NECA
Rural ILEC Cost Recovery

Presented to

Washington State Public Utility Commissioners

July 14, 2005

Introduction to NECA

- Formed in 1983 at the direction of the Federal Communications Commission (FCC)
  - Not-for-profit membership corporation (includes all ILECs)
  - Governed under FCC Part 69 Rules
- Key responsibility — filing interstate access tariffs on behalf of approximately 1,200 telephone companies
  - Includes operation of revenue pools
  - Average Schedule Development
  - Tariff 4 (Wire Center Data)
- Additional responsibilities include
  - High Cost Loop Data Collection
  - Telecommunications Relay Service Fund Administration

Introduction to NECA

- 15 Member Board of Directors Elected by Membership:
  - 2 Subset I
  - 2 Subset II
  - 6 Subset III
  - 5 Outside Directors

- Headquarters – Whippany, NJ
  - 7 Regional Offices
  - Government Relations office – Washington, D.C.

Interstate Access Tariffs & Pooling

- Optional participation based on annual elections
  - Two pools
    - Common Line
      - 1,244 Companies
      - 11.7 Million Access Lines
      - $2.0 Billion Revenue Requirement
    - Traffic Sensitive
      - 1,120 Companies
      - 6.8 Million Access Lines
      - $1.1 Billion Revenue Requirement

Average Schedule Development & Administration

- Approximately half of the companies in the NECA pools have chosen to have their settlements based on Average Schedules
- Revenue distribution from the pools based on formulas, developed by NECA and approved by the FCC
- Formulas act as surrogate for cost of providing access services

Wire Center Tariff FCC #4

- Contains extensive information about Wire Centers and Central Offices for both ILECs and CLECs
  - Including a complete list of participating carrier Company Codes and related contact information. (32,260 wire centers listed)
- Tariff 4 data used for:
  - Ordering, Billing and Provisioning access services
  - Verifying access and private line bills
  - Customized research projects
  - Data identifying access services available at wire center

Additional NECA Data Submissions and Analyses

- Quarterly Minutes of Use Data
- Assistance to Rural Task Force
- Access Market Surveys
- Broadband Studies
- End User Cost Recovery Study
- Analyses of Various Intercarrier Compensation Approaches

Federal Universal Service Funds - Overview of Programs

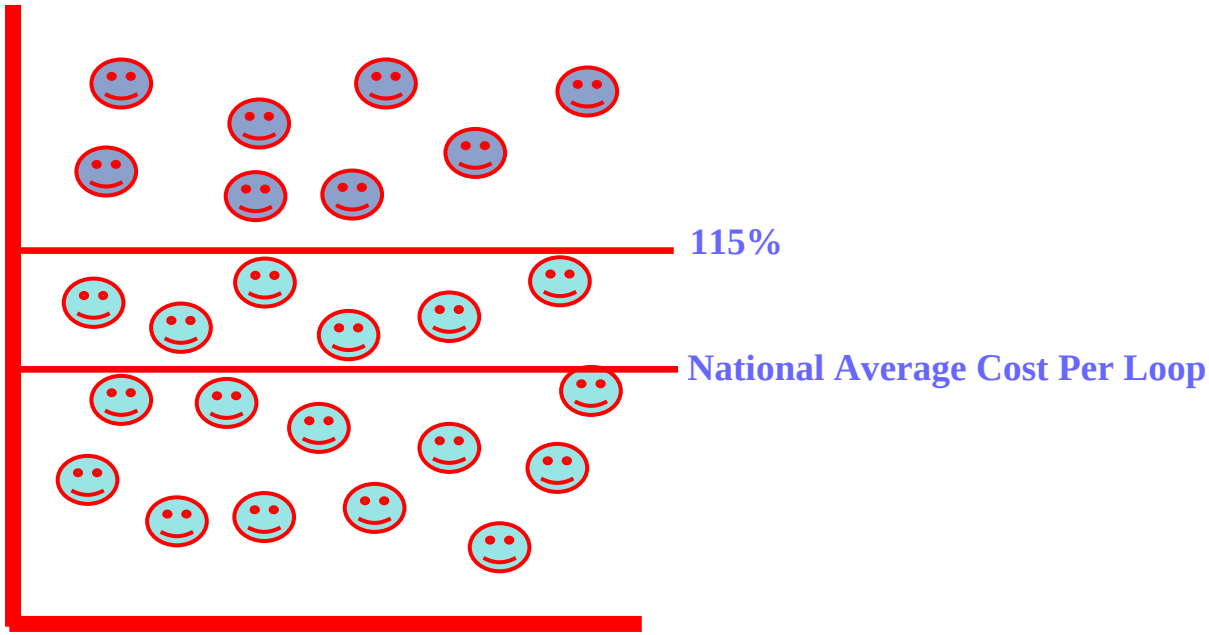
- Series of support funds were established to foster the concept of "**Universal Service**"
  - Established in Telecommunications Act of 1934
    - Affordable telecommunications to as many users as possible
  - Re-defined by Telecommunications Act of 1996

Federal Universal Service Funds - Overview of Programs

- High Cost:
  - High Cost Loop Support
  - Interstate Common Line Support
  - Local Switching support
  - High Cost Model
  - Interstate Access support
  - Safety Valve
  - Safety Net
- Low Income
  - Lifeline Assistance
  - Link-Up America
- Schools and Libraries
- Rural Health Care

Federal Universal Service Funds - High Cost

- **High Cost Loop Fund-Rural - Supports those ILECs with high loop costs**
  - **Exceeding 115% of national average**
  - **Portable to ETCs**



National Average Cost per Loop

- Prior rules based expense adjustment calculation on cost data of all incumbent Local Exchange Carriers
- Commission adopted Rural Task Force recommendation to freeze national average cost per Loop at $240.00
- Initial qualifying threshold is 115% of $240 or $276.00

High Cost Loop

- Based on FCC Rule changes, required by the Telecommunications Act of 1996, the FCC ordered NECA to establish a separate subsidiary, the Universal Service Administrative Company (USAC). In a December 1998 Order, the FCC named USAC as the permanent administrator for all Part 54 federal universal service programs.

- Pursuant to Part 36 of FCC rules, NECA collects data and files information with the FCC and USAC relating to the universal service high cost loop program.

High Cost Loop

- FCC rules require all incumbent local exchange carriers to submit loop count, P.32 investment and expense data to the NECA
  - Rural carriers are required to submit data annually and can update data quarterly on a voluntary basis (loop updates required if competition exists)
  - Non-rural carriers are required to submit data annually and wire center loop count data quarterly (RTF Order lifted requirement for submitting quarterly expense and investment data.)

Data Collection

- Defined in FCC part 36.611:
  - "unseparated, i.e., state and interstate, gross plant investment, reserves, deferred taxes, expenses, and taxes associated with exchange line cable and wire facilities subcategory 1.3 and exchange line central office circuit equipment category 4.13 and the loop count data..."
- Part 32 Accounting Data
- Subscriber plant categorization
- Loop Count

Payment Calculation

- Support is calculated differently depending on the number of loops within study areas served by rural carriers
- For study areas with 200,000 or fewer working loops, support is calculated as follows:
  - 65% of costs between 115% and 150% of the NACPL
  - 75% of costs in excess of 150% of the NACPL

Payment Calculation

- For study areas with more than 200,000 working loops, support is calculated as follows:
  - 10% of costs between 115% and 160% of the NACPL
  - 30% of costs between 160% and 200% of the NACPL
  - 60% of costs between 200% and 250% of the NACPL
  - 75% of costs in excess of 250% of the NACPL

USF High Cost Data Collection

- NECA employs extensive validation tools:
  - Data edits and analysis
  - Reconciliation to financial statements
  - Certification by Company Official
  - P. 32 Account level detail reporting to FCC and USAC
  - Applied findings from cost study review
- Company data is also subject to examination by
  - Internal and/or external auditors
  - State regulators
  - USAC and FCC

USF High Cost Data Collection

- NECA performs initial edits to detect anomalous data inputs
  - Data entered into NECA's USF system is required to pass a series of hard and soft edits to test data integrity
  - Dollar and percent change tests are performed on
    - Cost per Loop
    - Estimated Expense Adjustment
    - Impact on National Average Cost per Loop
  - Range failure occurs when both dollar and percent change thresholds are exceeded for any of the three categories
- Exchange Carriers whose data fails the range testing are required to provide business reasons for range variances that exceed established thresholds

USF High Cost Data Collection

- Reconciliation to financial statements
  - NECA procedures require that data submitted by each company be reconciled
    - Tier 1 LECs — ARMIS or Underlying financial reports
    - Non-Tier 1 LECs — Unseparated financial information supporting cost study
- Cost Study reviews
  - NECA reviews company cost studies as part of tariff responsibilities
  - Findings are used to update USF results where necessary

USF High Cost Data Collection

- FCC Part 32 Account detail reporting
  - NECA provides the FCC and USAC with Part 32 reported account information from the annual USF data submission
  - This data can be found on the FCC's website athttp://www.fcc.gov/wcb/iatd/neca.html
  - Any interested party can use this information to validate NECA's calculations or review data for individual companies over time.

USF High Cost Data Collection

- Certification by Company Official
  - FCC Rules require that a company officer or employee responsible for the overall submission sign the certification statement
  - Knowingly false submissions are subject to penalty under federal statute

USF High Cost Data Collection

- NECA Process Review
  - Management Review
  - Internal Audits
  - External Audits
  - USAC & FCC Audits

USF High Cost Data Collection

- NECA Internal Audit of Data Collection Activities
  - Independent processing of high cost data to ensure that mechanized system produces accurate results
  - Sampling of region review efforts to ensure that appropriate reviews have been conducted
  - Reconciliation of company financial data to that submitted by carriers on a sample basis

USF High Cost Data Collection

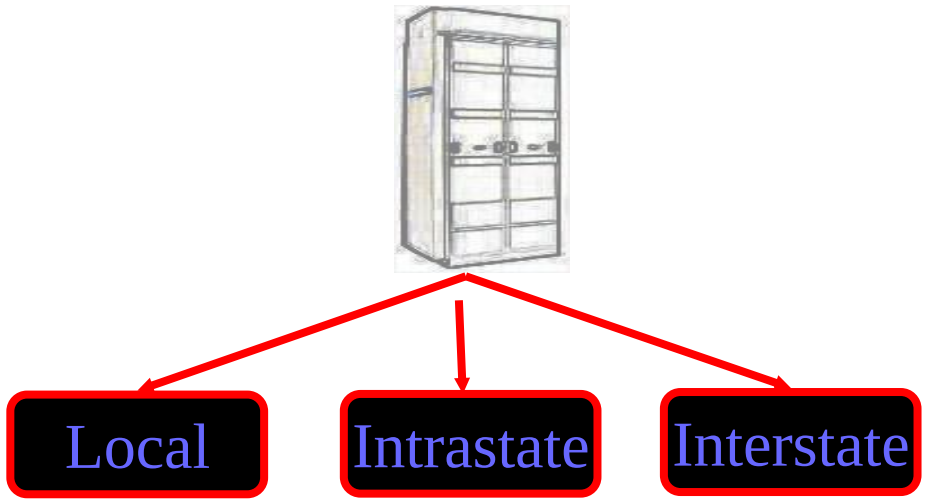
- NECA's External Auditor
  - NECA's external auditor independently performs the audit activities using its own sample of companies.
  - SAS 70 Type II Service Auditor's Report, includes
    - Description of controls
    - Detailed testing of the controls
    - Rendering of opinion on those controls
  - Service Auditor's Report shared annually with FCC

USF High Cost Data Collection

- USAC and FCC Audits
  - USAC external auditor independently performs an Agreed Upon Procedures audit of the high cost data collection
  - USAC and the FCC have performed audits and conducted surveys of the NECA data collection processes
  - USAC has performed audits on a sample of exchange carriers and the FCC has plans in place to perform audits on a large sample of exchange carriers and other high cost fund recipients.

Federal Universal Service Funds –High Cost

- **Local Switching Support (LSS)** - Fund established to support ILECs that serve 50,000 or fewer access lines in order to help offset local switching costs
  - Dial Equipment Minutes (DEM) Weighting
  - Formerly recovered in Local Switching Rate
  - Portable to ETCs



Federal Universal Service Funds - High Cost

- **Long Term Support (LTS) - Fund established to replace implicit cost support in the Carrier Common Line (CCL) rate**
  - **Initially established to keep rate parity when CCL pool participation became voluntary**
  - **Portable to ETCs**
  - **Combined into ICLS effective 7/1/04**

Federal Universal Service Funds - High Cost

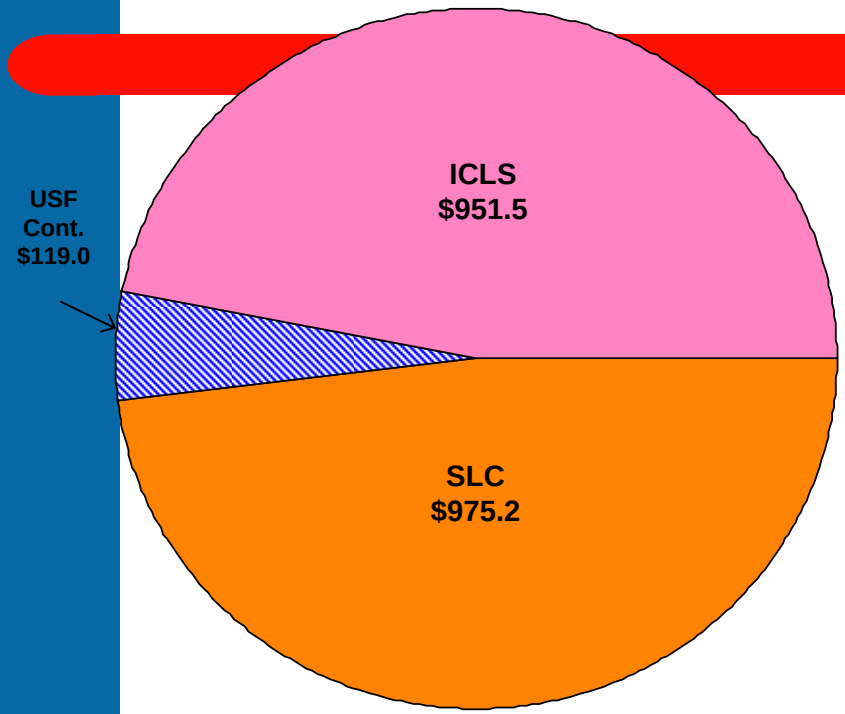
- **Interstate Common Line Support (ICLS) – Fund established to offset interstate access charges.**
  - **Only rate-of-return carriers are eligible to receive interstate common line support**
  - **Portable to ETCs.**

- **Interstate Access Support (IAS) – Fund established to offset interstate access charges.**
  - **Only price cap carriers are eligible to receive interstate access support**
  - **Portable to ETCs**

NECA POOLS

($ In Millions)

Common Line Revenues

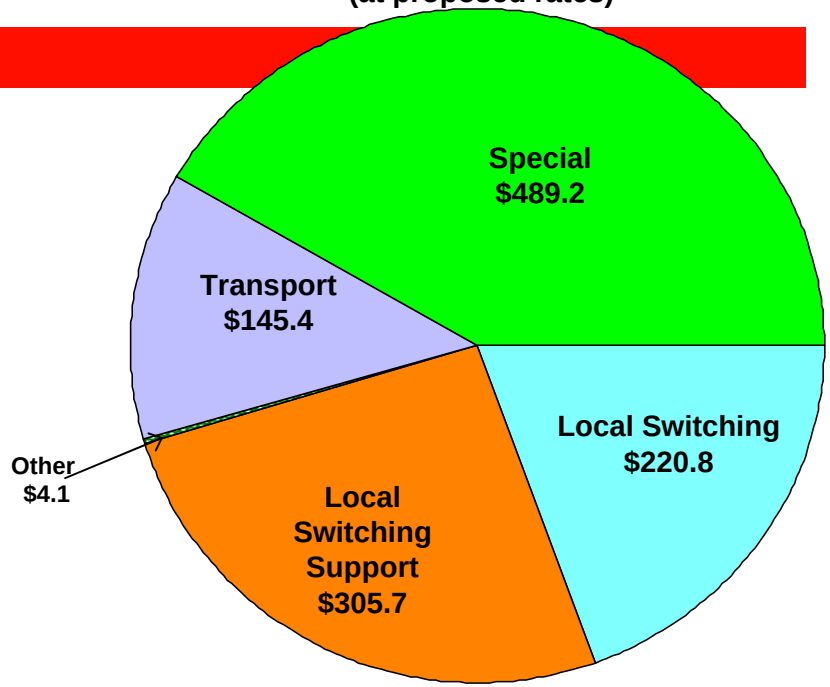


CL Access Lines = 11.7 Million

Study Areas	#	Rev Req
Cost	767	$1,663.0
AS	477	$382.7
Total	1,244	$2,045.7

Traffic Sensitive Revenues

(at proposed rates)

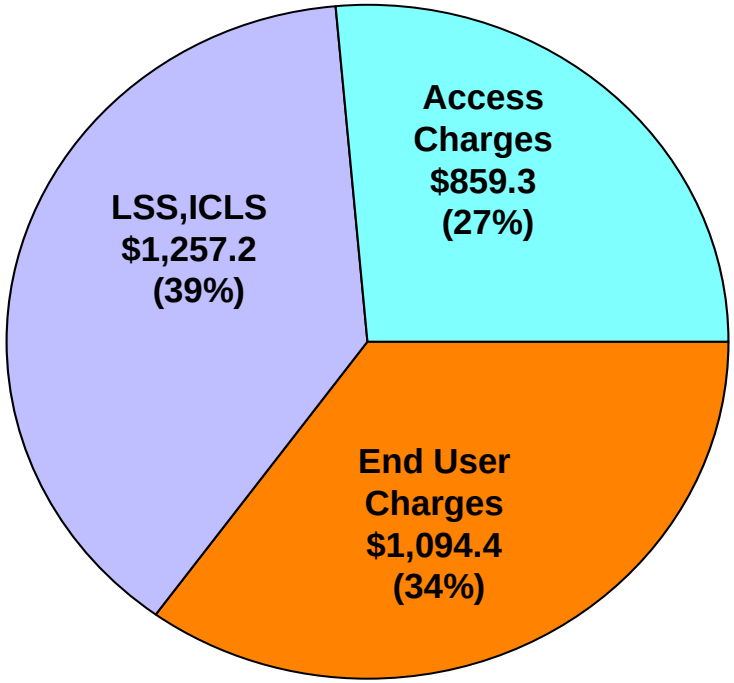


TS Access Lines = 6.8 Million

Study Areas	#	Rev Req
Cost	665	$796.1
AS	455	$369.1
Total	1,120	$1,165.2

NECA POOL REVENUE

($ In Millions)



TOTAL REVENUE REQUIREMENT
$3,210.9

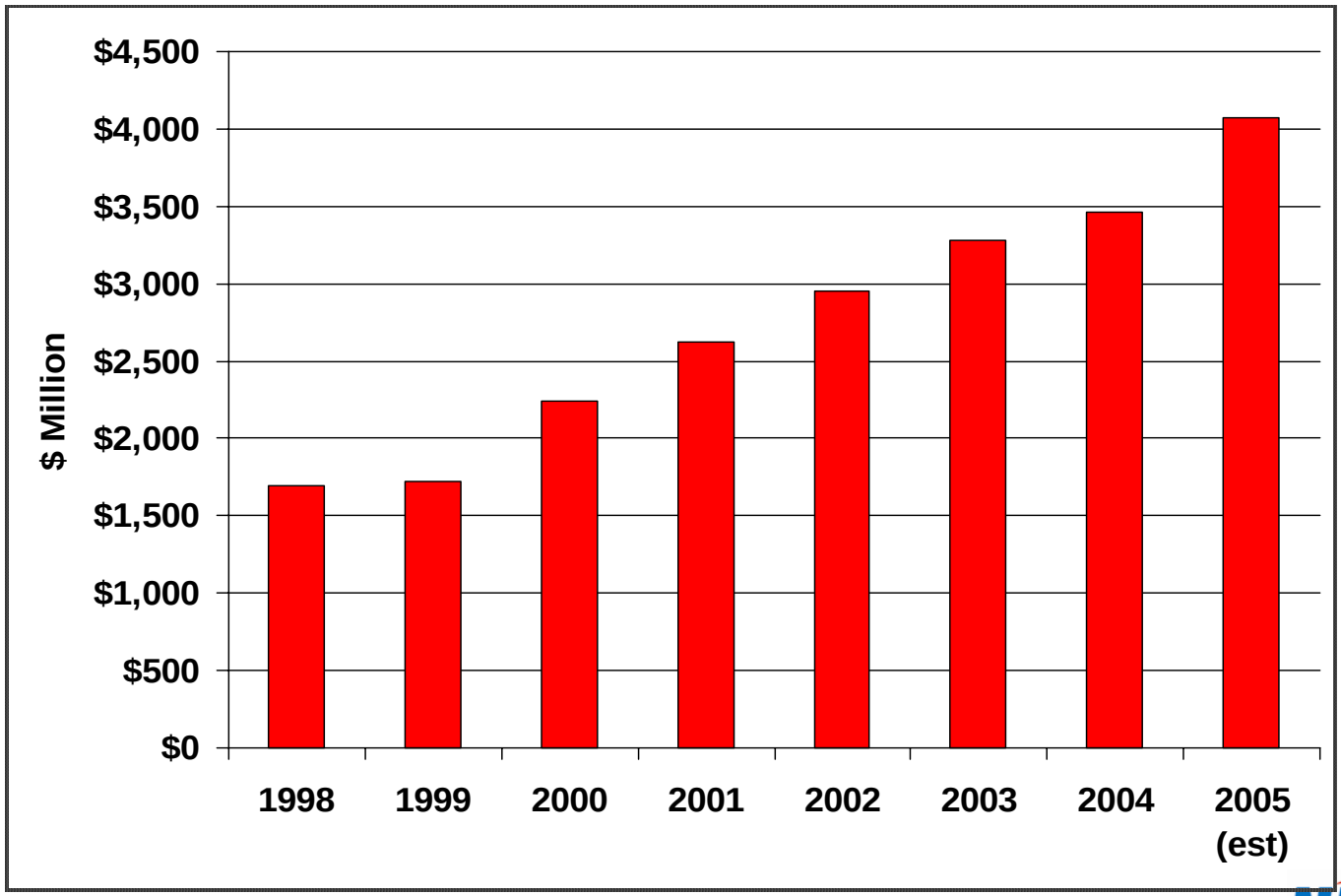
- End User Charges include SLC, ISDN Port, SAS revenues and USF Contribution
- Access Charges include revenues from Local Switching, Transport, Special Access, and Other

Universal Service Program Totals

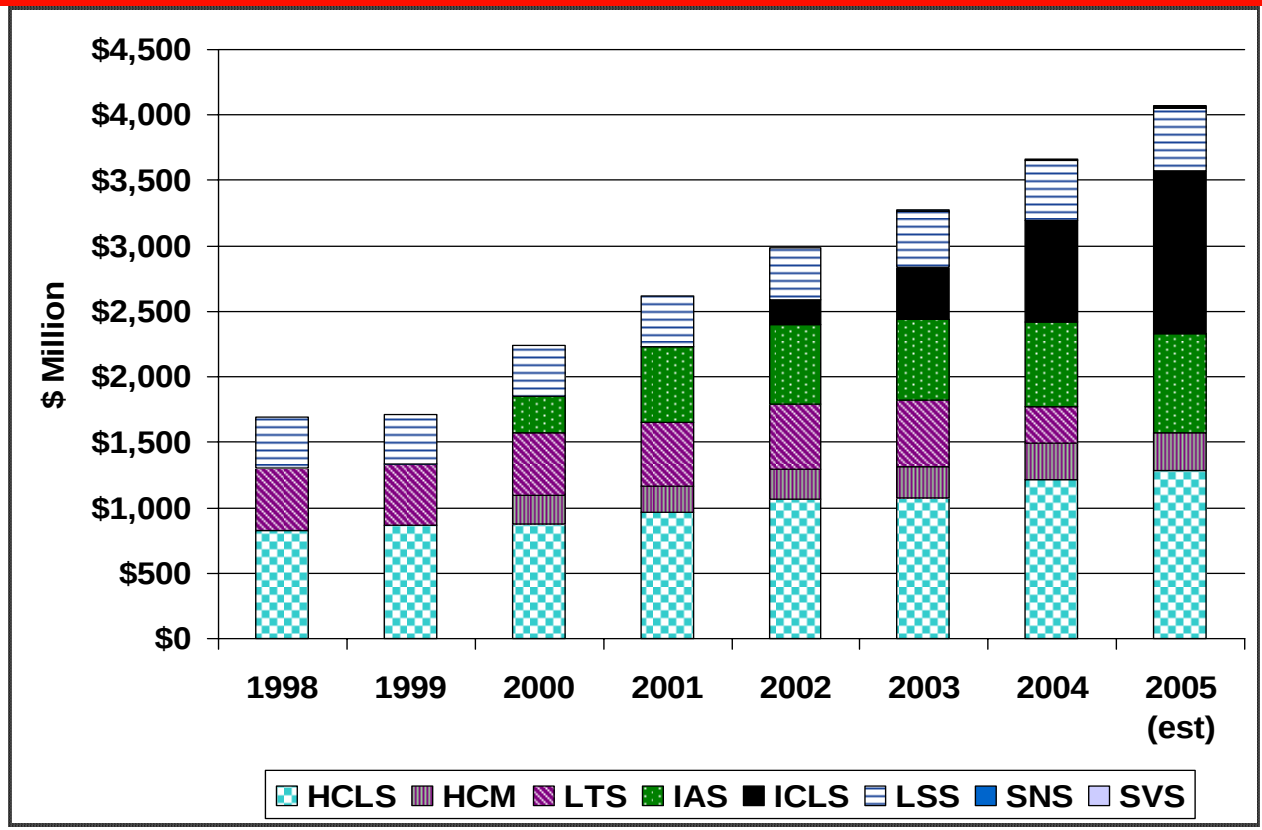
High Cost Fund	2005 Annual Payment*
High Cost Loop	$ 1,280.0M
Interstate Common Line Support	1,242.1M
Long Term Support	0.0M
Local Switching Support	475.4M
High Cost Model	290.3M
Interstate Access	762.5M
Safety Valve	3.3M
Safety Net	16.3M
Total High Cost Fund	$ 4,069.9M
Low Income Consumers Fund	$ 815.9M
Lifeline Assistance	
Link-Up America	
Schools and Libraries Fund	$ 2,250.0M
Rural Health Care Fund	$ 17.4M
Total Universal Service Fund	**$ 7,153.2M**

Source: USAC 3Q2005 Filing (annualized)

Total High Cost Funding



High Cost Funding
by Component ($Million)



HCLS = loop; HCM = Model (large co); LTS = long term; ICLS = interstate common line; LSS = local switching; SNS = safety net; SVS = safety valve

Note: Step function increases from program changes, shift from access revenue to universal service

Source: USAC

High Cost Loop Cap

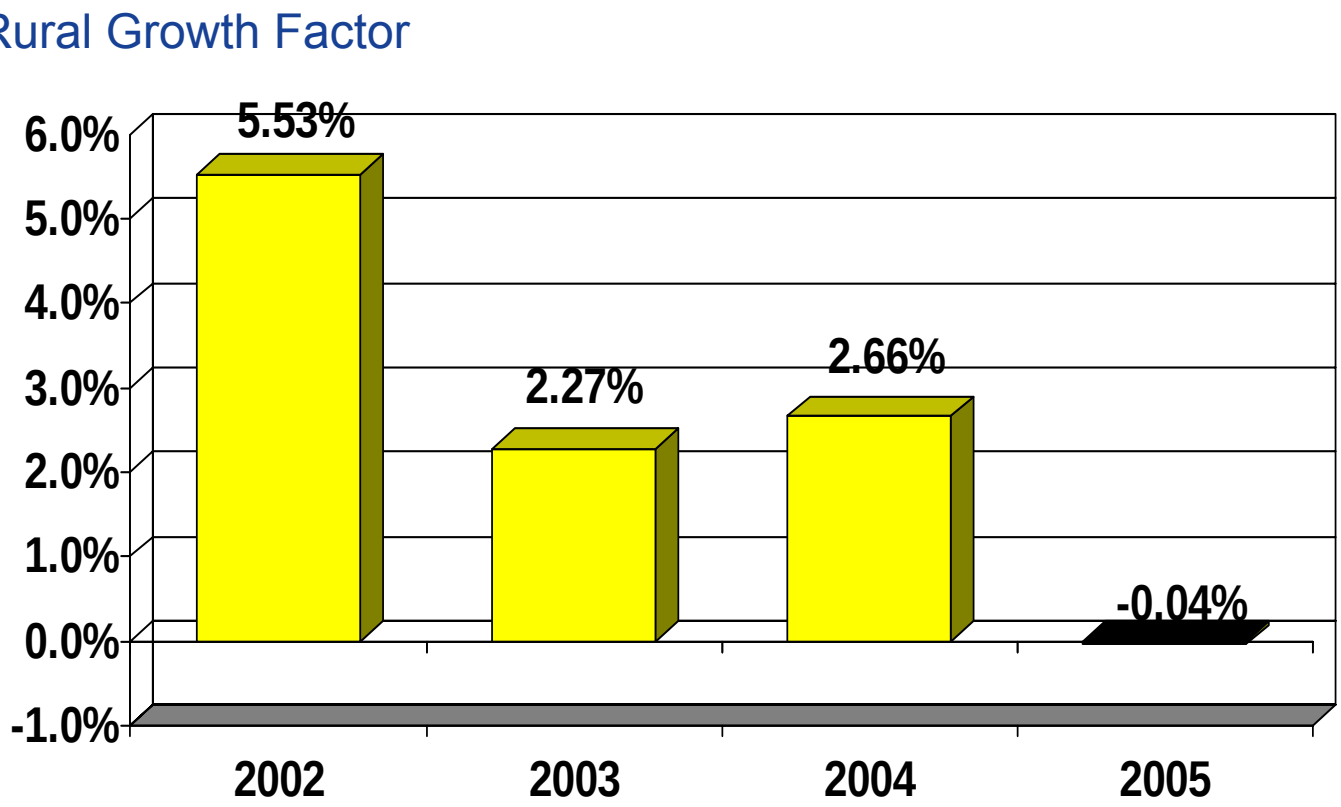
- Limit on Growth in Overall Fund Size
  - Fund growth based on “Rural Growth Factor”
  - RGF = annual % change in rural lines plus % change in gross domestic product chained price index (GDP-CPI)
  - RGF applied to prior year rural high cost loop funding to determine maximum fund size for following year

Rural Growth Factor (RGF)

		Percentage Change	
Year	RGF	Loop	GDP-CPI
2002	5.53	3.26	2.27
2003	2.27	-0.1	2.37
2004	2.66	1.53	1.13
2005	-0.04	-1.87	1.83

Source: NECA

Rural Growth Factor (RGF)



High Cost Loop Fund Cap

- High cost loop fund is capped.
- Capped v. uncapped difference is $512.9M
- High cost loop growth factor = rural line growth + inflation
- The factor did not envision negative line growth, which drives support further away from actual cost.

High Cost Loop (HCL)	Capped	Un-Capped
2005 Fund Size	$1,056.3 M	$1,569.2 M

Based on the 10/1/04 FCC filings for 2005 funding requirement

High Cost Support
ETCs - ILECs/CLECs

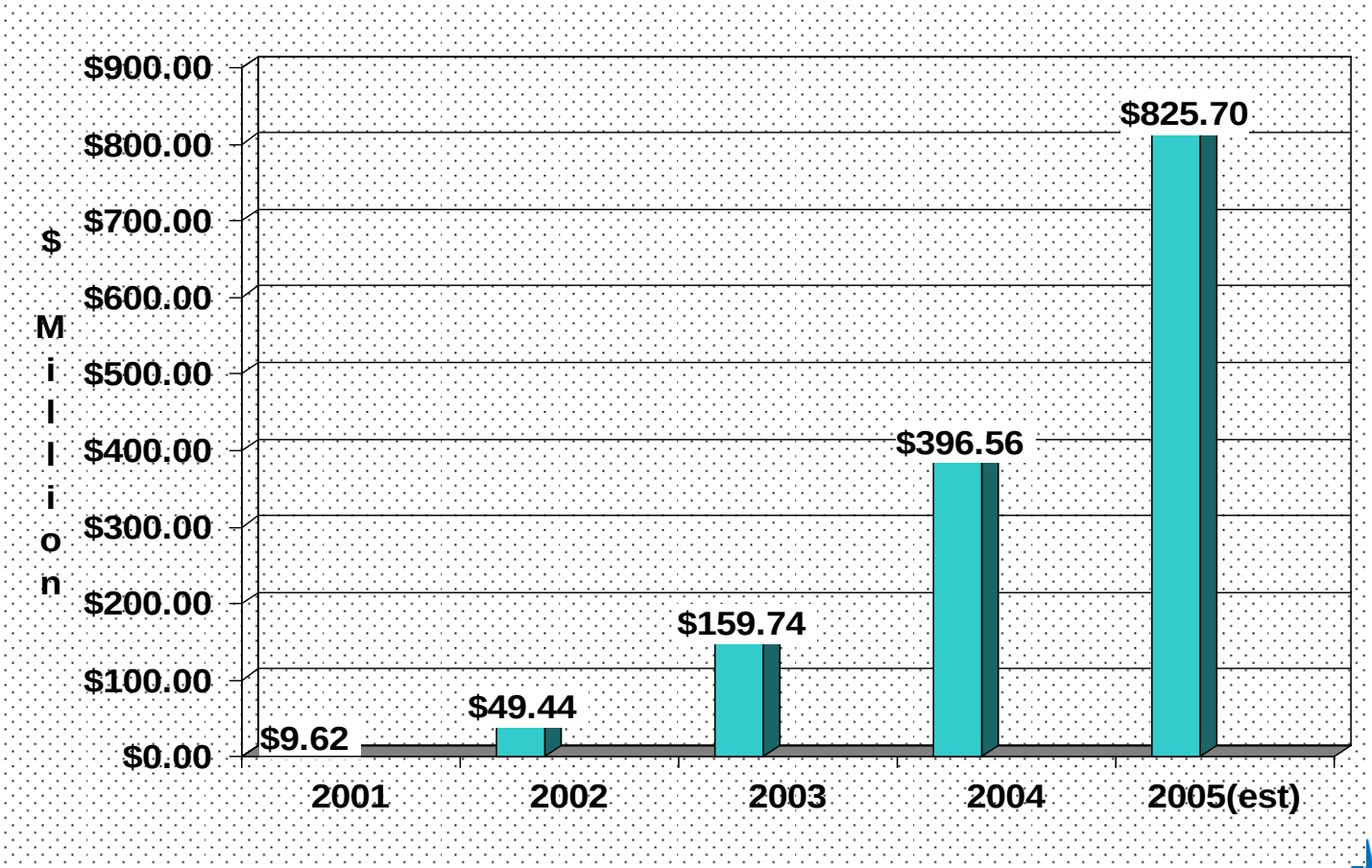
High Cost Fund	ILEC Annual	CLEC Annual*
High Cost Loop	$1,056.3M	$223.8M
Interstate Common Line	959.4M	282.7M
Long Term Support	0.0M	0.0M
Local Switching Support	390.1M	85.3M
High Cost Model	221.0M	69.3M
Interstate Access	602.5M	160.0M
Safety Valve	2.3M	1.0M
Safety Net	12.7M	3.6M
Total High Cost Fund	$3,244.2M	$825.7M

Source: USAC 3Q2005 Filing (annualized)
*wireless and wireline ETCs

Rural CETC

	3Q2002	3Q2005
Rural CETCs	26	161
Rural ILEC Study Areas with/CETCs	221	747
% of Total Rural High Cost Support	3.0%	17.8%

CETC Support



Where to Get More Information

- **www.neca.org**
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