Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

In the Matter of	)	
	)	
National Exchange Carrier Association, Inc.	)	**WC Docket No. 02-340**
Tariff F.C.C. No. 5	)	
Transmittal No. 951	)	

SPRINT CORPORATION OPPOSITION TO DIRECT CASE

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OPPOSITION TO DIRECT CASE

Sprint Corporation hereby respectfully submits its opposition to the Direct Case filed by the National Exchange Carrier Association, Inc. ("NECA") on October 31, 2002, in response to the Order (DA 02-2948) of the Pricing Policy Division ("Division") of the Commission's Wireline Competition Bureau, released October 31, 2002, in the above-captioned docket.

I. INTRODUCTION AND SUMMARY

NECA's proposed tariff revisions modifying its criteria for security deposits filed on August 21, 2002 in the above-captioned transmittal would expand significantly the bases on which it would be able to require deposits from its existing customers. NECA's currently effective tariff language, which was prescribed by the Commission in its 1984 decision in CC Docket No. 83-1145 (Phase I),[1] requires that a deposit be made only by "a customer which has a proven history of late payments to the Telephone Company or does not have established credit." NECA Tariff F.C.C. No. 5, Section 2.4.1(A), 4th Revised Page 2-26. NECA's proposed revisions would afford it the right to require an existing

[1] *Investigation of Access and Divestiture Related Tariffs,* 97 FCC 2d 1082, 1169 (1984) (*1984 Access Tariff Decision*).

customer to provide a security deposit even if the customer does not "have a proven history of late payments" or has "established credit," as long as "the customer's credit worthiness is below a commercially acceptable level." Id. Section 2.4.1(A)(2), 2nd Revised Page 2-26.1. NECA defines a "commercially acceptable level of credit worthiness" of a customer which issues debt securities to be "a corporate debt securities rating with respect to any outstanding general debt obligations of at least BBB according to Standard & Poor's or an equivalent rating from other debt rating agencies." Section 2.4.1, 5th Revised Page 2-26. For customers without debt securities, the customer must have "a composite credit appraisal rating published by Dun & Bradstreet of at least 'good' or a Paydex score as published by Dun & Bradstreet of at least 'average'." Id. In addition, NECA is proposing an extremely short time period for posting the deposit to "within fourteen (14) days of the date of the notice," and the deposits must be "in the form of funds that are available for use by the Telephone Company on the same day on which the funds are received" such as "U.S. Federal Reserve Bank wire transfers, U.S. Federal Reserve notes (i.e., paper cash) and/or U.S. Postal Money Orders." Section 2.4.1(A)(2), 2nd Revised page 2-26.2.

By attempting to introduce these alternatives in its tariffs, NECA is seeking unfettered discretion over which customers will be required to transfer to NECA millions of dollars in deposits. Such discretion would enable NECA to violate the Section 202(a) proscription against unjust discrimination with impunity, as it will be able to pick and choose among its customers for the imposition of deposit requirements. Although many CLECs compete in the local exchange market, the market share of incumbent local exchange carriers (LECs) was 90 percent as of December 31, 2001.[2] Thus, because they are dependent on the LECs' networks to provide their services, access customers have little alternative but to take most of their interstate access services from the dominant access providers, such as the NECA pooling companies, and to comply with any deposit requirement imposed or risk discontinuance of service.

To examine the lawfulness of the proposed provisions, the Division designated three issues for investigation and directed NECA to provide information related to each. As discussed below, NECA's Direct Case fails to demonstrate that its proposed revisions to its provisions for security deposits are not unjust and unreasonable, in violation of Section 201(b) of the Act, or unreasonably discriminatory, in violation of Section 202(a) of the Act. (Issue 1) NECA has not demonstrated that its currently effective tariff provisions would not have substantially mitigated its uncollectible issue – to the extent there is one – had such provisions been exercised in a timely manner. Nor has NECA demonstrated that the ill-defined criteria it proposes would be a better predictor of the likelihood that a customer will pay its bills than the customer's payment history, or that it could not use such criteria to impose deposit requirements in a discriminatory manner.

Despite NECA's claims to the contrary, nothing in the proposed revisions would exclude NECA's long-term pricing plans from their scope. (Issue 2) And, NECA must demonstrate that it has substantial cause to change these long-term plans, which it has not done. NECA has also failed to demonstrate the reasonableness of its proposed reduction in the notice interval before discontinuance of service or refusal to process orders. (Issue 3) The reduction of this interval from 30 days to 10 will not significantly decrease

[2] Industry Analysis and Technology Division, Wireline Competition Bureau, FCC, Local Telephone Competition: Status as of December 31, 2001, July 2002, Table 6.

NECA's exposure, while it will be a hardship for its larger carrier-customers that must review massive bills that generally contain a substantial amount of errors.

II. ANALYSIS OF THE ISSUES DESIGNATED FOR INVESTIGATION

A. Issue 1: Basis for Requiring a Deposit from a Customer

The Division calls upon NECA to "explain why it believes its rates do not adequately compensate its carrier participants for the risk of uncollectibles." Order, ¶ 11. In response, NECA claims that "the level of uncollectible revenue has increased dramatically beginning in 2001, and the sharp spike in 2002 clearly shows that the relatively steady, slow, and predictable growth in uncollectibles that existed during the 1990s no longer reflects the profound increase in risk associated with interexchange carrier accounts." Direct Case, p. 4. The increase in NECA's uncollectible percentage in 2001 and 2002 reflect the normal fluctuations associated with a business cycle. In particular, an increase in bankruptcies and uncollectibles is normal when the economy experiences a significant downturn, such as the economic recession that began in March 2001, with the GDP contracting through the third quarter of 2001 and the trough in December 2001.[3] That period also witnessed the bursting of the Internet bubble and the demise of many Internet-related firms and their suppliers. And, the fraud committed by certain carriers that came to light this year and has resulted in such companies filing for protection under the bankruptcy laws is not – and cannot be considered – indicative of a new trend in the telecommunications industry or of a shift in the level of uncollectibles. The burden of proof is on NECA to demonstrate that the increases in its uncollectibles in

[3] Simon Wilkie, Chief Economist, Federal Communications Commission, Macroeconomic Perspective, Presentation at the FCC's *en banc* hearing, October 7, 2002, Slide 2 entitled "Sizing the Recession."

2001 and 2002 reflect a permanent structural change in the interexchange access market. This it has not done.

The tariff changes NECA has proposed will have a significant impact on its access customers because there is a cost associated with posting the security deposits, which must be "in the form of funds that are available for use by the Telephone Company on the same day on which the funds are received… [F]unds include U.S. Federal Reserve Bank wire transfers, U.S. Federal Reserve notes (i.e., paper cash), and/or U.S. Postal Money Orders." NECA Tariff F.C.C. No. 5, Section 2.4.1(A)(2), 2nd Revised Page 2-26.2. Companies face limits on the amount that financial institutions are willing to lend to them; and the more debt a company requires, the higher the cost will be. Thus, the requirement to post either cash or a bond equivalent to two months' access charges because NECA decides to declare that the "customer's credit worthiness is below a commercially acceptable level" (id., 2nd Revised Page 2-26.1) will directly increase a company's expense associated with access charges.

The Division requests information from NECA regarding "the total dollar amount of security deposits held by its carrier participants that are attributable to interstate access services and the percentage relationship of that amount to average monthly interstate access billings." Order, ¶ 11. NECA responds that "[t]he low security deposits from carriers indicate most companies have not requested security deposits from their carrier customers." Direct Case, p. 7. NECA assumes that this is because "carrier customers did not generally have histories of late payments...." Id. It could also be that NECA's pooling carriers failed to request deposits from those who do not pay in a timely manner. NECA informs the Division that several participating companies "have instituted increased reviews of their customer accounts resulting in timelier notices to customers that have been delinquent in bill payments." Direct Case, p. 9. Thus, as suggested above, NECA participants may have failed to request deposits, as they legitimately may pursuant to the currently effective NECA tariff, from customers that have a history of late payments or that have not demonstrated established credit. Failure of the carriers to exercise their rights under existing tariffs hardly justifies giving them greatly increased and anti-competitive powers to require deposits.

In order to evaluate whether different treatment should be afforded customers whose services are billed in advance, the Division asked NECA to provide the amount it bills in advance. Order, ¶ 13. NECA states that the percentage of billings that are billed in advance increased from 42 % in 2001 to 73 % in 2002. Direct Case, p. 12. Although NECA rejects the suggestion that access services billed in advance should be treated differently than those billed in arrears, it is undeniable that, for services billed in advance of service, the lag between nonpayment and discontinuance of service is a month shorter than for services billed in arrears. NECA's Exhibit C confirms the shorter time frame for discontinuance of service from 97 days for charges billed in arrears to 67 days for charges billed in advance. Thus, NECA benefits from the growing percentage of its billings that are rendered in advance of service, further cushioning it from occasional increases in exposure to bad debt, and rendering a change in the deposit provisions unnecessary.

The Division asks NECA to explain why it believes that the risk of uncollectible debts has increased permanently and the reasons for this change. Order, ¶ 14. NECA's response does not demonstrate that any change is permanent. NECA's statement that "[a]ccess customers are experiencing decreasing demand for interstate switched access, decreasing long distance revenue, and have been impacted by the general downturn of the economy" (Direct Case, p. 14) does not prove that the increase in uncollectibles is anything more than part of the general economic downturn or the one-time rash of carrier bankruptcies that occurred in 2001 and 2002, largely as a result of the bursting of the Internet bubble and disclosures of financial fraud. Nor does its following statement that interexchange carriers will face "intense competition...from cellular carriers, Voice-Over-IP networks, and from RBOCs entering the long distance market" support its theory because many of these competitors resell the services provided by interexchange carriers. Nor do Merrill Lynch's third quarter financial projections for AT&T demonstrate a permanent change. Clearly, NECA has failed to sustain its burden of proof on the core issue of the reasonableness of its tariff provisions.

In addition, NECA's criteria would give undue credence to bond rating agencies at a time when they have been much quicker than they historically were to downgrade or put on review a company's bond ratings. Downgrades can occur for any number of reasons – because the company did not meet analysts' earnings expectations or because of a negative news item. The Financial Times recently reported that "investors perceive [rating agencies] have been too hasty with recent downgrades,"[4] and in an article in The Wall Street Journal, it was noted that "the fast-paced, fickle bond market can change its mind in an instant about a company's creditworthiness and how much to charge."[5] The

[4] Aline van Duyn, "Aggressive Downgrades Under Question: Bond Investors Are Concerned By The Apparent Changes in Rating Agencies Assessments." Financial Times, July 12, 2002.
[5] Greg Ip, "Suddenly, Banks Are Acting a Lot Like Bond Markets." The Wall Street Journal, September 17, 2002, page A1.

possibility that some "savvy players are whipsawing the market to their advantage" was discussed in today's The Wall Street Journal. Critics of the credit-derivative market believe that "hedge funds often use both the bond market and the credit-derivatives market to push companies that are barely investment grade into speculative-grade territory. This can happen by creating uncertainty about their access to additional capital, leading the ratings agencies to downgrade. If a company's debt loses investment-grade status, many institutional investors, prohibited from holding junk, are forced to sell the bonds, causing further bond-price declines."[6] NECA seeks to capitalize on the current low ratings in the telecommunications industry to demand significant deposits from its captive competitors/customers.

Also troubling is the discretion the tariff language would give NECA to rely – or not to rely – on the credit ratings to impose a deposit on a customer. Under the proposed tariff language, it could impose a deposit requirement on Carrier A but not on Carrier B, even though each might have been rated below BBB by one organization; alternatively, it could choose among rating organizations in order to find the lowest rating for each carrier.[7] Plainly, NECA could use the proposed deposit language to discriminate among its customers, and it is abundantly clear that NECA reserves to itself the discretion to consider whatever information it chooses and weigh these various factors however it wants to decide whether or not to require a deposit from a customer under the proposed language.

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[6] Henny Sender, "A Market Backfires, and Investors Pay," The Wall Street Journal, December 5, 2002, page C1, C4.

[7] Under NECA's proposed threshold of BBB, it could require security deposits from carriers that have a grade of BBB-, which is above the non-investment grades. This threshold is higher than those proposed by other carriers, and is clearly unreasonable.

To support it claim that its "proposed revision does target those companies that are most likely to default," NECA relies on Verizon's analysis (which was filed confidentially by Verizon) which purports to "demonstrate[] a clear correlation between S&P credit ratings and customers with outstanding receivables for 90 days or more." Direct Case, p. 20. Verizon's exhibit shows little apparent correlation between the receivables outstanding for 90 days or more and the S&P credit ratings, and Verizon failed to provide any statistics to support the validity of its analysis.

B. Issue 2: Application of Revised Deposit Requirements to Term Plan Customers

NECA claims that its "[t]erm plans do not state that the tariff's General Regulations will not change during the length of the plan." Direct Case, p. 23. The deposit provision is part of the "General Regulations" section of the tariff, which applies to all services contained in the tariff, including the term plans. In order to avoid application of the "General Regulations," a particular service would have to specifically exclude their application. No such exclusion has been made for term plans. Thus, unless otherwise specified, the "General Regulations" applicable when the customer enters into the term plan should apply throughout the term. It would be unreasonable to assume that the customer is locked into a multi-year term plan with no option but to accept a carrier's new, onerous requirements simply because such requirements are in a different section of the tariff. Clearly, the proposed deposit requirement will apply to term plans, and any change in the regulation must pass the "substantial cause" test.

In considering whether or not a carrier has "substantial cause" to make revisions to its long term commitments, the Commission evaluates whether the modification is a material change to the agreement. According to NECA, "[t]he imposition of revised security deposit provisions does not constitute a material change for NECA's term plan customers." Direct Case, pp.23. As discussed, the requirement to post deposits valued in the millions of dollars and which tie up a carrier's working capital may well play an important role in the customer's decision about whether to subscribe to a term plan and the length of such plan. Although the proposed change is not an increase to a particular rate element, it could cause customers to post huge deposits in cash or bonds, will increase the cost of obtaining access services because their overall cost of capital will increase, and may jeopardize pre-existing financial agreements. Thus, the change must be considered "material."

NECA asserts that it has demonstrated substantial cause to modify its tariff even if the modification is found to be material. The first part of the substantial cause test requires the examination of "the carrier's explanation of the factors necessitating the desired changes at that particular time."[8] As discussed above, NECA has not demonstrated that its current tariff provisions, if properly enforced, would not adequately protect it from an increase in uncollectibles which result from the economic recession and accounting scandals.

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[8] *In the Matter of RCA American Communications, Inc.*, 86 FCC 2d 1197, 1201-02 (1981) (*RCA American Order).*

The second part of the substantial cause test requires an evaluation of "the position of the relying customer in evaluating the reasonableness of the change." *RCA American Order*, 1201-02. For any customer, deposits equivalent to one or two months of interstate access charges are hardly *de minimis*, with little financial impact on the customer. Given the dominant position of the NECA participating carriers in the provision of access services, the customer cannot simply switch to another service provider. The customer has no alternative but to immediately post a substantial deposit, which will be both unexpected and costly. NECA has not shown that the impact of business cycle fluctuations and the fraud-related bankruptcies on it is so severe as to warrant the imposition of substantial deposits on its term plan customers. Thus, NECA has failed to justify this material change to its term plan customers.

C. Issue 3: Shortened Termination Period

The third issue the Division has designated for investigation concerns the reasonableness of the reduction in the interval for refusal of additional applications for service and discontinuance of service from 30 to 10 days for customers that do not meet the requirements for the "Payment of Rates, Charges and Deposits" section of NECA's tariff. The shortening of the notice periods is unjust and unreasonable. The reduction of the interval will not decrease significantly NECA's exposure to uncollectibles, while it will be a hardship for its carrier customers. Customers may have inadequate time to review bills or discuss alternative payment arrangements with the local exchange carrier. The threat of discontinuance of service or refusal to process applications affords the carrier considerable weight in any negotiations on these matters, especially since the customer probably has no alternative service provider.

Without support, NECA claims that "[s]hortened notice periods and increased security deposit provisions are both necessary to contain the spread of the insolvency virus, so that it does not pass on to other IXCs or ILECs." Direct Case, p. 25. Given that the shortened notice period is meant to address the same alleged uncollectible issue as the two-months' deposit, NECA should not be permitted to impose both on its captive customers.

III. CONCLUSION

For the above reasons, Sprint urges the Commission to find that NECA has failed to demonstrate in its Direct Case that its proposed deposit requirements are not unjust and unreasonable, in violation of Section 201(b) of the Act; are not unjustly discriminatory, in violation of 202(a) of the Act; and are not impermissibly vague, in violation of Section 61.2 and 61.54(j) of the Commission's Rules.

Respectfully submitted,

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December 5, 2002

CERTIFICATE OF SERVICE

I hereby certify that a copy of that portion of Sprint's Opposition to Direct Case of the National Exchange Carraier Association, Inc., Tariff F.C.C. No. 5, Transmittal No. 951, WC Docket No. 02-340, was sent electronically and/or by U.S. First Class Mail and facsimile on this 5th day of December 2002 to the parties listed below.

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