GCI PETITION TO SUSPEND AND INVESTIGATE NECA TARIFF

NECA's 2005 Annual Access Tariff raises substantial questions of lawfulness, and thus should be suspended because:

- **NECA fails to explain how its rates target an 11.25% rate of return for the entire 2005-2006 Monitoring Period – as required under 47 C.F.R. 65.701 – rather than just the 2005-6 tariff year.**
- **NECA fails to supply sufficient data to determine the reasonableness of a $91 million (37%) upward adjustment to its company-forecasted special access revenue requirement for the cost companies.**

I. NECA Fails to Target an 11.25% Return for the Monitoring Period.

Background – As the Commission outlined in *GCI v. ACS of Anchorage*, 16 FCC Rcd 2834 (2001), the rate of return regulatory process is as follows:

- "Rate-of-return carriers are permitted to earn no more than a Commission-prescribed return on the investments they make in providing exchange access services."
- "To comply with this prescription, rate-of-return carriers estimate their costs of providing exchange access services and project their demand for such services for a two-year period in the future (*i.e.*, the monitoring or enforcement period)."
- "They then file tariffs containing rates for their access services that they believe, given their estimate of costs and demand, will result in *earnings within the prescribed rate of return at the end of the two-year forecast period*."
- "During the course of the two-year monitoring period, rate-of-return carriers *must* review how their actual costs and demand calculations compare to their earlier projections, *and make rate adjustments, if necessary, to ensure that they do not exceed their prescribed rate of return*."
- "If a rate-of-return carrier ultimately exceeds its rate of return at the end of the two-year monitoring period, the Commission may then require refunds of any such overearnings to affected customers."
- However, if a rate is filed under streamlined tariff procedures and is "deemed lawful," the Commission cannot later require refunds. *ACS of Anchorage v. FCC*, 290 F.3d 403 (2002)

Rule 65.701: "[I]nterstate earnings shall be measured over a two year period to determine compliance with the maximum allowable rate of return." The applicable two year period for this tariff is January 2005-December 2006.

NECA's switched traffic sensitive and special access earnings for January-June 2005 (first six months of the two year Monitoring Period) will likely exceed 11.25%.

- NECA tariff data shows likely earnings over 11.25 (or 11.65)% for both switched traffic sensitive (by $16.9 million) and special access (by $23.8 million).
- First 3 months NECA-reported switched traffic sensitive return was 15.9%.
- NECA's 2005 tariff support materials show that its 2004-2005 switched traffic sensitive tariffs were based on company-supplied projections that systematically overforecast revenue requirement, and thus overinflated NECA's 2004-2005 rates.

Notwithstanding likely excessive earnings for first six months of the Monitoring Period, NECA's 2005-2006 tariff shows that it has not "ma[de] rate adjustments" to ensure that earnings will be "within the prescribed rate of return at the end of the two year monitoring period." (*GCI v. ACS*, at ¶ 5)

- NECA's 2005 Annual Access Tariff ignores entirely its earnings in the first six month of the Monitoring Period.
- NECA's supporting documents do not describe how its current rates target 11.25% "measured over a two year period" as required by Rule 65.701.

Accordingly, NECA's proposed 2005 rates raise a substantial question of lawfulness and must be suspended and investigated for compliance with the prescribed rate-of-return.

Response to likely NECA arguments:

- <u>Argument</u>: *Vitelco,* 989 F.2d 1231 (1993), precludes ordering refunds based on less than a full two-year monitoring period performance.
- <u>Response</u>:
    - *Vitelco supports evaluating earnings from prospective rates over a two-year monitoring period. Vitelco* held that compliance with the rate of return prescription must be measured over the two year period specified in Rule 65.701. When applied to refunds, as the court ruled in *Vitelco,* this means that refunds for past period overcharges cannot be ordered without evaluating the full two-year period return. However, with respect to proposed tariff rates, the same period also must be used to determine whether the proposed rate complies with the prescribed rate of return. Here, NECA has not demonstrated (or even attempted to demonstrate) that it has targeted an 11.25% return for the two year monitoring period.
    - *Refunds are not the same as setting prospective rates.* The Commission should not confuse a refund, which is a repayment of overcharges on past demand, with setting prospective rates, which apply only to future demand. The difference is subtle but important. Under *Vitelco*, a retroactive refund on past demand is only due if a carrier earns in excess of 11.25% during the entire two-year monitoring period. But *Vitelco supports* requiring a carrier to makes a mid-course correction – i.e., adjusting rates for future months during that two year monitoring period – to ensure that the carrier does not exceed allowable rates of return during the period.

- <u>Argument</u>: Although initial rates of return reports appear high, these rates of return always recede to within the permissible rate of return once final company adjustments are submitted to NECA, 24 months after the close of the tariff year.
- <u>Response</u>: This is simply not true for switched traffic sensitive rates. Data filed by NECA during the investigation of its 2004 annual access tariff demonstrated that switched traffic sensitive rates never to within the permitted rate of return for 1999-2003. In any event, the first 6 months of 2005 performance can be evaluated using the same data NECA uses to justify its proposed rates, so should be the most accurate possible current view.

II. NECA's Fails to Justify its Special Access Revenue Requirement.

Background: NECA's proposed special access rates are calculated including a $91 million *upward* adjustment to the special access revenue requirement for the cost companies (NECA's tariff covers "cost" and "average schedule") companies. This upward adjustment to the projections provided by the NECA cost companies is reportedly based on linear trends.

NECA fails to provide sufficient documentation of its calculations of the "trend" supporting the $91 million adjustment. It's adjustment is a "black box."

- NECA does not provide the back-up study area data that it analyzed to produce its linear trend analysis. Without this data, there is no way to evaluate whether the linear model is appropriate or whether some other model is appropriate.
- Without this data, it is impossible to determine whether and to what extent some companies may have seen investment accelerate and decelerate (such as might occur if a company made substantial one-time investments in DSL), and the distribution of companies within such an S-shaped investment curve.
- Projecting special access revenue requirement for the 2005-6 tariff year based on a linear extrapolation from 2002-2003 growth may not be appropriate, particularly if, for example, high special access revenue requirement growth in past years was driven by a large number of companies investing substantially in DSL. The number of high investment companies in 2005-2006 could well be lower than in 2002-2003, as many NECA companies have already turned up DSL services.

Especially for tariffs submitted under streamlined tariff processes, the Commission must be especially rigorous in requiring carriers to submit workpapers and other underlying documentation, rather than just cursory descriptions that do not allow affected parties to actually review the underlying data and calculations.

- Affected parties have only, at most, 7 calendar days to review and comment upon ILEC tariffs. When carriers "hide the ball," neither affect parties nor the Commission have a meaningful opportunity to review tariff proposals.
- Because streamlined tariffs when not suspended are "deemed lawful," and therefore preclude refunds, pre-effectiveness review is the *only* opportunity affected parties have to seek Commission intervention to prevent non-refundable overcharges.

Accordingly, the Commission should suspend and investigate NECA's special access revenue requirement projections.