 2004 constitute separate “relevant periods” for purposes of calculating the ICLS true-up. Moreover, the Commission has commanded that no LTS revenues are to be provided after July 1 of 2004. Furthermore, USAC's own, normal calculations of ICLS revenue – including both current and true-up amounts – involve both monthly and quarterly, as well as annual, calculations. Finally, to the extent that a straightforward and proper application of the ICLS and LTS rules might lead to a situation in which PRTC exceeds its authorized return, that problem can be directly addressed by other means.³⁷

³⁷ Centennial provided USAC with the proper calculation of ICLS for 2004. Specifically, Centennial used 50% of the non-LTS amounts used by USAC in its initial own calculations to create two half-year figures for each of the two affected PRTC study areas. We then attributed the actual LTS amounts PRTC received for each study area (again, from the data USAC provided) to the first half of the year. This results in no ICLS at all during the first half of the year, but substantial ICLS amounts for the second half. These calculations are shown in the attachment to Centennial's September 25, 2006 letter to USAC, which is attached hereto as Exhibit 2. Here, Centennial requests that the Commission direct USAC to recalculate Centennial's ICLS true-up amounts for 2004 based on the basic methodology contained in Centennial's submission to USAC, *i.e.*, calculating true-up amounts separately for the first and second halves of the year.

B. It Is Improper To Use Prior-Period Line Counts In Calculating True-Ups Supposedly Based On “Actual” Data.

A competitive ETC such as Centennial is entitled to receive support equivalent, on a per-line basis, to the support received by the incumbent ETC. 47 C.F.R. § 54.307(a). Because Centennial does not use PRTC unbundled elements or resold services, it is entitled to “the full amount of universal service support that the incumbent LEC would have received for that customer.” 47 C.F.R. § 54.307(a)(3). This amount is initially calculated in accordance with 47 C.F.R. § 54.901(b)(2), which calls for the division of the ILEC’s projected ICLS revenues by “its total lines served.” And the ICLS true-up rule calls for an adjustment of the initial ICLS payments based on actual data. 47 C.F.R. § 54.903(a)(4). USAC’s true-up calculations did not conform to these requirements.

As a mathematical matter, this error has two elements: mistakenly high PRTC line counts, and mistakenly low Centennial line counts.

The first step in the calculation of per-line amounts is to determine PRTC’s total ICLS entitlement. This figure is then divided by the applicable number of lines to generate PRTC per-line amounts. The number of PRTC lines is thus the denominator in a fraction (ICLS entitlement / PRTC lines), which means that if the line count is too high, the resulting quotient will be too low. In fact, PRTC has been losing lines each year for some time. USAC used PRTC 2003 line data to calculate the true-up for 2004, despite the fact that actual line count data have been available since August 2005.³⁸ Because PRTC had more lines in 2003 than in 2004, this lowers the per-line ICLS to which Centennial is entitled, with no impact on PRTC.

The next step in the calculation is to multiply the PRTC per-line amount just derived by Centennial lines in service. While PRTC’s lines are the denominator in a fraction, Centennial’s

³⁸ See 47 C.F.R. § 36.612 (filing schedule for line count data); *USAC Decision* at 14-17.

lines are a factor in a multiplication. So, if Centennial's line count is too low, that lowers Centennial's ICLS entitlement. Here again, USAC used Centennial's 2003 line counts to calculate its ICLS entitlement for 2004.³⁹ But Centennial had more lines in 2004 than in 2003. As a result, using 2003 line counts lowers Centennial's 2004 ICLS entitlement.

USAC's apparent reason for using stale line counts when calculating true-ups is that it uses those line counts when projecting how much support carriers will need overall. *See USAC Decision* at 14-17. In addition, USAC relied on certain discussion in the *MAG Order* regarding how support would be distributed on a "current" basis – which is necessarily based on older data – to justify relying on stale data when doing the true-up calculations. *Id.* at 14-17, *citing MAG Order* at ¶ 171. None of these rationales justifies ignoring actual line count data in making true-up calculations.

First, § 54.307(a)(3) requires that for each customer to which a competitive ETC "provides the supported services," it "will receive the full amount of universal service support that the incumbent LEC would have received for that customer." In making true-up calculations, the amount that PRTC "would have received" in any quarter within 2004 can only be determined by dividing PRTC's *actual* universal service support for that quarter (that is, its trued-up total, based on its *actual* costs and revenues) by its actual number of customers in that quarter. Note that this rule does not refer to customers for which the competitive ETC "provided the supported services" in some *prior* period. The rule's use of the present tense clearly indicates that payments should be based on the number of customers actually served.

Second, the description of the required per-line calculations in § 54.901(b) refers repeatedly to the number of "lines served" by the ILEC and by the competitive ETC. Nothing in

³⁹ *See id.* at 17.

the phrasing of this rule suggests that “lines served” means anything other than lines *actually* served during the relevant period.

Third, as noted, § 54.903(a)(4) calls for true-ups to be calculated by comparing projected cost and revenue data with “the ICLS for which the carrier is ultimately eligible based on its *actual* common line cost and revenue data *during the relevant period.*” Since the determination of the “ICLS for which [a competitive ETC] is ultimately eligible” depends on both ILEC and competitive ETC line counts, this rule’s reference to “actual” data “during the relevant period” requires that true-ups be determined using actual period line counts.

Fourth, § 54.903(b)(3) directs USAC to reconcile ICLS payments based on projected data with the ICLS “for which each carrier is eligible based on *actual data.*”

It is impossible to square these repeated references to “actual data” with the use of stale line count data to calculate its true-ups – especially when the actual line count data is, not available when making funding projections, is clearly available by the time the true-up calculations are made.

USAC also suggests that using prior period line counts is necessary so that the total ICLS amounts paid out for a particular year match the amount paid into the fund for that year. As USAC reasoned, since the assessment percentage for a given year is based on projected costs and line counts, the true-ups must be based on projected line counts as well. *USAC Decision* at 13-14. This is clearly wrong, for at least two reasons.

First, this argument is inconsistent with the specific language of the Commission’s rules, noted just above, that require true-ups to be calculated on the basis of “actual’ data.

Second, and more fundamental, this approach is illogical. The amount of money actually collected into the fund for any given year is determined by the application of the assessment