

**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. 2006)	
Modification of Average Schedule Universal)	
Service Formulas)	
)	

ORDER

Adopted: January 12, 2006

Released: January 12, 2006

By the Chief, Wireline Competition Bureau:

I. INTRODUCTION

1. Each year, the Commission must review and approve or modify any proposed modifications to the formulas used to calculate Part 36 high-cost loop support and local switching support for average schedule companies.¹ Historically, the National Exchange Carrier Association, Inc. (NECA) has filed the annual average schedule company formula modifications for both Part 36 high-cost loop support and local switching support. Pursuant to section 54.301(f) of the Commission's rules, however, the Universal Service Administrative Company (USAC) now submits the proposed formula for local switching support.² The Commission's rules require that these formulas simulate the disbursements that would be received by a company that is representative of average schedule companies.³

2. On August 30, 2005, NECA filed proposed modifications to the current high-cost loop universal service formula for average schedule companies, requesting that they take effect on January 1, 2006, and remain in effect through December 31, 2006.⁴ On September 30, 2005, USAC filed proposed modifications to the current local switching support formula for average schedule companies.⁵ On October 20, 2005, the Wireline Competition Bureau (Bureau) issued a public notice soliciting comments

¹ See 47 C.F.R. § 69.606; 47 C.F.R. § 36.613.

² 47 C.F.R. § 54.301(f).

³ See 47 C.F.R. § 69.606; 47 C.F.R. § 54.301(f).

⁴ See 2006 NECA Modification of the Average Schedule Universal Service High Cost Loop Support Formula, National Exchange Carrier Association, Inc., CC Docket No. 96-45 (filed Aug. 30, 2005) (*NECA 2006 Filing*).

⁵ See Letter from Karen M. Majcher, USAC, to Marlene H. Dortch, FCC, CC Docket No. 96-45 (filed Sept. 30, 2005) (attaching 2006 average schedule local switching support formula). In the *NECA 2005 Filing*, NECA notified the Commission that beginning on October 1, 2005, pursuant to section 54.301(f)(1) of the Commission's rules, USAC, instead of NECA, would file with the Commission the average schedule local switching support formula for each subsequent year. 2005 NECA Modification of Average Schedule Universal Service Formulas, National Exchange Carrier Association, Inc. at II-12, n.10 (filed Sept. 29, 2004) (*NECA 2005 Filing*).

on NECA's high-cost support filing.⁶ For the reasons discussed below, we approve USAC's modified local switching support formula and, with respect to Part 36 high-cost support, we adopt NECA's cost per loop (CPL) formula. As we have done previously, we direct USAC to provide support to average schedule carriers consistent with this Order retroactive to January 1, 2006.⁷

II. LOCAL SWITCHING SUPPORT FORMULA

3. The local switching support formula is used to determine the amount of support for switching costs that will be provided to average schedule companies from the Commission's universal service high-cost support mechanism.⁸ The current interstate local switching support formula was approved on December 30, 2004.⁹ In its September 30, 2005, filing, USAC proposes a formula for 2006 that, if approved, would increase annual payments for local switching support from approximately \$83.7 million in 2005 to approximately \$85.8 million in 2006, an increase of approximately 2.5 percent.¹⁰ We have reviewed USAC's filing and the supporting information in *NECA's 2005 Modification of Average Schedules* and find that the method used to develop this year's proposed formula is the same method that NECA has used to develop the formula we approved during the last payment period.¹¹ Consistent with the Bureau's prior orders, we approve USAC's proposed 2006 average schedule local switching support formula.¹²

4. USAC's average schedule local switching support filing provided only its proposed 2006 formulas. Supporting documentation for the 2006 local switching support formulas was filed eight months earlier in *NECA's 2005 Modification of Average Schedules*. In average schedule local switching support filings prior to 2005, NECA provided detailed explanations, supporting documentation, and data. Such a consolidated single filing of the formulas, necessary information, and data enables us to conduct a more efficient review of local switching support filings. Thus, beginning with the local switching support filing due in 2006, and for all subsequent filings, we require USAC to provide at least the same level of explanative detail and data that NECA had included previously with its average schedule local switching

⁶ *Wireline Competition Bureau Seeks Comment on the National Exchange Carrier Association, Inc. 2006 Modification of Average Schedule Universal Service Formula*, Public Notice, CC Docket No. 96-46, 20 FCC Rcd 16539 (2005). The Bureau received comment in support of the *NECA 2006 Filing* from the Organization for the Promotion and Advancement of Small Telecommunications Companies.

⁷ *See National Exchange Carrier Association, Inc. Proposed 2002 Modification of Average Schedule Formulas*, CC Docket No. 96-45, Order, 17 FCC Rcd 14236 (WCB 2002) (2002 Order).

⁸ 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.

⁹ *See National Exchange Carrier Association, Inc. 2005 Modification of Average Schedule Universal Service Formulas*, CC Docket 96-45, Order, 19 FCC Rcd 24998 (WCB 2004) (2005 Order).

¹⁰ USAC's average schedule local switching support formula is developed by studies documented in NECA's annual modification of average schedules filing. *See National Exchange Carrier Association, Inc., 2005 Modification of Average Schedules*, WC Docket No. 04-437 (filed Dec. 23, 2004) (*NECA's 2005 Modification of Average Schedules*). *See also* Federal Universal Service Support Mechanisms, Fund Size Projections for the Fourth Quarter 2005, filed Aug. 2, 2005; Federal Universal Service Support Mechanisms, Fund Size Projections for the First Quarter 2006, filed Nov. 2, 2005 (both available at <http://www.universalservice.org/about/governance/fcc-filings/>).

¹¹ *See NECA 2005 Filing; 2005 Order*, 19 FCC Rcd at 24998-99, para. 2.

¹² *See, e.g., 2005 Order*, 19 FCC Rcd at 24999, para 2.

support formula filings.¹³

III. PART 36 HIGH-COST SUPPORT FORMULA

A. Background

5. 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.¹⁴ 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 Commission has permitted expense adjustments for average schedule companies pursuant to formulas developed by NECA and approved or modified annually by the Bureau.¹⁵ 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 generally files proposed modifications to the formula on October 1 of each year, effective January 1 of the following year.¹⁶ In the *2005 Order*, the Bureau required 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 NECA's more detailed data submission.¹⁷

6. In its 1999, 2000, and 2001 orders, 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.¹⁸ In each instance, the Bureau instead retained the existing formula

¹³ USAC is required, at a minimum, to describe the methods and results of the studies it utilizes to develop the local switching support formula and provide a list of all average schedule companies eligible for local switching support that includes the number of access lines served by each company, the estimated local switching support resulting from the proposed formula, and the amount of support each company received during the prior year. *See, e.g., NECA 2005 Filing*. As discussed below, under certain circumstances, USAC may be required to disclose additional information. *See infra* para. 9.

¹⁴ *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 federal universal service support equal to this expense adjustment.

¹⁵ *See National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, 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 section 36.621(a). 47 C.F.R. § 36.621(a).

¹⁶ 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.*

¹⁷ *See 2005 Order*, 19 FCC Rcd at 24999, para 3.

¹⁸ *National Exchange Carrier Association, Inc. Proposed Modifications to the 1998-99 Interstate Average Schedule Formulas*, Order, 14 FCC Rcd 4049, 4051-55, paras. 6-12 (Acc. Saf. Div. 1999) (*Bureau 1999 Order*); *National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal Service Formulas*, Order, 15 FCC Rcd 5065, 5067-68, paras. 5-7 (Acc. Saf. Div. 2000) (*2000 Order*), *application for review pending* (*see* *National Exchange Carrier Association, Inc. Proposed 2000 Modification of Average Schedule Universal*

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with an adjustment for growth in the number of loops.¹⁹ The Bureau also indicated each time that it would prefer a formula that more accurately predicted cost per loop.²⁰ For 2003, 2004, and 2005, NECA again proposed its EAPL formula, but also provided a CPL formula for the Bureau's consideration.²¹ NECA contended that the EAPL formula better estimated the support that average schedule carriers would receive if they were to begin filing cost studies.²² 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 2003, 2004, and 2005.²³

7. NECA's proposal for 2006 average schedule formulas is essentially the same as its 2003, 2004, and 2005 proposals.²⁴ NECA proposes its EAPL formula, but also provides its CPL formula for consideration.²⁵ Each formula contains minor changes from last year's formulas, but reflects the same methodology.²⁶ NECA claims that both formulas would result in an increase in support to average

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Service Formulas, ASD 99-43, *Application for Review*, filed Apr. 17, 2000); *National Exchange Carrier Association, Inc. Proposed 2001 Modification of Average Schedule Formulas*, Order, 16 FCC Rcd 25 (Acc. Saf. Div. 2001) (*2001 Order*), *application for review pending* (see *National Exchange Carrier Association, Inc. Proposed 2001 Modification of Average Schedule Universal Service Formulas*, ASD 00-42, *Application for Review*, filed Jan. 26, 2001).

¹⁹ *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.

²⁰ *2000 Order*, 15 FCC Rcd at 5058, para. 7; *2001 Order*, 16 FCC Rcd at 30, para. 8.

²¹ See 2003 NECA Modification of Average Schedule Universal Service Formulas, *National Exchange Carrier Association, Inc.*, at I-13 (dated Oct. 1, 2002) (*NECA 2003 Filing*); *NECA 2004 Filing* at I-13 to I-14; *NECA 2005 Filing* at III-2 to III-36.

²² See, e.g., *NECA 2005 Filing* at I-12 to I-16.

²³ *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*; *National Exchange Carrier Association, Inc. Proposed 2004 Modification of Average Schedule Formulas*, CC Docket 96-45, Order, 18 FCC Rcd 26619 at 26622, para. 6 (WCB 2003) (*2004 Order*); *2005 Order*, 19 FCC Rcd at 24999, 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.

²⁴ See *NECA 2006 Filing* at 1-37; *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.

²⁵ *NECA 2006 Filing* at 1-37.

²⁶ *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 5-7. To estimate current year costs, NECA applies forecasted growth factors to data collected from sample average schedule carriers one and two years

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schedule companies in the aggregate due to increased costs in the sample companies.²⁷ The current high-cost support formula is expected to provide \$35.3 million in payments in 2005 to 353 study areas.²⁸ NECA's proposed EAPL formula, if approved, would provide an estimated \$53.9 million payable to 421 study areas for 2006, an increase of 52.7 percent over 2005 year payments.²⁹ NECA's updated CPL model, if approved, is estimated to pay a total of \$49.9 million to 419 study areas for 2006, an increase of 41.6 percent over 2005 total payments.³⁰

B. Discussion

8. Consistent with our reasoning in our *2003 Order*, *2004 Order*, and *2005 Order*, we adopt the CPL formula for purposes of calculating average schedule company expense adjustments for 2006. In previous average schedule formula filings, NECA conceded that the CPL formula better estimates cost per loop, but argued 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.³¹ We again find, however, 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. The Bureau has 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.³² 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 it did 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.³³ 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

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prior to the current year. NECA then applies cost allocation factors—developed from the cost 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 5-7, 17-18. NECA then uses regression analyses to predict loop costs and expense adjustments for all average schedule carriers. *See id.* at 17-37. 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 33-37. 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 20-33.

²⁷ *Id.* at 22-23.

²⁸ We note that the current amount of \$35.3 million is less than the amount that was indicated in the *NECA 2005 Filing* using the CPL formula. The *NECA 2005 Filing* estimated the CPL formula would result in total payments of \$39.78 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 2.

²⁹ *See NECA 2005 Filing* at III-2 to III-3; *NECA 2006 Filing* at 2.

³⁰ *NECA 2006 Filing* at 3.

³¹ *NECA 2004 Filing* at I-5 to I-15; *NECA 2005 Filing* at I-5 to I-16; *NECA 2006 Filing* at 33, 37.

³² *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.

³³ *See 2003 Order*, 17 FCC Rcd at 26207-08, para. 8.

August 30, 2005 submission.

9. Although today, based on the current record, we approve NECA's CPL formula for 2006, which is essentially the same CPL formula filed since 2002 adjusted for changes in the sample cost data, we are concerned about yearly increases in high-cost loop support. For the three years beginning with 2004, and ending with the estimate of high-cost loop support for 2006, high-cost loop support provided to average schedule companies has increased by 16.4 percent, 38.7 percent, and 41.6 percent, respectively.³⁴ NECA states that increases in support are primarily driven by the increases in costs reported by sample average schedule companies.³⁵ Although support for 2006 is estimated to be going up by over 41%, NECA's filing also shows that the support will be provided to more carriers.³⁶ We also note that the increase in NECA's high-cost loop support estimate is due, in part, to NECA's implementation of loop count reporting modifications pursuant to a 2004 Commission order.³⁷ NECA makes marginal reference to this order without specific details of the effect on universal service fund payments resulting from its implementation of the loop count adjustment.³⁸ For future filings, we find that NECA should clearly disclose and quantify any significant modifications to the development of average schedule universal service formulas in its annual average schedule universal service filings. We require NECA to disclose when a Commission order or rule change causes a change in aggregate universal service support to average schedule companies by more than five percent of the previous year's universal service support. Similarly, we require USAC to disclose when a Commission order or rule change causes a change in aggregate local switching universal service support to average schedule companies by more than five percent of the previous year's support.³⁹

IV. ORDERING CLAUSES

10. 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 Universal Service Administrative Company on September 30, 2005, for local switching support IS ADOPTED, effective retroactively as of January 1, 2006.

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 the average schedule cost per loop formula described by the National Exchange Carrier Association on August 30, 2005, for high-cost loop support IS ADOPTED, effective

³⁴ See *2004 Order*, 18 FCC Rcd at 26622, para. 5; *2005 Order*, 19 FCC Rcd at 25002; *NECA 2006 Filing* at 3.

³⁵ See, e.g., *NECA 2006 Filing* at 22-23.

³⁶ For example, under the CPL formula, payments to average schedule companies in 2006 would be payable to 419 average schedule study areas, as compared to 353 average schedule study areas in 2005. See *NECA 2006 Filing* at 2-3.

³⁷ See *National Exchange Carrier Association Petition to Amend Section 69.104 of the Commission's Rules*, WC Docket No. 04-259, RM 10603, Order Granting Petition for Rulemaking, Notice of Proposed Rulemaking and Order Granting Interim Partial Waiver, 19 FCC Rcd 13591, 13606, para. 44 (2004). In this order, the Commission permitted, pursuant to an interim partial waiver, incumbent local exchange carriers to report DS-1 loops as 5 loops even though a DS-1 loop provides 24 loops. See *id.* at 13604-05, para. 39. As a result, NECA adjusted sample companies access lines and loop counts using a DS-1 Channel line count adjustment factor of 0.984. See *NECA 2006 Filing* at 6, n.6. Because fewer loops are reported for formula development purposes while costs remain constant, resultant costs per loop are increased.

³⁸ See *NECA 2006 Filing* at 6, n.6.

³⁹ See *supra* n.12.

retroactively as of January 1, 2006.

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

Thomas J. Navin
Chief, Wireline Competition Bureau