

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

In the Matter of)	
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	
National Exchange Carrier Association, Inc. 2005)	
Modification of Average Schedule Universal)	
Service Formulas)	
)	

ORDER

Adopted: December 30, 2004

Released: December 30, 2004

By the Deputy Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. On September 29, 2004, the National Exchange Carrier Association, Inc. (NECA) filed proposed modifications to the current universal service formulas for average schedule companies, requesting that they take effect on January 1, 2005, and remain in effect through December 31, 2005.¹ These formulas include a local switching support formula and a Part 36 high-cost support formula. On October 5, 2004, the Wireline Competition Bureau (Bureau) issued a public notice soliciting comments on NECA's filing.² For the reasons discussed below, we approve NECA's modified local switching support formula and, with respect to Part 36 high-cost support, we adopt NECA's cost per loop formula (CPL formula).

II. LOCAL SWITCHING SUPPORT FORMULA

2. The local switching support formula is used to determine the amount of support for switching costs that will be provided from universal service support mechanisms.³ The current interstate local switching support formula was approved on December 23, 2003.⁴ NECA proposes a formula that, if

¹ See 2005 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., CC Docket No. 96-45 (filed Sept. 29, 2004) (*NECA 2005 Filing*).

² Pleading Cycle Established for Comments on National Exchange Carrier Association, Inc. 2005 Modification of Average Schedule Universal Service Formulas, Public Notice, DA 04-3191 (rel. Oct. 5, 2004). The Bureau received comment in support of the *NECA 2005 Filing* from the Organization for the Promotion and Advancement of Small Telecommunications Companies.

³ Local switching support is a portion of the settlements that average schedule companies receive for providing interstate local switching access service. Average schedule companies recover the remaining costs of providing interstate local switching access costs through NECA's local switching access charges.

⁴ See *National Exchange Carrier Association, Inc. Proposed 2004 Modification of Average Schedule Formulas*, CC Docket 96-45, Order, DA 03-4063, 18 FCC Rcd 26619 (WCB 2003) (*2004 Order*).

approved, would decrease annual payments for local switching support from approximately \$78.1 million in 2004 to approximately \$74.7 million in 2005, a decrease of 4.4 percent.⁵ We have reviewed NECA's filing and find that the method NECA used to develop this year's proposed formula is the same method that it used to develop the formula we approved for use during the last payment period.⁶ Consistent with the Bureau's prior orders, we approve NECA's proposed 2005 average schedule local switching support formula.⁷

III. PART 36 HIGH-COST SUPPORT FORMULA

A. Background

3. Part 36 high-cost support, also known as the loop expense adjustment, is intended to provide universal service support to carriers with high loop costs based on the degree that an individual company's cost per loop exceeds the national average.⁸ Because average schedule companies are not required to perform company-specific cost studies – the basis upon which a carrier's expense adjustment is calculated – the Federal Communications Commission (Commission) has permitted expense adjustments for average schedule companies pursuant to formulas developed by NECA and approved or modified annually by the Bureau.⁹ These formulas are developed by NECA using data from a sample group of average schedule carriers and from similarly situated companies that file cost data and are used to determine support amounts for all average schedule carriers. NECA files proposed modifications to the formula on October 1 of each year, for an effective date of the subsequent January 1.¹⁰

4. For 1999, 2000, and 2001, the Bureau rejected NECA's proposed expense adjustment per loop formula (EAPL formula) because it failed to provide a reasonable estimate of the cost per loop of the sample companies.¹¹ In each instance, the Bureau instead retained the existing formula with an

⁵ *NECA 2005 Filing* at II-1 to II-14.

⁶ *Id.*; 2004 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc. (dated Oct. 1, 2003) (*NECA 2004 Filing*).

⁷ *See, e.g., 2004 Order*, 18 FCC Rcd at 26619-20, para. 2.

⁸ *See* 47 C.F.R. Part 36, subpart F. The Commission's rules permit a rural carrier that has significantly higher than average loop costs to shift a portion of its loop costs from the intrastate jurisdiction to the interstate jurisdiction. The carrier then receives universal service support equal to this expense adjustment

⁹ *See National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, FCC 99-395, 15 FCC Rcd 1819, 1819-20, para. 2 (1999) (*Commission 1999 Order*). Average schedule companies have been permitted by the Commission to estimate their access settlements and universal service support through the use of average schedules to avoid the difficulties and expenses involved with conducting company-specific cost studies. *See, e.g., ALLTEL Corp. v. FCC*, 838 F.2d 551, 553 (D.C. Cir. 1998). Company-specific cost studies, which require performance of detailed jurisdictional separations and cost allocation studies under Parts 32, 36, 64, and 69 of the Commission's rules, are used in calculating the carrier's Part 36 expense adjustments. *See, e.g., 47 C.F.R. Part 36, subpart F*. The costs used in calculating a carrier's average cost per loop are specified in 47 C.F.R. § 36.621(a).

¹⁰ Under Part 36 of our rules, high-cost loop support payments become effective for a 12-month period beginning January 1. *See* 47 C.F.R. § 36.601 *et seq.*

¹¹ *National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, DA 99-530, 14 FCC Rcd 4049, 4051-55, paras. 6-12 (Accounting Safeguards Div. 1999) (*Bureau 1999 Order*); *National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal Service Formulas*, Order, DA 00-588, 15 FCC Rcd 5065, 5067-68, paras. 5-7 (Accounting Safeguards

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adjustment for growth in the number of loops.¹² The Bureau also indicated each time that it would prefer a formula that more accurately predicted cost per loop.¹³ For 2002, 2003, and 2004, NECA again proposed its EAPL formula, but also provided a CPL formula for the Bureau's consideration.¹⁴ NECA contended that the EAPL formula better estimated the support that average schedule carriers would receive if they were to begin filing cost studies.¹⁵ The Bureau concluded, however, that the CPL formula better estimated the cost per loop of average schedule companies, in the aggregate, than the proposed EAPL formula and therefore approved the CPL formula for use in 2002, 2003, and 2004.¹⁶

5. NECA's proposal for 2005 average schedule formulas is essentially the same as its 2002, 2003, and 2004 proposals.¹⁷ NECA proposes its EAPL formula, but also provides its CPL formula for consideration.¹⁸ Each formula contains minor changes from last year's formulas, but reflects the same methodology.¹⁹ Both formulas would result in an increase in support to average schedule companies in

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Div. 2000) *application for review pending (2000 Order)*; *National Exchange Carrier Association, Inc. Proposed 2001 Modification of Average Schedule Formulas*, Order, DA 00-2891, 16 FCC Rcd 25 (Accounting Safeguards Div. 2000) *application for review pending (2001 Order)*.

¹² *Bureau 1999 Order*, 14 FCC Rcd at 4055-56, paras. 13-14; *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30, para. 8. The Commission denied NECA's Petition for Review of the Bureau's *1999 Order*, concluding that the Bureau could properly reject NECA's proposed EAPL formula because it failed to accurately predict costs per loop. *Commission 1999 Order*, 15 FCC Rcd at 1820-22, para. 4 & n.15. NECA subsequently appealed the Commission's order to the U.S. Court of Appeals for the District of Columbia, claiming that the decision to reject the proposed EAPL formula and instead adjust the expense adjustment by growth in lines was arbitrary and capricious. *National Exchange Carrier Association, Inc. v. FCC*, 253 F.3d 1 (2001). The court denied NECA's appeal, concluding that NECA "fail[ed] to articulate an intelligible explanation of its substantive claim" *Id.* at 2. The court also denied NECA's procedural claim that the Commission failed to follow notice and comment rulemaking procedures required under the Administrative Procedures Act. *Id.* at 4.

¹³ *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30, para. 8.

¹⁴ See 2002 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., at I-16 (dated October 1, 2001) (*NECA 2002 Filing*); 2003 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc., at I-13 (dated October 1, 2002) (*NECA 2003 Filing*); and *NECA 2004 Filing* at I-13 to I-14.

¹⁵ *Id.*

¹⁶ *National Exchange Carrier Association, Inc. Proposed 2002 Modification of Average Schedule Formulas*, CC Docket No. 96-45, Order, 17 FCC Rcd 14236, 14239-41, paras. 8-11 (WCB 2002) (*2002 Order recon. pending*); *National Exchange Carrier Association, Inc. Proposed 2003 Modification of Average Schedule Formulas*, CC Docket 96-45, Order, 17 FCC Rcd 26204, 26207-08, para. 8 (WCB 2002) (*2003 Order recon. pending*); *2004 Order*, 18 FCC Rcd at 26622, para. 6. In particular, the Bureau found that the CPL formula was, for average schedule carriers as a whole, a more accurate predictor of costs per loop than the EAPL formula. The Bureau noted that NECA agreed that the CPL formula was an unbiased predictor of costs per loop.

¹⁷ See *NECA 2005 Filing* at III-2 to III-36, *NECA 2004 Filing* at III-2 to III-36, *NECA 2003 Filing* at III-2 to III-36, and *NECA 2002 Filing* at III-2 to III-38.

¹⁸ *NECA 2005 Filing* at III-2 to III-36.

¹⁹ *Id.* NECA uses regression analyses to develop both the EAPL and CPL formulas. For each, NECA collects Part 32 account data from a sample group of average schedule carriers. See *id.* at I-2 to I-3, III-3 to III-4. To estimate current year costs, NECA applies forecasted growth factors to data collected from sample average schedule carriers one and two years prior to the current year. NECA then applies cost allocation factors—developed from the cost

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the aggregate due to increased costs in the sample companies.²⁰ The current high-cost support formula provides \$28.7 million to 349 study areas.²¹ NECA's proposed EAPL formula, if approved, would provide an estimated \$44.1 million payable to 377 study areas for 2005, an increase of 53.7 percent over 2004 year payments.²² NECA's updated CPL model, if approved, is estimated to pay a total of \$39.8 million to 368 study areas for 2005, an increase of 38.7 percent over 2004 total payments.²³

B. Discussion

6. Consistent with our reasoning in our *2002 Order*, *2003 Order*, and *2004 Order* we adopt the CPL formula for purposes of calculating average schedule company expense adjustments for 2005. NECA concedes that the CPL formula better estimates cost per loop, but argues that the Bureau should instead approve NECA's EAPL formula because NECA believes it better estimates the expense adjustments that an average schedule carrier should receive.²⁴ NECA again argues that section 69.606(a) of the Commission's rules requires that the Bureau adopt a formula based on its ability to simulate "disbursements" to similarly situated non-average schedule carriers, rather than a formula that estimates cost per loop and that the Bureau must therefore adopt NECA's EAPL formula.²⁵ In the Bureau's *2003 Order*, we rejected NECA's argument.²⁶ We again find that we are not required to adopt a formula based on its ability to predict expense adjustments per loop, *i.e.*, "disbursements," compared to a formula's ability to predict costs per loop. As we stated in the *2003 Order*, section 69.606(a) is not applicable because it relates only to access settlements distributed to cost companies pursuant to section 69.607, not to universal service support provided pursuant to Part 36 of the Commission's rules.²⁷ The Bureau has

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studies of similarly situated cost companies—to the account balances of each sample average schedule company to estimate a CPL for each of the sample companies. *See id.* at I-2 to I-3, I-6, III-3 to III-6. NECA then uses regression analyses to predict loop costs and expense adjustments for all average schedule carriers. *See id.* at III-18 to I-35. For the CPL formula, the regression is performed on the sample companies' estimated CPLs to develop a formula from which CPLs can be derived for all average schedule carriers. *See id.* at III-31 to III-35. Each average schedule company's derived CPL is then used to calculate the appropriate support amount. For the EAPL formula, NECA calculates an EAPL for each sample company from its estimated CPL, and then performs a regression analysis on those EAPLs to derive a formula which is used to calculate a support amount for each average schedule company. *See id.* at III-5 to III-23.

²⁰ *Id.*, at I-15.

²¹ We note that the current amount of \$28.7 million is less than the amount that was indicated in the *NECA 2004 Filing* using the CPL formula. The *NECA 2004 Filing* estimated the CPL formula would result in total payments of \$35.4 million. Because of adjustments made to the national average cost per loop in order to assure that the fund remains under the cap, however, payments to all cost companies and average schedule companies were reduced. *Id.* at III-2 to III-3.

²² *See NECA 2004 Filing* at III-35, *NECA 2005 Filing* at III-2 to III-3. *See also* 47 C.F.R. § 36.622.

²³ *NECA 2005 Filing* at I-14.

²⁴ *NECA 2003 Filing* at I-7 to I-15, *NECA 2004 Filing* at I-5 to I-15, and *NECA 2005 Filing* at I-5 to I-16.

²⁵ *See NECA 2005 Filing* at I-10.

²⁶ *See 2003 Order* at 26207-8, para. 8 & n.22, citing *Commission 1999 Order*, 15 FCC Rcd at 1820-22, para. 4 & n.15 (affirming Bureau's rejection of NECA's proposed EAPL formula because it did not reasonably estimate the cost per loop).

²⁷ *Id.* *See also* 47 C.F.R. § 69.606(a).

consistently held, and the Commission has upheld, that the appropriate high-cost loop support formula should reasonably approximate the cost per loop of the sample average schedule companies and allocate funds accurately to average schedule companies.²⁸ Because the CPL formula provided by NECA in its filing better estimates the cost per loop of sample average schedule companies than the proposed EAPL formula, based on the current record, the Bureau concludes, as in its *2003 Order*, that the CPL formula is a more appropriate means of calculating universal service high-cost loop support for average schedule companies.²⁹ Because NECA's submission of the results derived from the CPL formula appear to be accurate and complete, we therefore approve the CPL formula results provided in NECA's September 29, 2004 submission.

7. Although today, based on the current record, we approve NECA's CPL formula for 2005, which is essentially the same CPL formula filed since 2002 adjusted for changes in the sample cost data, we are concerned about the trend of increases in high-cost loop support that have taken place for the past three years. For the three years beginning with 2003 and ending with the estimate of high-cost loop support for 2005, high-cost loop support provided to average schedule companies has increased by 31.0 percent, 16.4 percent, and 38.7 percent, respectively.³⁰ NECA indicates that increases in support are primarily driven by the increases in costs reported by sample average schedule companies.³¹ As part of its annual average schedule universal support submission, NECA includes the cost per loop calculated for each sample average schedule company.³² We note that NECA does not include in the annual submission the detailed actual account and loop data that NECA uses to develop the cost per loop for each sample average schedule company because the Bureau has not required NECA to file this information in past years. Accordingly, we require NECA to file, within 90 days of release of this Order, all unadjusted account and loop data for each sample average schedule company used in the development of average schedule high-cost loop support for the years 2003, 2004, and 2005.³³ Also, we require NECA to provide for each of those years the account level and access line growth rates used to project costs and loop data. Although we have previously accepted the CPL formula, we expect to consider whether we should continue to accept the formula in the future. In addition, in the future, we intend to examine the underlying cost data of the companies used to calculate the high-cost loop support. Therefore, we intend to use this data to establish a baseline for the Bureau to conduct a thorough analysis of NECA's future average schedule universal service formula filings. We also require NECA to file such unadjusted sample data and growth rates in all future annual high-cost loop support filings. Finally, we require NECA to submit its universal service average schedule filing for 2006, including unadjusted accounting and loop data for each average schedule company, no later than September 1, 2005 in order to provide the Bureau additional time to review its more detailed data submission.

²⁸ *Commission 1999 Order*, 15 FCC Rcd at 1820-22, para. 4 & n.15; *2001 Order*, 16 FCC Rcd at 27-30, paras. 5-8; *2002 Order*, 17 FCC Rcd at 14239-41, paras. 8-11.

²⁹ See *2003 Order* at 26207-08, para. 8.

³⁰ See *NECA 2003 Filing* at I-14; *2004 Order* 18 FCC Rcd at 26622, para. 5; *NECA 2005 Filing* at I-15.

³¹ See, e.g., *NECA 2005 Filing* at I-15.

³² *NECA 2005 Filing*, Appendix C.

³³ Unadjusted data are the "raw" data as submitted to NECA by sample average schedule companies without any adjustments to forecast or project costs or loops to present values. For example, NECA indicates sample data used for the NECA 2005 Filing were "projected to December 2003 using account level and access line growth rates developed in NECA's 2003 study and filed in the 2004 NECA Modifications of Averages Schedules." See *NECA 2005 Filing* at III-4.

IV. ORDERING CLAUSES

8. Accordingly, IT IS ORDERED, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that the average schedule formula proposed by the National Exchange Carriers Association, Inc., on September 29, 2004, for local switching support SHALL BECOME EFFECTIVE January 1, 2005.

9. IT IS FURTHER ORDERED, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that the average schedule cost per loop formula described by NECA on September 29, 2004, for high-cost loop support SHALL BECOME EFFECTIVE January 1, 2005.

10. IT IS FURTHER ORDERED, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that NECA is required to submit to the Commission the average schedule sample data as described in this ORDER within 90 days of the release of this ORDER.

11. IT IS FURTHER ORDERED, pursuant to sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that NECA is required to submit its 2006 universal average schedule filing, including unadjusted accounting and loop data for each average schedule company, no later than September 1, 2005.

12. IT IS FURTHER ORDERED, pursuant to section 4(i) of the Communications Act of 1934, as Amended, 47 U.S.C. § 154(i), and sections 0.91 and 0.291 of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, that THIS ORDER IS EFFECTIVE UPON ITS RELEASE.

FEDERAL COMMUNICATIONS COMMISSION

Lisa S. Gelb
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