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June 27, 2005

Ms. Marlene Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: July 1, 2005 Annual Access Charge Tariff Filings – National Exchange Carrier Association Tariff No. 5: Petitions of General Communication Inc. and AT&T to Suspend and Investigate Transmittal No. 1077, WCB Docket No. 05-22

Dear Ms. Dortch:

On June 24, 2005, Tina Pidgeon, Vice President Federal Regulatory Affairs, General Communication Inc. ("GCI"), and Stephanie Weiner and I, of Harris, Wiltshire & Grannis, LLP, on behalf of GCI, met with Tamara Preiss, Chief, Pricing Policy Division, Wireline Competition Bureau, Judy Nitsche, Jay Atkinson, Gene Gold, Dick Kwiatkowski, and Doug Slotten, all of the Pricing Policy Division, regarding GCI's Petition to Suspend and Investigate NECA Transmittal No. 1077 (NECA 2005 Annual Access tariff filing). The points we presented are contained in GCI's petition and in the attached document. As summarized therein, it is imperative – and a critical enforcement matter – that the Commission actually enforce its rate-of-return prescription rules in the tariff process, and not permit the ILECs to evade enforcement of those rules through the "deemed lawful" protections of streamlined tariffing.

In addition, we further explain herein that the D.C. Circuit's decision in *Virgin Islands Telephone Corp. v. FCC*, 989 F.2d 1231 (D.C. Cir. 1993)("*Vitelco*") actually supports, rather than precludes, suspension and investigation of NECA's tariff to require NECA to target an 11.25% rate of return for the 2005-2006 Monitoring Period. *Vitelco* itself was predicated on the fact that the ILEC has the opportunity, during the Monitoring Period to adjust its filed rates "to correct for excessive or inadequate earnings."[1] *Vitelco* teaches that the proper remedy for potential excessive earnings discovered during the course of a Monitoring Period is for the ILEC to be required to make mid-course corrections, rather than, in the first instance, ordering the ILEC to provide refunds.[2] That is exactly the remedy that GCI seeks in its petition to suspend and investigate

[1] 989 F.2d. at 1237.
[2] To the extent permitted by Section 204(a)(3), refunds remain available if, after review of the entire Monitoring Period, the ILEC has exceeded the maximum allowable rate of return.

Vitelco arose after when the FCC, after Hurricane Hugo, permitted the Virgin Island Telephone Company (Vitelco) to make an interim, mid-course correction to increase its access rates for the period from January - June 1990.[3] These rates were predicated on an assumed decrease in demand because Hurricane Hugo had devastated the telephone plant in the Virgin Islands.[4] When the Bureau granted the requested rate increase, it also suspended the tariff for one day and instituted an investigation.[5] During the investigation, it became clear that the anticipated decrease in demand had not occurred, and thus that Vitelco's annualize interstate access earnings for the first three months of 1990 were over 36%, well in excess of the authorized rate of return of 12%.[6] The Commission, upon reviewing this information, "concluded that Vitelco had 'overearned' *during that time* [the six month period from January to June 1990] and that the interim rates were therefore unjust and unreasonable," and "ordered Vitelco to refund, with interest, any amounts earned during the six month interim period in excess of the then-applicable 12% rate."[7]

On petition for review, the D.C. Circuit reversed the FCC's order finding Vitelco's rates to be unjust and unreasonable and ordering refunds. The Court concluded that the Commission had improperly judged Vitelco's earnings on six months performance, far less than the full two year Monitoring Period, and that doing so "ignore[d] the temporal dimension of rate-of-return regulation."[8]

Notably, however, the opportunity for the ILEC to make mid-course corrections was a critical part of the D.C. Circuit's decision. The two year Monitoring Period, the Court explained, "allows the Commission to monitor interstate access rates *while still providing carriers an opportunity to respond to changing market conditions with mid-course rate revisions*."[9] As the Court observed, "[w]ithin each two-year monitoring period, the company would normally have two scheduled rate revisions to correct for excessive or inadequate earnings."[10] Furthermore, the Court noted that this is what Vitelco appeared to be doing – proposing lower annual access rates to take effect in July 1990 such that "it was not unreasonable for Vitelco to believe that it could reduce its earnings over the two-year review period to an acceptable level."[11] Indeed, the Court found significant the fact that the Commission did not "find that Vitelco's earnings from January 1, 1989 through December 31, 1990, had exceeded the authorized 12% rate of return for that period."[12]

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3 989 F.2d at 1235.
4 *Id*.
5 *Id*.
6 *Id*.
7 *Id*. at 1236 (emphasis in original).
8 *Id*. at 1238-9.
9 *Id*. at 1237 (emphasis added).
10 *Id*.
11 *Id*. at 1238.
12 *Id*. at 1236.

Properly analyzed, what *Vitelco* teaches is that the remedy when potential overearnings are discovered during the course of the Monitoring Period is to reduce future rates during the remainder of the Monitoring Period to target the prescribed rate of return. The Commission in *Vitelco* selected the wrong remedy, and may not have had a record on which to select the proper remedy. Had the Commission had the basis in the record to do so, it could have found that "Vitelco's earnings from January 1, 1989 through December 31, 1990" would likely "exceed[] the authorized 12% rate of return for that period."[13] Had it done so, the Commission could then have ordered Vitelco to reduce its proposed rates for July 1, 1990 to December 31, 1990 to correct for the potential excessive earnings. However, Vitelco had already proposed reduced rates that, as the court found, could have reduced earnings for the Monitoring Period to "an acceptable level."

What GCI asks the Commission to do here is to adopt precisely the remedy not taken but left open in *Vitelco, i.e.,* to conclude that NECA will likely earn more than the 11.25% prescribed rate of return (or even the 11.65% maximum rate of return) during the January 1, 2005 – December 31, 2006 Monitoring Period and that therefore further reductions to NECA's rates for the remainder of the Monitoring Period are warranted. This is not a step to order refunds for the January 1, 2005 – June 30, 2005 period now, but instead to make mid-course adjustments to prospective rates for the remainder of the Monitoring Period so that the overall two-year rate-of-return falls within acceptable levels.

This approach is also consistent with Section 204(a)(3)'s streamlined tariff procedures, and allows the Commission to harmonize *Vitelco*, Section 204(a)(3), and the D.C. Circuit's decision in *ACS of Anchorage v. FCC*, 290 F.3d 403 (2002), while still maintaining some accountability for rate-of-return LECs in filing their tariffs. Section 204(a)(3) permits tariffs filed under specified review period to be "deemed lawful," unless the Commission takes action prior to the end of the review period.[14] Consistent with *Vitelco*, a tariff might be subject to suspension and investigation (and thus not deemed lawful pursuant to Section 204(a)(3)) is if the FCC's finds it to be likely that the ILEC's "demand projections . . . were based upon incorrect data, or that the company made erroneous calculations using that data"[15] or if its proposed rates are likely to lead to overearnings for the entire Monitoring Period.[16] Thus, the ILEC that must file annually (such as NECA) will have an incentive during the early part of the Monitoring Period not to over-inflate its estimates of revenue requirement or understate its demand projections, because its excessive earnings in the first part of the Monitoring Period may lead to reduced rates later in the Monitoring Period. However, if the Commission, after reviewing the tariffs and any petitions filed under Section 204(a)(3)'s streamlined procedures, does not suspend and investigate, the ILEC's tariff is deemed lawful, and refunds will no longer be available, even if the ILEC's returns in fact exceed the maximum rate of return for the entire monitoring period. In essence, after enactment of Section 204(a)(3), the tariff review process is the only means of

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[13] *Id*.
[14] 47 U.S.C. § 204(a)(3).
[15] *Vitelco*, 989 F.2d at 1236.
[16] *Id*.

enforcing ILEC compliance with the rate-of-return prescription of an 11.25% return measured over a two year Monitoring Period.

If the Commission does not force ILECs to make mid-course corrections, however, then there will be no mechanism to enforce the rate-of-return prescription rules whenever a tariff is allowed to take effect with Commission action pursuant to Section 204(a)(3). Because refunds are not available for rates that are "deemed lawful," ILECs can consistently overearn without any consequence once those rates become effective. In that instance, the ILECs have every incentive to overestimate revenue requirement and underestimate demand, so as to inflate rates to the maximum extent possible and plausible.

Accordingly, NECA Transmittal No. 1077 should be suspended and investigated for its failure to show how the proposed rates offset anticipated excessive earnings for the first six months of 2005, and thereby comply with the requirement that NECA's rates target an 11.25% rate-of-return determined over the entirety of the January 1, 2005 to December 31, 2006 Monitoring Period.

In accordance with FCC rules, a copy of this letter is being filed electronically in the above-captioned docket.

Sincerely,

/s/

John T. Nakahata
Counsel to General Communication Inc.

cc: Ms. Michelle Carey, Legal Adviser to the Chairman
Mr. Tom Navin, Chief, Wireline Competition Bureau (WCB)
Ms. Tamara Preiss, Chief, Pricing Policy Division, WCB
Ms. Judy Nitsche, Assistant Chief, Pricing Policy Division, WCB
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