

DO NOT FILE COPY

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

FCC 93-25

In the Matter of: )  
)  
Safeguards to Improve the )  
Administration of the Interstate )  
Access Tariff and Revenue )  
Distribution Processes )

CC Docket No. 93-6 ✓  
RM 7736

NOTICE OF PROPOSED RULEMAKING

Adopted: January 14, 1993;

Released: February 11, 1993

Comment Date: April 14, 1993

Reply Comment Date: May 14, 1993

By the Commission:

Table of Contents

	<u>para.</u>
I. INTRODUCTION . . . . .	1
II. BACKGROUND . . . . .	2
III. NECA'S BOARD . . . . .	5
A. Inclusion of Outside Directors on NECA's Board . . . . .	5
B. Eligibility Criteria for Outside Directors . . . . .	12
C. Selection of Outside Directors . . . . .	15
D. Term of Office . . . . .	18
E. Voting Privileges on Committees . . . . .	21
F. Prohibition of "Ad Hoc" Committees . . . . .	23
IV. NECA RESPONSIBILITIES UNDER COMMISSION RULES . . . . .	25
A. NECA's Overall Responsibilities . . . . .	25
B. Resolving Controversial Issues . . . . .	27
C. On-line Access to NECA Data Bases . . . . .	31
V. STRENGTHENING NECA'S INTERNAL PROCEDURES . . . . .	33
A. Overview . . . . .	33
B. Monitoring Commission Developments . . . . .	35
C. Incentive Compensation . . . . .	38
D. Cost Study Review Process . . . . .	42
E. Independent Audits for Non-pooling LECs . . . . .	45
VI. CONCLUSION . . . . .	47

VII. PROCEDURAL MATTERS . . . . .	49
A. Ex Parte . . . . .	49
B. Regulatory Flexibility . . . . .	50
C. Comment Dates . . . . .	51
VIII. ORDERING CLAUSES . . . . .	52

**I. INTRODUCTION**

1. This Notice of Proposed Rulemaking proposes measures to improve the interstate access tariff and revenue distribution processes administered by the National Exchange Carrier Association, Inc. (NECA). To help assure that NECA considers independent views in administering those processes and that those processes comply with our rules, we propose to amend Section 69.602 of our rules<sup>1</sup> to include directors from outside the local exchange carrier (LEC) industry on NECA's Board of Directors. We also invite comment on additional steps that we believe would increase NECA and LEC accountability to this Commission, and strengthen NECA's internal operations.

**II. BACKGROUND**

2. This rulemaking arises from an audit that the Common Carrier Bureau (Bureau) conducted during 1989 and 1990. That audit disclosed that several NECA directors appeared to have participated in an attempt to improperly manage the earnings of NECA's common line (CL) pool for 1988. The audit also disclosed that these directors' actions may have induced certain large LECs to report data to NECA that were inconsistent with our accounting, separations, and access charge rules. We initiated enforcement actions to redress the LECs' apparent rule violations.<sup>2</sup> These actions have been terminated by Consent Decrees without any finding of wrongdoing or liability.<sup>3</sup>

3. We also expressed concern with the directors' apparent conduct. In a

---

<sup>1</sup> 47 C.F.R. §69.602.

<sup>2</sup> Southwestern Bell Telephone Company, Notice of Apparent Liability for Forfeiture and Order to Show Cause, 5 FCC Rcd 7179 (1990); Pacific Bell, Notice of Apparent Liability for Forfeiture and Order to Show Cause, 5 FCC Rcd 7176 (1990); New York Telephone Co., Notice of Apparent Liability for Forfeiture and Order to Show Cause, 5 FCC Rcd 7173 (1990); New England Telephone and Telegraph Co., Notice of Apparent Liability for Forfeiture and Order to Show Cause, 5 FCC Rcd 7170 (1990).

<sup>3</sup> Southwestern Bell Telephone Company, Consent Decree Order, 7 FCC Rcd 7692 (1992); New England Telephone and Telegraph Co. and New York Telephone Co., Consent Decree Order, 7 FCC Rcd 822 (1992); Pacific Bell, Consent Decree Order, 6 FCC Rcd 7467 (1991).

November 9, 1990 letter to NECA,<sup>4</sup> we indicated that several NECA directors may not have discharged their responsibilities under Commission rules and that the NECA Board as a whole may not have displayed sufficient vigilance in regard to these directors' actions. We stated that we intended to consider expanding the NECA Board to include two or more members from outside the LEC industry.<sup>5</sup>

4. Our November 9 letter required NECA to retain an independent auditor to recommend safeguards to prevent manipulation of NECA's processes.<sup>6</sup> NECA filed the independent auditor's report on this audit on December 9, 1991.<sup>7</sup> The Safeguards Report observes NECA's strong commitment to its integrity and notes that NECA has improved its administrative processes considerably in response to our November 9 letter. The report concludes, however, that additional measures would help improve the interstate access tariff and revenue distribution processes. The independent auditor's recommendations for improving those processes focus on the composition and operation of NECA's Board, on the relationship between NECA and this Commission, and on methods for strengthening NECA's internal operations. We address those recommendations that we believe may warrant Commission action as part of our discussion of safeguards to improve NECA's processes.

### III. NECA'S BOARD

#### A. Inclusion of Outside Directors on NECA's Board

##### 1. Background

5. Prior to the completion of the Safeguards Report, NECA filed a petition for rulemaking to amend Section 69.602 of our rules to add two directors from outside the telephone industry to NECA's Board.<sup>8</sup> The rule

---

<sup>4</sup> Letter from Donna R. Searcy, Secretary, FCC, to Lawrence C. Ware, Chairman of the Board of Directors, NECA, 5 FCC Rcd 7183 (1990) (November 9 Letter).

<sup>5</sup> Id. at 7183.

<sup>6</sup> Id. Our letter also required NECA to retain an independent auditor to review adjustments that the Bell Operating Companies (BOCs) had reported to NECA during 1988 and 1989. Id. We will address the independent auditor's report on those adjustments in the near future.

<sup>7</sup> Ernst & Young, Review and Recommended Pool Safeguards, AAD 91-24 (filed Dec. 9, 1991)(Safeguards Report).

<sup>8</sup> On January 28, 1991, the National Association of Regulatory Utility Commissioners (NARUC) filed a petition for rulemaking urging that we initiate a rulemaking to determine how best to administer the national interstate pools. On November 18, 1992, however, NARUC adopted a resolution formally withdrawing that petition and urging that we grant NECA's petition for rulemaking. Resolution on NECA Administration and Expansion of Board of Directors, Bulletin

provides that NECA's Board shall consist of fifteen directors, of whom three are to be selected by and represent the Bell Operating Companies (BOCs), three are to be selected by and represent other telephone companies having annual operating revenues in excess of \$40 million, and nine are to be selected by and represent telephone companies having annual operating revenues of less than \$40 million.<sup>9</sup> These directors are referred to as subset I, subset II, and subset III directors. They are elected for one-year terms that begin on the January 1 following their election.

6. At the time NECA filed its petition for rulemaking, it also filed a petition for waiver that proposed to include outside directors on its Board pending our action on the petition for rulemaking. The Bureau granted this petition for waiver in part and permitted NECA's members to elect two outside directors for the January 1 through December 31, 1992 term.<sup>10</sup> In granting that waiver, the Bureau stated that once we received the Safeguards Report, we would take whatever action we deemed appropriate to ensure that NECA settlements reflect actual financial results as calculated in accordance with our rules.<sup>11</sup> The Bureau subsequently permitted NECA's members to elect two outside directors for the January 1 through December 31, 1993 term.<sup>12</sup>

## 2. Arguments

7. In its petition for rulemaking, NECA requests that we amend Section 69.602 to permit two directors from outside the telephone industry to serve on NECA's Board. NECA argues that these directors will benefit its membership, and increase public confidence in its processes and overall management.<sup>13</sup> In addition, NECA asserts that the outside directors' skills and experience would be a valuable asset that would complement NECA's commitment to the highest standards of conduct.<sup>14</sup>

8. The commenters generally support NECA's proposal to add two outside

---

No. 48-1992 (NARUC Nov. 30, 1992). In view of this resolution and our proposals in this Notice of Proposed Rulemaking, we dismiss NARUC's petition for rulemaking as moot.

<sup>9</sup> Id.

<sup>10</sup> Expansion of the NECA Board to Include Two Directors from Outside the Telephone Industry, 6 FCC Rcd 5403 (1991) (1991 Waiver Order).

<sup>11</sup> Id. at 5403.

<sup>12</sup> Expansion of NECA Board to Include Two Directors from Outside the Telephone Industry, 7 FCC Rcd 4401 (1992) (1992 Waiver Order).

<sup>13</sup> NECA Petition at 2, 6.

<sup>14</sup> Id. at 5.

directors to its Board.<sup>15</sup> Iowa, NARUC, and NTCA agree that outside directors would promote public confidence in NECA's processes.<sup>16</sup> NARUC states that outside directors would add an independent view to and have a moderating effect on NECA's deliberations.<sup>17</sup> Iowa asserts that because NECA's decisions have a broad impact on telephone customers as well as telephone companies, non-telephone company representatives should be included on NECA's Board.<sup>18</sup> USTA emphasizes that it has consistently supported NECA-initiated Board changes since NECA's inception.<sup>19</sup>

### 3. Discussion

9. Our rules require NECA to administer several important programs, including the CL pool, the traffic sensitive (TS) pool, the universal service fund (USF), and the lifeline assistance program. We believe that continuing outside directors' participation on NECA's Board would help assure that NECA considers independent views in administering those programs and that those programs comply with our rules. Therefore, we tentatively conclude that we should amend Section 69.602 of our rules to include at least two outside directors on that Board on a permanent basis. We invite comment on this tentative conclusion.

10. When we stated in our November 9 letter that we intended to consider adding outside directors to NECA's Board, we were addressing concerns about the ability of a Board composed exclusively of LEC representatives to assure that NECA discharged its obligations under Commission rules. We invite the commenters to address whether outside directors adequately address this concern.

11. We also invite comment on how many outside directors should be included on NECA's Board and on whether we should change the overall composition of that Board. That Board presently consists of seventeen directors, of whom two are outside directors serving pursuant to Bureau waiver. Of the other directors, three represent subset I companies, three represent subset II companies, and nine represent subset III companies. That configuration was intended to ensure the NECA Board's responsiveness to the concerns of each subset of NECA members after the CL pool became voluntary on

---

<sup>15</sup> Beehive Telephone Company (Beehive), the Iowa Utilities Board (Iowa), NARUC, the National Telephone Cooperative Association (NTCA), and the United States Telephone Association (USTA) filed comments on NECA's petition. NECA and Southwestern Bell Telephone Company (Southwestern) filed replies to those comments.

<sup>16</sup> Iowa Comments at 1; NARUC Comments at 1, 5; NTCA Comments at 2.

<sup>17</sup> NARUC Comments at 5.

<sup>18</sup> Iowa Comments at 2.

<sup>19</sup> USTA Comments at 1.

April 1, 1989.<sup>20</sup> We believe that the Board's principal concern must be compliance with our rules and that the present configuration may not be optimal to address this concern. Therefore, we request the commenters to discuss whether alternative configurations, such as a Board composed of three outside directors, two subset I directors, two subset II directors, and six subset III directors, would improve NECA's administrative processes.

## B. Eligibility Criteria for Outside Directors

### 1. Arguments

12. Our rules do not provide eligibility criteria for NECA directors. The directors elected pursuant to Section 69.602 have been employees of NECA member companies. In its petition, NECA proposes that current or former officers or employees of NECA or any of its members, and anyone related to such persons, be ineligible for outside directorships. NECA also proposes that outside directors not have business relationships or other interests that could interfere with their judgment.<sup>21</sup> These eligibility criteria would exclude current federal and state regulators as well as former officers and employees of NECA and its member LECs. According to NECA, the proposed criteria would ensure the outside directors' independence and objectivity.<sup>22</sup>

13. Although the parties generally support the eligibility criteria proposed by NECA, Iowa states that current federal and state regulators should be eligible for outside directorships.<sup>23</sup> NTCA maintains that former officers, employees, and the relatives of former officers and employees of NECA members should also be eligible. According to NTCA, making these persons ineligible would exclude a range of qualified persons who may have no existing ties to member companies, but possess valuable knowledge and skills and the ability to perform the fiduciary duties required of directors.<sup>24</sup> NTCA and Southwestern stress that we should not interpret NECA's request as an opportunity to place NECA adversaries on the Board, because the addition of antagonistic directors would impair the NECA's operational efficiency and disserve consumers.<sup>25</sup> USTA believes that the proposed rule change would avoid the conflict of interest that could result if NECA's Board included members whose interests directly or indirectly conflicted with those that NECA exists to serve.<sup>26</sup> NTCA and USTA

---

<sup>20</sup> MTS and WATS Market Structure, NECA Board of Directors, Report and Order, CC Docket No. 78-72, Phase I, 4 FCC Rcd 4449, 4449-50 (1989).

<sup>21</sup> Petition at 4; see also USTA Comments at 2.

<sup>22</sup> Id. at 6; NECA Reply at 4-5.

<sup>23</sup> Iowa Comments at 2.

<sup>24</sup> NTCA Comments at 5.

<sup>25</sup> NTCA Comments at 4; Southwestern Comments on NECA Petition at 3.

<sup>26</sup> USTA Comments at 3-4; NECA Reply at 5-6.

point out that in establishing NECA, the Commission initially determined that it would be unwise to include federal or state commission, interexchange carrier, or consumer representatives on NECA's Board.<sup>27</sup>

## 2. Discussion

14. The eligibility criteria NECA proposes would permit the selection of candidates for outside director from the business, professional, financial, and academic communities, including former governmental officials. We believe that these groups provide a sufficient pool of outside director candidates, even applying the eligibility criteria NECA proposes. In contrast, current federal and state regulators might find it impossible to act as directors without compromising confidential information obtained in course of their official employment or encountering substantial conflicts of interest. In addition, we believe that the public may perceive former LEC officers and employees of NECA and its members as too partial to LEC interests to function as independent outside directors. Therefore, we propose to adopt the criteria NECA proposes. We invite comment on this proposal.

### **C. Selection of Outside Directors**

#### 1. Arguments

15. NECA proposes that its Board's Election Committee screen outside director candidates after soliciting nominees from the business, professional, financial, and academic communities. Nominees deemed qualified by the Board would be listed on the ballot for NECA's annual election. NECA's members would select the outside directors from among the listed candidates.<sup>28</sup> NECA does not propose any requirement for a specific number of candidates to be listed for each outside director position.

16. NTCA supports the procedures NECA suggests for nominating and selecting outside directors because they comport with existing procedures for selecting NECA directors. NTCA believes that both the industry and the Board would benefit from treating the election of outside directors in the same manner as the election of other NECA directors.<sup>29</sup> Beehive suggests that we require NECA to make public "[t]he companies voting and the number of ballots cast for proposed director per company" in order to obtain valuable insight into the attitudes of NECA members.<sup>30</sup>

---

<sup>27</sup> NTCA Comments at 3; USTA Comments at 3; see also MTS and WATS Market Structure, Third Report and Order, 93 FCC 2d 241, 335 (1983).

<sup>28</sup> NECA Petition at 4-5.

<sup>29</sup> NTCA Comments at 5-6.

<sup>30</sup> Beehive Comments at 1.

## 2. Discussion

17. Although the procedures NECA proposes appear reasonable, we are concerned that NECA members have an opportunity to choose among a range of qualified candidates for outside directorships. Therefore, we invite comment on whether we should require that the Board nominate multiple candidates for each outside director position.<sup>31</sup> We decline to seek comment on Beehive's suggestion that NECA publicly disclose voting information regarding individual NECA members. That suggestion is similar to one Beehive made in a prior petition for rulemaking.<sup>32</sup> As the Commission stated in rejecting that prior suggestion, we see no useful purpose that would be served by the required disclosure of information regarding the votes of individual LECs.<sup>33</sup>

### D. Term of Office

#### 1. Arguments

18. Beehive complains that all NECA directors are "inbred from lack of turn-over" and that the Board "by and large, is the same today as it was when first constituted." Beehive suggests that the Commission mandate staggered terms for all directors with no one director serving more than two terms.<sup>34</sup> NECA states that in 1987 the Commission declined to require staggered terms despite a similar request from Beehive.<sup>35</sup> Also, NECA states that its Board has changed considerably since its inception in 1983. According to NECA, its Board members average three years of service, and only three members of the 1983 Board remained NECA directors as of July 1991.<sup>36</sup>

#### 2. Discussion

19. We believe that two-year terms might increase the outside directors' effectiveness. Many NECA initiatives last more than one year. Two-year terms might enhance the ability of the outside directors to ensure that these initiatives are carried to completion in accordance with Commission rules. Therefore, we invite comment on whether we should set two-year terms for outside directors. In addition, since two-year terms also might increase the effectiveness of the NECA directors that represent individual subsets, we invite comment on whether we should adopt such terms for the entire NECA Board.

---

<sup>31</sup> See 1991 Waiver Order, 6 FCC Rcd at 5403 (waiver conditioned upon the nomination of five or more candidates for two outside directors positions).

<sup>32</sup> Rules Pertaining to the National Exchange Carrier Association, 2 FCC Rcd 1 (1987) (Beehive Order).

<sup>33</sup> Id. at 2.

<sup>34</sup> Beehive Comments at 1.

<sup>35</sup> NECA Reply at 3, n.4, citing Beehive Order, 2 FCC Rcd at 2.

<sup>36</sup> NECA Reply at 3.

20. We also invite comment on whether we should adopt staggered terms for any director positions for which we set two-year terms. With staggered terms, at least one experienced director normally would be available to serve a second year. For instance, if we were to adopt a rule providing for two outside directors, we could specify that NECA's members elect one outside director to a one-year term and a second outside director to a two-year term in the first annual election following the rule's adoption. For every subsequent election, NECA's members would elect one outside director to a two-year term, while the incumbent director would continue in office for another year.

## **E. Voting Privileges on Committees**

### 1. Background

21. Our rules restrict membership on NECA's CL and TS committees to directors from companies that participate in the CL and TS pools.<sup>37</sup> In the Safeguards Report, the independent auditor recommended that these committees be expanded to include outside directors as well as directors from non-pooling LECs.<sup>38</sup> In response to this recommendation, NECA filed a petition for waiver to permit such expansion. The Bureau granted this waiver request to the extent that outside directors were granted voting membership on all NECA Board committees, not just the CL and TS committees, during the 1992 term.<sup>39</sup> The Bureau deferred to this proceeding consideration of NECA's proposal to allow directors from non-pooling LECs to vote on the CL and TS committees.<sup>40</sup> The Bureau subsequently granted the outside directors voting membership on all NECA committees during the 1993 term.<sup>41</sup>

### 2. Discussion

22. As the independent auditor observes, much of the NECA Board's work is done in its committees.<sup>42</sup> We believe that having outside directors serve as voting members of these committees would increase the committees' accountability and help the Board as a whole monitor the committees' actions. We also believe that directors from non-pooling LECs would broaden the perspectives of NECA's voluntary pooling committees. Therefore, we propose to require that each NECA Board committee include as a voting member at least one outside director and that both the CL and TS committees include as voting

---

<sup>37</sup> See 47 C.F.R. §69.602(e).

<sup>38</sup> See Safeguards Report, supra at 28-29.

<sup>39</sup> See Expansion of Voting Membership on Voluntary Access Tariff Committees, 7 FCC Rcd 2050 (1991) (Voting Membership Order).

<sup>40</sup> Id. at 2050-51.

<sup>41</sup> See 1992 Waiver Order, 7 FCC Rcd at 4402.

<sup>42</sup> See Safeguards Report, supra at 28-29.

members at least one director from non-pooling LECs. We invite comment on these proposals.

#### **F. Prohibition of "Ad Hoc" Committees**

##### 1. Background

23. The independent auditor recommends that NECA change its bylaws to prohibit Board committees other than "standing committees." Unlike standing committees, "ad hoc" committees do not keep formal minutes, so there is no official record of the committees' deliberations and decisions. In response, NECA has amended its bylaws to require that all Board committees be appointed by Board resolution. The amended bylaws also require Board committees to keep formal minutes and report all their actions to the full Board.<sup>43</sup>

##### 2. Discussion

24. While these amendments should help assure that NECA administers the interstate access tariff and revenue distribution processes in accordance with our rules, NECA's bylaws permit NECA committees to establish subcommittees, without making clear whether the subcommittees must be appointed by committee resolution, keep formal minutes, and report all their actions to the full committee. We tentatively conclude that we should require NECA to amend its bylaws to specify these procedures. We invite comment on this tentative conclusion.

#### **IV. NECA RESPONSIBILITIES UNDER COMMISSION RULES**

##### **A. NECA's Overall Responsibilities**

25. NECA was created to prepare and file access charge tariffs and to collect and distribute access charge revenue in accordance with Commission rules.<sup>44</sup> Because it is an association of LECs, NECA faces potentially conflicting forces in the performance of these functions. On the one hand, NECA must make reasonable efforts to ensure that all LECs that participate in its access tariff and revenue distribution processes comply with the Commission rules that affect those processes. On the other hand, many of NECA's members expect NECA to maximize their interstate earnings, a goal that may not advance strict compliance with our rules.

26. In this Part, we address ways to improve NECA's efforts to achieve the goal of rule compliance. Before turning to specific measures, we wish to make clear that we expect NECA to make reasonable efforts to interpret our rules correctly and to implement those interpretations. In the course of its

---

<sup>43</sup> By-laws of National Exchange Carrier Association, Inc., §§5.3, 5.5 (amended Sept. 10, 1992) (NECA Bylaws).

<sup>44</sup> See 47 C.F.R. §§69.601, 69.603; MTS and WATS Market Structure, 93 FCC 2d at 335-36.

operations, NECA receives much data that LECs must assemble in accordance with our accounting, separations, and access charge rules. We recognize that NECA cannot review each LEC submission in minute detail and that NECA has adopted review standards, methods, and procedures designed to detect LEC noncompliance. If, as a result of its review, NECA concludes that LEC data do not comply with our rules, we expect NECA to correct the data in its revenue requirement and revenue distribution computations. We invite comment on how these procedures should evolve.

## **B. Resolving Controversial Issues**

### 1. Background

27. Many of the issues requiring NECA interpretations arise in the application of general rules to specific facts and circumstances. The independent auditor recommends several steps to reduce the need for such interpretations and to ensure their accuracy. First, the independent auditor suggests that NECA establish an "early warning" procedure to alert the Commission to emerging and potentially controversial issues so that the Commission would be familiar with them if and when NECA makes a filing. Second, the independent auditor suggests that a process be established for timely Commission action on LEC petitions for waivers or requests for clarification of Commission rules. Third, the independent auditor recommends that NECA petition us to set minimum standards for the timing and content of the studies LECs use to perform jurisdictional separations and to allocate the interstate portion of their costs among access elements. Finally, the independent auditor suggests that NECA should develop a long-term plan for simplifying the pooling process.<sup>45</sup>

### 2. Discussion

28. We recognize that NECA sometimes is uncertain about what our rules require in specific circumstances. However, as stated above, we require only that NECA make reasonable efforts to interpret our rules correctly and to implement its interpretations.<sup>46</sup> We believe that the cost issues manual that NECA has maintained since 1990 is an effective tool for these purposes. We believe that the procedure NECA uses to update this manual can be improved. According to the independent auditor, NECA includes interpretations in this manual only after circulating them throughout NECA's cost study membership.<sup>47</sup> Although we have no objection to consultations between NECA and its members, NECA's efforts to understand a rule's meaning should not focus on developing either an industry consensus regarding that meaning or an interpretation that accommodates divergent LEC viewpoints. Such efforts are unlikely to lead to a correct interpretation. Instead, NECA must exercise its own independent interpretive judgment and then implement its interpretation.

---

<sup>45</sup> Safeguards Report at 31-32, 35.

<sup>46</sup> See Part IV(A), supra.

<sup>47</sup> Safeguards Report at 23.

29. Our staff is, of course, available to assist NECA's interpretative efforts through informal discussions. NECA may also file a petition for declaratory ruling to obtain an interpretation of our rules.<sup>48</sup> We will act on any such petitions as early as practicable. We emphasize that the pendency of such petitions neither eliminates NECA's obligation to implement our rules nor excuses rule violations by LECs.

30. We also believe the independent auditor raises important questions regarding our standards for cost study revisions and the prospect of simplifying the pooling process. We intend to examine these questions as part of our continuing efforts to reform our regulatory requirements. For instance, in our proceeding regarding tariffing processes for rate of return LECs, we invited the commenters to address how in the future we might remove obstacles to the introduction of incentives for increased efficiency into the NECA pools.<sup>49</sup> In these circumstances, we decline to consider the independent auditor's question regarding the pooling process in this proceeding.

### C. On-line Access to NECA Data Bases

31. NECA maintains computer-based files of the data that LECs provide it pursuant to our rules. These files include cost and demand data that individual LECs submit to NECA to enable it to prepare interstate access tariffs and to distribute revenues from those tariffs. NECA's files constitute a relatively complete source of company-specific data on NECA pool participants. The files also contain extensive information that pool non-participants submit to NECA to enable it to administer the USF, lifeline assistance, and long term support programs.

32. We believe that on-line, dial-up access to these computer-based files would enhance our ability to assure that NECA administers the interstate access tariff and revenue distribution processes in accordance with our rules. Therefore, we propose to require NECA to provide us with such access once safeguards are established to guarantee data base integrity and prevent unauthorized access. We invite comment on this proposal and on what safeguards we should adopt.

---

<sup>48</sup> See, e.g., 47 C.F.R. §32.17 (accounting questions involving matters of significance that our rules do clearly provide for are to be submitted to the Bureau for explanation, interpretation, or resolution).

<sup>49</sup> Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, Notice of Proposed Rulemaking, CC Docket No. 92-135, 7 FCC Rcd 5023, 5030 (1992).

## V. STRENGTHENING NECA'S INTERNAL PROCEDURES

### A. Overview

33. We believe NECA's successful administration of the interstate access tariff and revenue distribution processes must be based on three premises. First, NECA must understand our rules sufficiently to instruct LECs how to implement them. Second, NECA must have sufficient tools at its disposal to determine whether LEC submissions comply with those rules. Third, NECA must use those tools to secure compliance.

34. In the Safeguards Report, the independent auditor discusses a number of broad-based changes that NECA has made in its internal procedures since the conclusion of the Bureau's audit. They affect how NECA trains and compensates its officers and employees, how NECA reviews LEC data, and how NECA determines whether its review is sufficient. While the independent auditor concludes that these changes generally improve NECA's internal operations, it recommends additional changes. We agree with this overall assessment, and the remainder of this Part discusses measures to strengthen NECA's internal operations. We invite comment on each of these measures.

### B. Monitoring Commission Developments

#### 1. Background

35. In the Safeguards Report, the independent auditor observes that since the Bureau audit, NECA has expanded and improved its programs for educating its staff and member companies regarding Commission requirements.<sup>50</sup> The independent auditor recommends, however, that NECA develop a more formal program for monitoring our decisions as well as the status of LEC filings with this Commission. In the independent auditor's view, such a program would help inform NECA's members of changes in our requirements in sufficient time to reflect them in data filed with NECA. The independent auditor also suggests that improved monitoring would help NECA prevent LECs from prematurely implementing relief sought in waiver petitions.<sup>51</sup> NECA states that it will continue to improve its programs for gathering, analyzing, and disseminating information on our rules and that it will develop additional procedures to ensure that its staff and member companies use this information.<sup>52</sup>

#### 2. Discussion

36. It appears that NECA has improved its programs for making its staff aware of our requirements. However, these programs may give NECA's employees inadequate guidance when they instruct LECs how to comply with our rules and review LEC submissions for compliance. For instance, the independent auditor

---

<sup>50</sup> See, e.g., Safeguards Report at 11, 23-24.

<sup>51</sup> Id. at 33.

<sup>52</sup> Id., Attachment II at 14.

finds that in the cost issues manual that NECA maintains to instruct its employees,<sup>53</sup> NECA "strives to attain consistency across [our rules] by identifying one or more acceptable interpretations of particular [rules]" and "is reluctant to take a firm position on ambiguous issues."<sup>54</sup> We believe that these multiple interpretations are inconsistent with NECA's responsibility to implement its own, independent interpretations of our rules.<sup>55</sup>

37. Absent a stay or waiver, it is unacceptable for any carrier to fail to comply with our rules, even when the rules are subject to pending petitions for reconsideration, stay, or waiver. We believe that it would help NECA detect instances of noncompliance, if responsible LEC officers or employees were to certify whether data submitted to NECA comply with our rules. We invite comment on whether we should require such a certification and, if so, how we might implement it in regard to data submitted to NECA only in computer format.

### C. Incentive Compensation

#### 1. Background

38. During 1987, NECA initiated an incentive pay plan that rewards certain NECA officers and employees with annual bonuses above regular base salaries for achieving performance objectives. The objectives include NECA's CL and TS pools' achievement of the authorized rate of return. Although NECA revised this plan in 1991, an average of seven percent of NECA's executive compensation continues to depend on the CL and TS pools' rates of return. The independent auditor recommends that NECA reduce this incentive compensation, so as to avoid potential conflicts of interest or at least the appearance of such conflicts. The independent auditor also recommends that NECA create performance incentives for ensuring rule compliance throughout NECA.<sup>56</sup>

#### 2. Discussion

39. To an extent, the rates of return the CL and TS pools realize are dependent on the quality of the data that NECA uses in preparing its access tariff filings. If those data accurately forecast both the costs of and the demand for the services the pool participants will provide under the tariffs, the pools should earn the authorized rate of return. We support NECA's efforts to improve the accuracy of the forecasts that it uses in its tariff filings.

40. However, NECA's incentive compensation plan may reward noncompliance with our rules. This could occur, for example, if a plan motivated officers or employees to insure conformance of reported data with forecast data, regardless

---

<sup>53</sup> See Part IV(B), supra.

<sup>54</sup> Id. at 23-24.

<sup>55</sup> See Part IA(A), supra.

<sup>56</sup> E.g., id. at 10-11, 32.

of the forecast's accuracy. Incentive compensation plans that have this effect are unacceptable. As the independent auditor suggests, such plans create at least a potential conflict of interest.

41. Neither the Safeguards Report nor NECA's response to it makes clear the precise details of NECA's current incentive compensation plan. Because improper incentives could undermine NECA's administration of the CL and TS pools, we propose to require NECA to submit that plan for our review. We also propose, pending that review, to preclude NECA from paying any officer or employee based on the rate of return earned by the CL and TS pools. We invite comment on these proposals. We also invite the commenters to recommend methods by which NECA might assess its effectiveness in securing LEC compliance with our rules.

#### D. Cost Study Review Process

##### 1. Background

42. In 1990, NECA implemented a new process for reviewing the studies that NECA pool participants use to determine their CL and TS costs. This process has several steps. Initially, the NECA staff checks each study for input and methodological errors, and runs the study through NECA's jurisdictional cost allocation program to see if NECA's and the LEC's results agree. Thereafter, NECA attempts to identify the "riskiest" cost studies for further review. This review is generally "streamlined," but NECA conducts a limited number (seven in 1991) of on-site, cost study reviews each year.<sup>57</sup>

43. In the Safeguards Report, the independent auditor suggests that NECA should redesign this process to provide greater assurance of LEC compliance with Commission rules. Although the independent auditor agrees that NECA need not review each cost study in detail every year, the independent auditor states that NECA needs to do more selective and effective field reviews. According to the independent auditor, these on-site reviews need not cover all possible cost study items, but rather, should focus on compliance in areas where the LEC has demonstrated problems before or where the nature of the LEC's operations suggests risk factors.<sup>58</sup>

##### 2. Discussion

44. Informal discussions with NECA's staff indicate that NECA has refined and focused its cost study review efforts since the completion of the Safeguards Report. We invite NECA to describe those efforts in detail in its comments so they can be made part of the record in this proceeding. Upon review of that information, we may make additional proposals. Among the actions we may require is to have NECA provide us with an annual report on the results of its cost study review process. We invite comment on whether such a

---

<sup>57</sup> Id. at 12-22.

<sup>58</sup> Id. at 33.

report would be an effective tool for ensuring that NECA's members implement our rules.

## E. Independent Audits for Non-pooling LECs

### 1. Background

45. Our rules permit CL and TS pool participants to leave those pools and file their own tariffs.<sup>59</sup> In the Safeguards Report, the independent auditor recommends that all LECs be subjected to the same cost study review standards, methods, and procedures, regardless of pool participation. The independent auditor states that if the review standards are different, LECs may consider the differences in choosing whether or not to participate in the pools. The independent auditor recommends that the Commission, NECA, and the industry agree on cost study review standards, methods, and procedures for all LECs. The independent auditor also suggests that, if the Commission's cost study review resources are limited, it could "outsource" to NECA the responsibility for reviewing cost studies for small LECs that file their own tariffs with the Commission.

### 2. Discussion

46. We believe that we cannot properly "outsource" to NECA the responsibility for reviewing LEC cost studies that do not affect NECA's revenue requirement or revenue distribution computations. Therefore, we will not implement the independent auditor's recommendation in this regard. We are concerned, however, that LECs may leave NECA's pools to avoid NECA's review processes. One response may be for this Commission to require a sample of rate of return LECs that file their own tariffs to retain independent auditors to report annually on the sufficiency of the LECs' cost studies. We invite comment on whether the benefits of this approach would exceed its costs. We also invite the commenters to suggest alternative measures that might achieve comparable benefits at lower costs.

## VI. CONCLUSION

47. In this Notice, we initiate a rulemaking to strengthen NECA's administration of the interstate access tariff and revenue distribution processes. We propose to amend Section 69.602 of our rules to add outside directors to NECA's Board on a permanent basis. We also invite comment on a series of proposals to strengthen that Board, help NECA fulfill its responsibilities under our rules, and improve NECA's internal operations.

48. In initiating this rulemaking, we wish to emphasize our belief that NECA has improved itself significantly since our November 9 letter. We are heartened by that constructive response. We believe that the measures we propose would enable NECA to add to its record of achievement in administering the interstate access tariff and revenue distribution processes.

---

<sup>59</sup> See, e.g., 47 C.F.R. §69.3.

## VII. PROCEDURAL MATTERS

### A. Ex Parte

49. This is a non-restricted notice and comment rulemaking proceeding. Ex parte presentations are permitted, except during the Sunshine Agenda period, provided they are disclosed as provided in the Commission's rules.<sup>60</sup>

### B. Regulatory Flexibility

50. We certify that the Regulatory Flexibility Act of 1980 does not apply to this rulemaking proceeding because if the proposals in this proceeding are adopted, there will not be a significant economic impact on a substantial number of small business entities, as defined by Section 601(3) of the Regulatory Flexibility Act.<sup>61</sup> Those proposals address the administration of the interstate access tariff and revenue distribution processes by NECA, which is an association of LECs. Because of the nature of local exchange and access service, the Commission has concluded that LECs, including small LECs, are dominant in their fields of operation and therefore are not "small entities" as defined by that act.<sup>62</sup> The Secretary shall send a copy of this Notice of Proposed Rulemaking, including the certification, to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 603(a) of that act.<sup>63</sup>

### C. Comment Dates

51. We invite comment on the proposals and tentative conclusions set forth above. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules,<sup>64</sup> interested parties may file comments on or before April 14, 1993, and reply comments on or before May 14, 1993. To file formally in this proceeding, you must file an original and four copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments, you must file an original plus nine copies. You should send comments and reply comments to Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554. A courtesy copy should also be sent to William A. Kehoe III, Accounting and Audits Division, 2000 L Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business

---

<sup>60</sup> See generally 47 C.F.R. §§1.1202, 1.1203, 1.1206(a).

<sup>61</sup> 5 U.S.C. §601(3).

<sup>62</sup> See MTS and WATS Market Structure, 93 FCC 2d 241, 338-39 (1983).

<sup>63</sup> 5 U.S.C. §603(a).

<sup>64</sup> 47 C.F.R. §§1.415, 1.419.

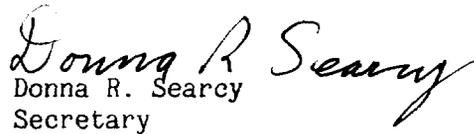
hours in the FCC Reference Center, Room 239, 1919 M Street, N.W., Washington, D.C. 20554.

#### VIII. ORDERING CLAUSES

52. Accordingly, IT IS ORDERED that, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-05, 218-20, and 403, NOTICE IS HEREBY GIVEN of proposals described in this Notice of Proposed Rulemaking.

53. IT IS FURTHER ORDERED that the petition for rulemaking filed January 28, 1991 by the National Association of Regulatory Utility Commissioners IS HEREBY DISMISSED AS MOOT.

FEDERAL COMMUNICATIONS COMMISSION

  
Donna R. Searcy  
Secretary