NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.
OVERVIEW AND ANALYSIS OF 2005 USF DATA SUBMISSION

I. BACKGROUND

Section 36.613 of the Commission's rules requires NECA to file Universal Service Fund (USF) cost and expense adjustment information annually with the Commission and the Administrator on October 1st each year.[1] The information in this filing is compiled from data as of December 31, 2004 that are supplied to NECA by incumbent local exchange carriers (ILECs) on or before July 31, 2005 as specified in section 36.611 of the Commission's rules.[2] As in prior years, NECA is providing the detailed Part 32 data and loop counts submitted by companies pursuant to section 36.611 of the Commission's rules used in the cost per loop and expense adjustment calculations. The ILECs included with their data submission signed certifications attesting to the accuracy of their data.

This USF Data Submission includes estimated high cost expense adjustment amounts for average schedule companies. Support amounts for these companies for calendar year 2006 are consistent with the expense adjustment formulas proposed in NECA's 2006 Modification of Average Schedule Universal Service Formulas (filed August 30, 2005).

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[1] The Universal Service Administrative Company (USAC) has been designated the administrator of the Federal Universal Service Programs.

[2] NECA's role, as detailed in section 36 of the Commission's rules, is to collect the required data and develop an average cost per loop for each ILEC study area based on its historical data. The expense adjustment projections contained herein are based on the results of the annual submission data and are subject to change due to voluntary quarterly updates, reporting of errors and omissions, etc. Detailed data supplied by companies for these purposes are submitted to USAC on a quarterly basis. NECA would be willing to submit these data to the Commission as well, if so desired.

The 2005 USF Data Submission includes the following information:[3]

- Appendix A: Instructions and form used to collect the information for individual study area loop cost calculations;
- Appendix B: Formulas and algorithms used to determine the study area and national average loop costs, including the limitations on Corporate Operations expenses;
- Appendix C: Comparison of study area types during 2005 and 2006;
- Appendix D: Rural and non-rural study area loops, loop cost and projected 2006 expense adjustments by state;
- Appendix E: Rural and non-rural study area loops, loop cost and projected 2006 expense adjustments by study area code;
- Appendix F: Listing of rural incumbent carriers with acquired exchanges recognized during 2006;
- Appendix G: Analysis of Telephone Plant in Service investment per loop for potential Safety Net Additive qualifiers;
- Appendix H: Comparison of rural support projections calculated with and without the annual cap;
- Appendix I: Five-year trend of study area loops, loop cost and expense adjustment amounts.

II. RESULTS OF 2005 USF SUBMISSION

A. Indexed Cap Calculation

Pursuant to the Commission's rules, indexed fund caps are calculated separately for rural and non-rural carriers.

1. Non-Rural Carriers

For non-rural ILECs, the annual amount of the total nationwide loop cost expense adjustment is limited to the prior year's non-rural high cost loop support multiplied by the percentage increase in the total number of working loops during the calendar year preceding the July 31st filing. For 2006, the indexed cap is $68.7 million, a growth rate of -4.2443% from last

[3] NECA is required to provide the results for the industry as a whole and a reporting of the current and previous four years' results annually to the Commission and USAC. The information provided herein is included in both paper format and on compact disc. In addition, the disc contains line item detail for each ILEC study area for each of the last five years.

year. It should be noted that non-rural ILECs receive high cost loop support only to the extent that they qualify for hold-harmless support pursuant to section 54.311.

2. Rural Carriers

Under the rural indexed cap mechanism, current year support for rural ILECs is based on the prior year's rural high cost loop support grown by the Rural Growth Factor (RGF).[4] The RGF is calculated as the sum of annual change in the total number of rural ILEC working loops and the percentage change in the Gross Domestic Product-Chained Price Index (GDP-CPI).[5] For 2006, the RGF is -0.7466%, which represents a decrease in loops of -3.3729% and a percentage change in GDP-CPI of 2.6263%. NECA estimates the indexed cap for rural incumbent local exchange carriers to be $1,047.3 million for 2006, which is a reduction from the 2005 rural fund cap of $1,055.2 million. Attachment 1 displays the details of this calculation.

B. Corporate Operations Expense Limitation

Section 36.621 of the Commission's rules limits the amount of corporate operations expenses assigned to the loop cost calculation. The corporate operations expense limitation is based on a formula in which the dollar values in the formula are indexed by the GDP-CPI.[6] For calendar year 2006, the applicable GDP-CPI increase is 2.6263%. Corporate operations expense limitations developed in accordance with the prescribed formulas have been increased by this

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[4] 47 C.F.R. § 36.604.

[5] U.S. Department of Commerce, Bureau of Economic Analysis, Gross Domestic Product: Second Quarter 2005 (Preliminary), *News Release*, rel. August 31, 2005, at Table 6.

[6] Section 36.621 of the Commission's rules limits corporate operations expenses assigned to the loop cost calculation to the lesser of the actual corporate operations expenses per loop per month or a monthly per-loop amount computed according to the following schedule:

- Study areas with 6,000 or fewer working loops the amount monthly per working loop shall be [$33.30853 - (.00246 x the number of working loops)] x GDP-CPI or ($50,000 ÷ the number of working loops) x GDP-CPI, whichever is greater;
- Study areas with more than 6,000 but fewer than 18,006 working loops, the monthly amount per working loop shall be [$3.83195 + (88,429.20 ÷ the number of working loops)] x GDP-CPI; and
- Study areas with 18,006 or more working loops, the monthly amount per working loop shall be $8.74472 x GDP-CPI.

amount over the calendar year 2005 levels to establish the maximum allowable assignment for calendar year 2006.[7] The algorithm used to implement the corporate operations expense limitation is displayed in Appendix B. If the limitation on Corporate Operations Expenses had not been instituted, the NACPL for 2006 for rural carriers would have been $326.25, an increase of $19.89 over the $306.36 calculated from the current view of 2003 data used for 2005 support payments.

C. National Average Cost Per Loop Calculation

For rural ILECs, a fixed NACPL of $240.00 is to be used in calculating the expense adjustment levels for rural carriers subject to the availability of funds under the indexed capping mechanism discussed previously.[8] Total rural ILEC expense adjustment amounts are the lesser of the actual payment calculated at the $240 frozen NACPL or the capped amount for the applicable period. Based on the $240 frozen NACPL, rural ILEC expense adjustment calculations for 2006 total $1,682 million. As a result, rural ILEC expense adjustment payments are limited as a result of the indexed cap.[9]

The NACPL calculated from calendar year 2004 data reported by rural carriers is $318.74, which is $13.14 more than the NACPL of $305.60 calculated from the current view of 2003 data used for 2005 support payments. For non-rural carriers, the corresponding 2004 NACPL is $301.10.

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[7] The GDP-CPI factor used in the corporate operations expense limitation schedule for calendar year 2006 is 1.106517. This factor captures the composite growth over a five-year time span.

[8] For purposes of the historical trend report and for use in calculating non-rural carrier “hold harmless” support projections in this data submission, NECA calculated the NACPL pursuant to section 36.622 of the Commission’s rules as it existed prior to July 1, 2001.

[9] Actual 2006 expense adjustment amounts paid to individual study areas may change subject to optional quarterly updates permitted by the Commission’s rules and to correct errors and omissions in the data should they occur.

D. Sale of Exchanges

Section 54.305 of the Commission's rules governs the high cost loop support for situations where a rural carrier purchases an exchange from a non-rural carrier.[10] A rural carrier that incorporates acquired exchanges into an existing study area excludes the costs associated with the acquired exchanges from the costs associated with the pre-acquisition study areas. Acquiring rural carriers must separately provide the information listed in section 36.611 of the Commission's rules for acquired and existing exchanges as if these two categories of exchanges constitute separate study areas.[11] Appendix F provides information on study areas that have acquired exchanges.

E. Safety Net Additive Support

Section 36.605 of the Commission's rules provides for a Safety Net Additive to provide additional support to those rural carriers that have made significant investment in years in which the fund is capped.[12] The Commission determined that a 14 percent increase in a carrier's Telephone Plant in Service (TPIS) investment on a per-line basis, provides a reasonable method for assessing whether the carrier has made significant investment to qualify its study area for safety net additive support. Appendix G contains a display of the rural cost companies whose annual data submission indicates that the year-over-year growth in TPIS per line has exceeded the 14 percent threshold.

III. KEY STATISTICS FOR 2005 AND 2006 USF DATA

The following table displays the percentage changes between data underlying the 2005 and 2006 high cost loop expense adjustments. These data include the impact of both the limitation on

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[10] *See* 47 C.F.R. § 54.305. Specifically, the rules state that the acquiring carrier receives support based on the Commission's new universal service support mechanism for the acquired exchange at the same per-line support as calculated at the time of the transfer, regardless of the rural carrier's cost characteristics or the support the rural carrier purchasing the exchange may receive for any other exchanges.

[11] The information provided for the acquired exchanges will, upon notice to the Administrator, be used as the index year for determination of potential Safety Valve support for those exchanges. *See* 47 C.F.R. § 54.305.

[12] 47 C.F.R. § 36.605.

Corporate Operations Expenses and the indexed cap on Expense Adjustment growth for the Fund.

Data for the total industry and for rural carriers are displayed in separate tables.

Total Industry Statistics

Category	Filed For 2005	Latest View of 2005	Filed For 2006	% Change (LV 2005 vs. Filed 2006)
Unseparated Revenue Requirement	$46,883.9 M	$46,985.3 M	$45,755.7 M	-2.62%
USF Loops	173.1 M	173.1 M	166.0 M	-4.10%
Cost per Loop[13]	$270.79	$271.37	$275.67	1.58%

Rural Carrier Statistics

Category	Filed For 2005	Latest View of 2005	Filed For 2006	% Change (LV 2005 vs. Filed 2006)
Unseparated Revenue Requirement	$8,011.3 M	$8,016.7 M	$8,107.6 M	1.13%
USF Loops	20.4 M	20.4 M	19.7 M	-3.43%
Cost per Loop[13]	$378.00	$378.27	$395.80	4.63%
Capped NACPL	$298.45	$305.60	$318.74	4.30%

[13] Cost per loop is based on actual unseparated revenue requirement, except where limited by the Corporate Operations Expense limitation, divided by total loops.