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

RECEIVED

JUL - 5 1995

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
The National Exchange Carrier Association, Inc.	)	
Proposed Revision of Part 69 of the	)	RM 8389
Commission's Rules to Allow for Incentive	)	
Settlement Options for NECA Pool Companies	)	

REPLY

National Exchange Carrier Association, Inc.
100 South Jefferson Road
Whippany, New Jersey 07981

July 5, 1995

TABLE OF CONTENTS

SUMMARY

The Commission issued a Public Notice on May 19, 1995 establishing a pleading cycle regarding NECA's Supplemental Comments filed May 15, 1995 to its 1993 Petition for Rulemaking which proposed additional rule revisions to allow it to offer incentive settlement options to NECA pool members. Comments in support of NECA's proposed incentive options were filed by ICORE, Inc. (ICORE), the National Telephone Cooperative Association (NTCA), the Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO), and the United States Telephone Association (USTA). These commenters urged the Commission to initiate a rulemaking proceeding in this matter. AT&T Corp. (AT&T), General Communication, Inc. (GCI) and MCI Telecommunications Corporation (MCI) filed comments questioning various aspects of NECA's plan.

In this Reply, NECA demonstrates that its plan is consistent with Commission policy of developing a continuum of incentive-based settlement plans for exchange carriers (ECs). NECA also shows that its incentive regulation lower access rates and benefits ratepayers, and that its proposed timing commitments are reasonable. NECA, along with supporting commenters, provide a reasonable explanation for why optionality is necessary. Finally, NECA shows that its proposed settlement calculations are reasonable.

NECA requests that the Commission initiate a rulemaking proceeding to propose its Customer Dividend Option and its Small Company Incentive Option, as well as to consider the pricing flexibility, streamlined procedures and pro forma rule changes which NECA proposed in its 1993 Petition for Rulemaking. Adoption of these incentive options will allow NECA's pool members and their customers to receive the benefits of incentive regulation that the Commission has adopted for companies that are no longer NECA pool members.

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

RECEIVED
JUL -5 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

In the Matter of	)	
	)	
The National Exchange Carrier Association, Inc.	)	
Proposed Revision of Part 69 of the	)	RM 8389
Commission's Rules to Allow for Incentive	)	
Settlement Options for NECA Pool Companies	)	

REPLY

Pursuant to the Commission's May 19, 1995 Public Notice[1] in the above-captioned proceeding, the National Exchange Carrier Association, Inc. (NECA),[2] hereby submits the following Reply. This Reply addresses comments[3] regarding NECA's Supplemental Comments[4] proposing

---

[1] Public Notice, RM 8389, DA 95-1133, NECA Files Supplemental Comments to Petition for Rulemaking to Allow for Incentive Settlement Options for NECA Pool Companies (May 19, 1995).

[2] NECA is a not-for-profit corporation responsible, under Subpart G of Part 69 of the Commission's rules, for activities including the preparation of access charge tariffs on behalf of all telephone companies that do not file separate tariffs, collection and distribution of access charge revenues, and the administration of the Universal Service and Lifeline Assistance programs. See 47 C.F.R. § 69.603.

[3] Comments were submitted by: AT&T Corp. (AT&T), General Communication, Inc. (GCI), ICORE, Inc. (ICORE), MCI Telecommunications Corporation (MCI), the National Telephone Cooperative Association (NTCA), the Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO), and the United States Telephone Association (USTA).

[4] The National Exchange Carrier Association, Inc. Proposed Revision of Part 69 of the Commission's Rules to Allow for Incentive Settlement Options for NECA Pool Companies, RM 8389, Supplemental Comments, filed May 15, 1995 (Supplemental Comments). In 1993, NECA filed a Petition for Rulemaking proposing revisions of Part 69 regarding incentive settlement options. See The National Exchange Carrier Association, Inc. Proposed Revision of Part 69 of the Commission's Rules to Allow for Incentive Settlement Options for NECA Pool Companies, RM 8389, Petition for

further rule revisions to allow it to offer incentive settlement options within NECA pools. In this Reply, NECA has responded thoroughly to issues raised and agrees with several commenters that support the issuance of a Notice of Proposed Rulemaking by the Commission regarding this matter.

I. BACKGROUND

On November 5, 1993, in response to Commission encouragement,[5] NECA filed its Petition proposing rule revisions that would allow it to offer incentive settlement options to its pool members. NECA petitioned the Commission to institute a rulemaking to revise Part 69 of the Commission's rules to allow exchange carriers (ECs) to elect regulatory incentive options, similar to those options adopted by the Commission for non-NECA tariff participants,[6] while also retaining the administrative benefits of NECA pool participation.[7] In its Petition, NECA proposed the "Pool Profit Sharing Incentive Option" and the "Pool Small Company Incentive Option."[8] NECA also proposed

---

Rulemaking, filed November 5, 1993 (Petition).

[5] See Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Report and Order, 8 FCC Rcd 4545 (1993) (Regulatory Reform Order). In that proceeding the Commission stated that:

> . . . we encourage NECA to continue to work on reforms to introduce optional incentive plans into the pooling process, which would be considered in the context of a separate proceeding, a waiver petition or a rulemaking. (Id. at 4562).

[6] See Regulatory Reform Order. See also sections 61.39 and 61.50 of the Commission's rules, 47 C.F.R. §§ 61.39 and 61.50.

[7] Petition at 1.

[8] See id. at 8-12.

streamlined new services introduction, pricing flexibility and administrative rule revisions that reflect actual operations of the NECA pools.[9]

Recently, the Commission conducted an extensive review of its EC Price Cap Plan. On April 7, 1995, the Commission released an order modifying its rules on incentive regulation.[10] The Commission stated at that time that it does not see profit sharing as a desired feature of its permanent price cap plan.[11] In response, on May 15, 1995, NECA filed Supplemental Comments to its 1993 Petition to replace its "Pool Profit Sharing Incentive Option" with a new "Customer Dividend Option."[12] The Customer Dividend Option removes the profit sharing mechanism and adds a customer dividend leading to reductions in tariff rates resulting from lower settlement rates for companies electing this option.[13] As NECA demonstrated in its Supplemental Comments, the Commission's adoption of incentive options for NECA pools will allow NECA members and their

---

[9] See id. at 12-16.

[10] Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 60 Fed. Reg. 19526 (April 19, 1995), FCC 95-132 (released April 7, 1995) (Price Cap Review Order).

[11] In the Price Cap Review Order, the Commission stated that sharing and low-end adjustment mechanisms should be eliminated as part of a permanent price cap plan for ECs. Price Cap Review Order at ¶ 184.

[12] Supplemental Comments at 2.

[13] Id. at 2. The Customer Dividend Option will: 1) allow a cost company in NECA's pools to elect incentive regulation for either traffic sensitive services only or for both common line and traffic sensitive services; 2) require a minimum commitment of four years, i.e., two, two-year incentive periods; and 3) use formulas to calculate EC-specific incentive settlement rates. Id. at 4. Historical revenue requirements and demand are used to set study area specific incentive settlement rates. NECA would reset these settlement rates at the end of each two-year incentive period to the authorized rate of return. The calculations that set the settlement rates in the Customer Dividend Option, however, would include application of a customer dividend factor equal to 0.65% per year. Id.

customers to enjoy the benefits of incentive regulation that the Commission had previously adopted for companies that are no longer NECA pool participants.[14]

ICORE, NTCA, OPASTCO and USTA were supportive of NECA's proposals and urged the Commission to initiate a rulemaking proceeding.[15] ICORE "heartily endorses NECA's proposed incentive settlement options, including the Customer Dividend Option and NECA's Pool Small Company Incentive Option, as extremely beneficial to non-Price Cap LECs, IXCs, and interstate ratepayers."[16] NTCA "continues to support NECA's proposals as necessary to keep pool participation options in step with regulatory treatment options allowed outside the pooling environment."[17] ICORE further states that "NECA's incentive settlement options will reward efficiency, encourage cost control and streamline the pooling process."[18] OPASTCO holds the belief that:

> . . . the Customer Dividend Option would provide a strong incentive to many small LECs to strive for challenging productivity gains while the resetting of rates every two years to the authorized rate of return would curtail the profit potential. Most importantly, reducing the settlement rates by the customer dividend would lower access costs

---

[14] Supplemental Comments at p. ii.

[15] ICORE at 1-3; NTCA at 2 and 4; OPASTCO at 2-3 and 7; USTA at 1-3.

[16] ICORE at 1. ICORE concludes its comments stating that "[s]ince interstate ratepayers will be the ultimate beneficiaries of NECA's proposal, its incentive settlement options should be adopted and implemented as soon as possible." Id. at 3.

[17] NTCA at 2.

[18] ICORE at 2. According to ICORE, NECA's incentive settlement options "will allow the very smallest LECs to avail themselves of Price Cap and Part 61.39 surrogates, initiating them to the benefits of those very positive processes." Id.

> for NECA's pools, which, in turn, may lead to reductions in NECA tariff rates charged to customers.[19]

"Adoption of an incentive regulation option for telephone companies who would also like to retain the benefit of the administrative cost savings permitted through the pooling process would serve the public interest" according to USTA.[20] In agreement with the other supporting commenters, NTCA requests that "the Commission [should] move forward expeditiously to modify the necessary access plan rules to broaden the settlement options available to pooling LECs consistent with the NECA proposals."[21]

AT&T, MCI and GCI, however, raised objections to NECA's plan. AT&T, MCI and GCI questioned the reasonableness of the calculation of the initial settlement rates,[22] the customer dividend factor,[23] the lack of profit sharing,[24] the optionality of NECA's plan,[25] and the benefits which will be derived.[26] AT&T asserted that the proposals still do not appear to satisfy the Commission's

---

[19] OPASTCO at 4. OPASTCO further comments that "NECA's Small Company Incentive Option . . . would provide significant cost efficiency incentives to Subset III study areas with less than 50,000 access lines." Id.

[20] USTA at 3.

[21] NTCA at 4. NTCA (at 2) and OPASTCO (at 5) note that the proposed incentive plans may not be appropriate for all small and rural ECs. Both agree that the Commission should adopt NECA's proposed plan as optional and continue to afford pooling companies the opportunity to choose cost pooling or average schedules. Id. See discussion infra in Section II. C.

[22] See GCI at 2 and MCI at 2-3.

[23] See AT&T at 5; GCI at 1-3; and MCI at 2-4.

[24] MCI at 4.

[25] AT&T at 4-5.

[26] Id. at 3-4.

goals for incentive regulation.[27] MCI questioned the accuracy of the proposed fixed settlement rate,[28] and GCI is concerned with ECs' ability to switch back and forth between the plan and a rate of return environment.[29]

In this Reply, NECA demonstrates that the comments made by AT&T, MCI and GCI are without merit. NECA's plan closely resembles policies and plans approved by the Commission which have produced solid benefits to access customers. NECA's plan is based on sound regulatory policy and will advance the Commission's goals by extending incentive regulation options to small and mid-sized telephone companies. NECA will show that its incentive regulation lowers access rates and that its settlement rates, timing commitments and optionality are reasonable. NECA urges the Commission to initiate a rulemaking proceeding and ultimately to adopt its proposed rule revisions.

---

[27] Id. at 3.

[28] MCI at 2-3.

[29] GCI at 2.

II. DISCUSSION

A. NECA's Plan is Consistent with Commission Policy

MCI questions the policy basis for NECA's proposals.[30] Adoption of NECA's proposed plan would, in fact, add a positive step to the Commission's policy of developing a continuum of incentive-based regulatory options for ECs.[31]

In 1987, the Commission began to examine alternatives to rate of return regulation and then adopted an optional means of filing traffic sensitive (TS) rates.[32] The Commission adopted a price cap plan for AT&T two years later.[33] This plan set price ceilings for each of three baskets and for selected services within each basket and described formulas for updating them. The Commission then

---

[30] MCI at 4.

[31] The Commission, while continuing its examination of improved regulatory regimes for small and mid-sized ECs in 1992, concluded that "the preferred approach for regulatory reform for this segment of the LEC industry is a continuum of increasingly incentive-based approaches that permit companies to choose a plan which best fits their circumstances." Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Notice of Proposed Rulemaking, 7 FCC Rcd 5023, 5024 (1992).

[32] In 1987, the Commission began to examine the "price cap" model. See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Notice of Proposed Rulemaking, 2 FCC Rcd 5208 (1987) (First Price Cap NPRM). The Commission adopted the Section 61.39 plan as a optional means of filing traffic sensitive rates. The plan was adopted in Regulation of Small Telephone Companies, CC Docket No. 86-467, Report and Order, 2 FCC Rcd 3811 (1987), and amended in Regulation of Small Telephone Companies, Order, 3 FCC Rcd 5770 (1988). See also Section 61.39 of the Commission's rules, 47 C.F.R. § 61.39.

[33] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989) (AT&T Price Cap Order).

adopted its EC price cap plan and required the eight largest ECs to convert to price cap regulation in 1990. [34] The EC price cap plan was specifically made voluntary for all other ECs.[35]

In the Second Price Cap Order, the Commission stated that it would continue to explore revisions to incentive plans to develop options that would meet the needs of small and mid-sized ECs remaining under rate of return regulation.[36] The Commission in 1992 initiated a Notice of Proposed Rulemaking to implement optional regulatory plans for small and mid-sized ECs that remain subject to rate of return regulation.[37] The Commission, in its 1993 Regulatory Reform Order, adopted the USTA-proposed Optional Incentive Regulation (OIR) Plan, with some modifications.[38] At the same time, the Commission also amended section 61.39 of the Commission's rules, 47 C.F.R. § 61.39, to

---

[34] Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786 (1990) (Second Price Cap Order) and Erratum, 5 FCC Rcd 7664 (1990), modified on recon., 6 FCC Rcd 2637 (1991) (EC Price Cap Reconsideration Order), petitions for further recon. dismissed, 6 FCC Rcd 7482 (1991), further modified on recon., 6 FCC Rcd 4524 (1991) (ONA/Part 69 Order), petitions for recon. of ONA/Part 69 Order pending, District of Columbia Public Service Commission v. FCC, No. 91-1279 (D.C. Cir. 1991), appeals of LEC Cap Order affirmed sub nom., National Rural Telecom Association v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

[35] Second Price Cap Order at 6818-6819. The Commission stated that it believed "that the diversity of LECs and the incompletely developed record on productivity caution against a broader mandatory application of the price cap system." Id. at 6819.

[36] Id. at 6799-6801.

[37] Regulatory Reform for Local Exchange Carriers Subject to Rate of Return Regulation, CC Docket No. 92-135, Notice of Proposed Rulemaking, 7 FCC Rcd 5023 (1992); Erratum, 7 FCC Rcd 5501 (1992) (Regulatory Reform NPRM).

[38] See generally Regulatory Reform Order. This OIR plan integrates rate of return and price cap incentive regulation.

extend the section 61.39 filing option to common line rates.[39] The Commission also encouraged NECA to continue work on proposals to introduce optional incentive plans into the pooling process.[40]

NECA requests that the Commission extend its range of incentive options by adapting existing plans for ECs that require NECA's administrative assistance and wish to maintain their participation in NECA pools. By combining pooling and optional incentive regulation, more ECs can participate in incentive regulation options while retaining the administrative efficiencies of centralized tariff administration.[41]

Both the Customer Dividend Option and Small Company Incentive Option offer continued pooling benefits. NECA's Customer Dividend Option is designed for ECs not eligible for participation in the Small Company plan. The Small Company Incentive Option would allow pool companies to mirror section 61.39, while continuing to benefit from the administrative cost savings that result from being a pool member. These savings are passed on to access customers in the form of lower rates.[42]

ICORE acknowledges that price caps and the section 61.39 plan, which require companies to exit the NECA pool and not participate in NECA's interstate tariff, are too much for many small

---

[39] Id. at 4559. See Petition at 5. This two-year option is available for both cost and average schedule study areas outside the NECA pools.

[40] See id. at 4562 and n. 5, supra.

[41] Administrative efficiencies include avoiding the need for over 1,000 individual access tariff filings which reduces burdens on ECs, IXCs and Commission staff.

[42] Supplemental Comments at 9.

ECs.[43] NTCA recognizes that NECA's proposed incentive plans will give small companies benefits without requiring them to file individual tariffs.[44] ICORE states that price caps and streamlined tariff rules can be extended to small average schedule companies and cost companies with less risk and financial hardship.[45] OPASTCO asserts that continued membership in NECA pools lessens some of the risks inherent in these plans by allowing pool members to continue the centralized tariff administration and ratemaking which are essential to small ECs' operations.[46]

B. Optional Incentive Plans Benefit Ratepayers

AT&T asserts that NECA has failed to show how its optional incentive plans provide benefits to access ratepayers.[47] Since both NECA's Customer Dividend Option and its Small Company Option are similar to the section 61.39 plan, the experience for companies that have opted for that plan provide relevant data on customer benefits. To date, that experience demonstrates that 61.39 ECs have lowered their access rates, thereby benefitting their ratepayers. NECA has identified sixty-seven (67) companies that have chosen this form of regulation, approximately 6.4% of the ECs

---

[43] ICORE at 2. MCI (at 4) states that rather than opt for a new plan, small carriers should seek pricing flexibility from current available plans. However, other plans require ECs to sacrifice NECA tariff advantages, e.g., the time and expense of preparing, filing, defending, and updating individual company tariffs. There are also administrative savings for both IXCs and the Commission from a reduced number of companies filing individual tariffs. See also supra n. 41.

[44] NTCA at 2.

[45] ICORE at 2.

[46] OPASTCO at 5-6.

[47] See AT&T at 3-4.

eligible.[48] Of these, fifty (50) refiled rates under the section 61.39 option for the 95-97 tariff period. Using their filed current and proposed rates, NECA calculated that these ECs, on average, have decreased access rates by 4.6%.[49]

C. NECA's Proposed Timing Commitments Are Reasonable and Optionality Is Necessary

GCI is concerned about the ability of ECs to switch back and forth between the plan and a rate of return environment and states that the Commission should determine if a longer or shorter period is needed.[50] There is no evidence that ECs who have opted for incentive regulation under the section 61.39 plan have taken undue advantage of some unintended benefit. NECA has identified 41 companies that were eligible to switch from 61.39 to 61.38 regulations and only four (4) (approximately 10%) chose to do so. NECA's Customer Dividend Option sets a minimum incentive commitment period of four years, i.e., two, two-year incentive periods, significantly reducing parties' ability to switch back and forth between settlement options. This is a reasonable time period and there is no justification for the Commission to alter it.

AT&T also suggests that, if NECA wants incentive regulation for its pool members, all members should participate and use the customer dividend factor in calculating the settlement rates.[51]

---

[48] See Attachment A. The number of companies that have elected the section 61.39 plan has steadily increased since the plan was adopted. In 1989 there were twenty-seven (27) participants and in 1995 there are sixty-seven (67) participants. See Attachment B. As more companies opt for the section 61.39 plan, further access rate reductions may be anticipated.

[49] See Attachment A. One additional company which refiled its Section 61.50 tariff also showed a TS switched rate reduction of 5.3% and a total interstate reduction of 4.5%.

[50] GCI at 2.

[51] AT&T at 5.

This suggestion is not compatible with either the operating characteristics of small and mid-size ECs or the Commission's own policy statements. Telephone companies require a continuum of regulatory plans that have built into them a tradeoff between risk and return. The Commission has stated that incentive plans are optional, except for the largest of companies, and were not intended to be mandatory for small companies.[52] NTCA and OPASTCO advise that the elements of incentive options may not be compatible with the operations of some small and rural ECs.[53] According to NTCA, high costs, low or unpredictable traffic volumes, and sparsely-populated service areas could result in variations in operations which make the commitment to rigid per-unit settlements too risky for some ECs.[54] For example, the loss of one large customer could impair the viability of a small EC. Both NTCA and OPASTCO agree that NECA's incentive settlement plans should be adopted as options thereby affording pooling companies the opportunity to continue to choose cost or average schedules settlements.[55] Therefore, as requested in NECA's Petition for Rulemaking, the proposed incentive plans should be optional.

D. NECA's Proposed Settlement Rate Calculations are Reasonable

In this section, NECA demonstrates that MCI, GCI and AT&T draw incorrect conclusions with regard to the mechanics of NECA's optional incentive plans and that their suggestions for more specificity are unfounded and without merit.

---

[52] See Second Price Cap Order, 5 FCC Rcd at 6787 and 6818-1819; and n. 35 supra.

[53] NTCA at 2; OPASTCO at 5; and n. 21 supra.

[54] NTCA at 2.

[55] NTCA at 2; OPASTCO at 5.

NECA's fixed settlement rate for its Customer Option Dividend for the first two-year period is calculated at the authorized rate of return, using the ECs' prior calendar year historical cost and demand.[56] Both MCI and GCI assert that these carriers' costs over the last 12 months may not be representative of typical costs and should not be used in determining the initial settlement rates.[57] NECA has simply followed the Commission's practice of using prior calendar year data to set initial rates for incentive companies. In both its AT&T and EC Price Cap Orders, the Commission similarly used the then effective rates as the starting point for initial incentive rates.[58] Prior year historical cost and demand are also used to establish incentive rates under section 61.39 and 61.50 of the Commission's rules, 47 C.F.R. §§ 61.39 and 61.50.

AT&T, MCI and GCI state that NECA has not justified its customer dividend and its productivity estimates.[59] AT&T asserts that NECA has not substantiated its 0.65% factor nor shown how this customer dividend factor will lead to greater efficiencies.[60] MCI and GCI state that taking half the difference between the highest and lowest productivity factors, which the Commission has established for Tier 1 price cap carriers, is an arbitrary measure and is not tied to the actual productivity performance of NECA member companies.[61] MCI and GCI assert that an analysis of

---

[56] See Supplemental Comments at 11 and Attachment 3.

[57] GCI at 2; MCI at 2.

[58] See AT&T Price Cap Order, 4 FCC Rcd at 3084-3085 and Second Price Cap Order, 5 FCC Rcd at 6814.

[59] AT&T at 5; MCI at 2-4; GCI at 1-3.

[60] AT&T at 5.

[61] MCI at 3; GCI at 1-2.

the carriers' historical productivity performance must be made.[62] Without this calculation, MCI believes that the productivity offset may be understated.[63]

NECA gave careful consideration to the difficulty and results demonstrated in the Commission's 1990 productivity studies for large ECs.[64] The Commission itself decided to conduct these productivity studies for EC price caps after it had rejected separate productivity studies submitted by ECs.[65] At that time, the Commission cited the difficulty in judging the diversity of approaches used to measure productivity.[66] The Commission's study required a significant industry effort to net out the effects of regulatory changes from historical data.[67] Reinterpretation of the study by the Commission, as discussed in the Price Cap Review Order, shows that these types of studies result in continuing controversy and are subject to many varying interpretations.[68]

---

[62] MCI at 3-4; GCI at 1-2.

[63] MCI at 3.

[64] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Supplemental Notice of Proposed Rulemaking, 5 FCC Rcd 2176, 2222-2225 (1990) (Supplemental NPRM) and Appendix C, A Study of Local Exchange Carrier Post-Divestiture Switched Access Productivity (Frentup-Uretsky study) and Appendix D, Total Telephone Productivity in the Pre- and Post-Divestiture Periods (Spavins-Lande Study). After examining suggestions and criticisms in the comments filed, as well as data submitted by AT&T and USTA, the Commission revised these two staff studies. See also Second Price Cap Order, 5 FCC Rcd at 6796-98 and Appendix C (Revised Frentup-Uretsky Study) and Appendix D (Revised Spavins-Lande Study).

[65] See Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-213, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3401-3408 (1988) (1988 FNPRM Notice). See also AT&T Price Cap Order, 4 FCC Rcd at 2975-2997; and Supplemental NPRM, 5 FCC Rcd at 2212-2222.

[66] See Supplemental NPRM, 5 FCC Rcd at 2227 and Second Price Cap Order, 5 FCC Rcd at 6796.

[67] See Second Price Cap Order, 5 FCC Rcd at 6798-99.

[68] See Price Cap Review Order at ¶¶ 144-145.

In light of the difficulties encountered by the Commission regarding these productivity studies, rather than doing another productivity study, NECA examined the section 61.39 plan (which involves freezing rates) and the Optional Incentive Regulation (OIR) plan in section 61.50 (which involves freezing rates and profit sharing). NECA patterned its plan after the 61.39 and 61.50 plans, but eliminated profit sharing in response to the recent Price Cap Review Order.

Both of these plans freeze rates for two-year periods. By freezing rates, these Commission options have implicitly established for smaller companies a productivity rate equal to the rate of inflation. For larger NECA ECs that elect the Customer Dividend Option, NECA added a customer dividend of 0.65%, and assuming that inflation continues to equal 3.0%, the overall productivity factor would be 3.65%.[69] Freezing rates as NECA does in its Small Company Option, or lowering rates an additional 0.65% each year of the two-year settlement period in the Customer Dividend Option, are challenging productivity hurdles.

MCI questioned whether the implicit small company productivity measure, equal to the rate of inflation, will remain at 3.0%, "especially in an industry with declining costs."[70] The theory behind requiring productivity improvements equal to the inflation rate is not dependent on the level of inflation. Historical cost and demand commitments mean that an EC will have to improve operations more than whatever the inflation rate turns out to be if the EC is to benefit.

NECA derived the additional 0.65% customer dividend for larger companies by taking half of the 1.3% difference between the 4.0% productivity factor for the basic EC price cap offering with

---

[69] Supplement Comments at 8.

[70] MCI at 4.

profit sharing and the 5.3% productivity factor for the option without profit sharing.[71] The dividend chosen is purposefully lower than the 1.3% dividend required by the Commission of price cap companies for the option without profit sharing.[72] By selecting a midpoint, NECA recognized that the smaller companies in the NECA pool have fewer opportunities than the larger price cap companies to reduce costs through scale economies or by offering complementary services.[73] NECA believes that its customer dividend factor is within a reasonable range.

NECA also recognized the need for a careful balance in determining the productivity factor for each option. If the productivity factor is set too high, there will be no participants. Setting it too low, on the other hand, could result in higher profits than are needed. OPASTCO states that the selected productivity factor, combined with the greater volatility of cost and demand changes associated with small study areas, produces a proper balance between risk and reward for NECA pool ECs.[74]

MCI also urges the Commission to require a sharing mechanism to compensate for the complexity of calculating accurate settlement rates and productivity.[75] This again raises the issue of the proper tradeoff between risk and return for an incentive plan. MCI suggests that a sharing

---

[71] Supplemental Comments at 7.

[72] Price Cap Review Order at ¶ 199-200.

[73] See Supplemental Comments at 7. See also Second Price Cap Order, 5 FCC Rcd at 6799. Regarding productivity factors for small to mid-size ECs, the Commission stated that ". . . and the diverse characteristics of smaller LECs, lead us to conclude that it is best premature to mandate either overall or individual productivity factors for them." Id.

[74] OPASTCO at 5.

[75] MCI at 4.

mechanism similar to one imposed on price cap companies electing lower productivity levels would protect the interests of ratepayers.[76] MCI's proposal, however, is contrary to current Commission policy. The Commission has stated it favors the elimination of profit sharing from its permanent price cap plan for ECs.[77] In light of the Commission's position, a sharing mechanism is not necessary.

Furthermore, ratepayers are protected by the backstop feature of NECA's plan that requires resetting incentive settlement rate levels to the authorized rate of return every two years.[78] The Commission adopted this same mechanism for its Section 61.39 and Section 61.50 plans.[79] As with the other alternative regulation plans, this automatic settlement rate adjustment recognizes the inherent risk of incentive regulation for small and mid-size companies, and protects both companies and ratepayers from the unanticipated impacts of imprecise initial targets.

Finally, AT&T is concerned that the earnings of non-incentive pool members could diminish any productivity benefits by incentive pool members. It asserts that nonparticipating pool companies would have no incentive to achieve greater efficiencies and productivity levels.[80] The notion that non-incentive pool members could dilute the productivity gains of incentive members is incorrect.

---

[76] Id. at 4.

[77] Price Cap Review Order at ¶ 184 and n. 11 supra.

[78] Another factor in arguing that profit sharing is not warranted may be found in the OIR experience. A possible explanation for why only one EC chose the OIR option is that profit sharing lowers potential rewards to the point they no longer compensate for the risks associated with freezing rates for two years.

[79] These plans and NECA's proposed incentive options include a self-correcting true-up mechanism at two-year intervals which is not found in price cap regulations. See Section 61.41 et seq. of the Commission's rules, 47 C.F.R. § 61.41 et seq.

[80] AT&T at 4.

An EC under incentive regulation in the pool has its settlement rates per unit of traffic preset to the authorized rate of return based on its study area-specific historical cost and demand data. The EC must lower its study area cost per unit of traffic below this settlement rate if it is to increase its earnings above the authorized level. Similarly, if its cost per unit of traffic rises above the settlement rate, its earnings will fall. The efficiency levels of other companies in the pool do not alter these conditions which are based on an EC's study area-specific unit costs.[81]

III. CONCLUSION

NECA's proposed plans advance Commission incentive policy statements and are consistent with other optional plans adopted by the Commission that are currently in place. As discussed above, NECA has demonstrated that optional incentive regulation lowers access rates and benefits ratepayers. In addition, NECA has demonstrated that its productivity factors and settlement rates are reasonable. NECA's plans allow access customers, the Commission and exchange carriers to benefit from incentive regulation while retaining the administrative efficiencies of pooling.

In conclusion, NECA requests that the Commission initiate a rulemaking proceeding to propose the Customer Dividend Option and its Small Company Incentive Option. Pricing flexibility,

---

[81] NECA will continue to adjust the earnings of all pool members (cost companies, average schedules and, if approved, incentive companies) to reflect actual pool earnings. All companies expect to share in the risks and rewards of pool rate setting. NECA access rates would add projected incentive company and average schedule settlements to forecasted cost company revenue requirements to determine the pool revenue requirement. This total revenue requirement would then be divided by total forecasted demand. To the extent that these tariff forecasts are wrong, all pool members share in the resulting variance. Both incentive company and average schedule settlements will be adjusted upward or downward as overall pool performance changes. See Supplemental Comments, Attachment 3. The earnings adjustments, however, would have no effect on study area-specific efficiency incentives nor would they alter the settlement mechanism for other pooling companies.

streamlined filing procedures, and pro forma rule changes which NECA proposed in its 1993 Petition for Rulemaking should also be advanced. Adoption of these incentive options will allow NECA's pool members and their customers to receive benefits of incentive regulation that the Commission has adopted for companies that are no longer NECA pool members.

Respectfully submitted,

NATIONAL EXCHANGE CARRIER ASSOCIATION, INC.

By: ______________________

Joanne Salvatore Bochis
100 South Jefferson Road
Whippany, New Jersey 07981

Its Attorney

Donna A. DiMartino
Regulatory Manager

July 5, 1995

TS RATES FOR NON - POOLING ECs

FCC SECTION 61.39

		12/1993 USF LOOPS	SETT TYPE	SAC	Composite CUR Rate	Composite PRO Rate	Percent Changes
1	Bay Springs Tel Co	10099	C	280446	0.072920	0.047521	-34.8%
2	Beehive Tel Co - NV	70	C	552284	0.337100	0.095180	-71.8%
3	Beehive Tel Co - UT	489	C	552284	0.337100	0.095180	-71.8%
4	Chickamauaga tel Corp	5177	A	220354	0.060920	0.059166	-2.9%
5	City of Brooking	12514	C	391650	0.040101	0.038318	-4.4%
6	Elkhart Tel Co	1464	C	411764	0.192600	0.187200	-2.8%
7	Fidelity Tel Co	11001	C	421882	0.048511	0.055028	13.4%
8	Bourbeuse Tel Co	1825	C	421859	0.050408	0.063400	25.8%
9	Great Plains Comm Inc	25481	C	371577	0.041700	0.055700	33.6%
10	Alhambra-Grantfork Tel Co	1025	C	340978	0.105268	0.089391	-15.1%
11	Ayrshire Farmer Mutual Tel Co	405	C	351105	0.262011	0.259140	-1.1%
12	C-R Tel Co	908	C	341009	0.070100	0.086159	22.9%
13	Cass County Tel Co	2763	C	340984	0.079193	0.071120	-10.2%
14	Citizens Tel Co Missouri	3785	C	421865	0.101842	0.090728	-10.9%
15	East Ascension Tel Co	26659	C	270429	0.046210	0.026480	-42.7%
16	Egyptian Tel Coop	2709	C	341003	0.113776	0.113776	0.0%
17	El Paso Tel Co	1726	C	341004	0.071747	0.065857	-8.2%
18	Grafton	668	C	341020	0.097735	0.084244	-13.8%
19	GridLy Tel Co	1234	C	341023	0.096077	0.128168	33.4%
20	Kerman Tel Co	5059	C	542324	0.036421	0.027597	-24.2%
21	La Harp Tel Co	1056	C	341043	0.124649	0.137201	10.1%
22	Leaf River Tel Co	582	C	341045	0.240828	0.206229	-14.4%
23	Madison Tel Co	1392	C	341049	0.129472	0.150195	16.0%
24	Oneida Tel Co	503	C	341066	0.134753	0.134753	0.0%
25	Moultrie Independent tel Co	669	C	341060	0.376584	0.371814	-1.3%
26	Roosevelt County Rural Tel Coop	1638	C	492272	0.104303	0.093293	-10.6%
27	Sierra Tel Co	15024	C	542338	0.067682	0.062798	-7.2%
28	Webb-Dickens Tel Corp	411	C	351327	0.158799	0.152624	-3.9%
29	West River Telcom Corp	9197	C	381637	0.049712	0.059212	19.1%
30	Woodhull Community Tel Co	649	C	341091	0.138526	0.137580	-0.7%
31	Flat Rock Tel Co	479	C	341012	0.068422	0.107586	57.2%
32	Shawnee Tel Co	3894	C	341025	0.103801	0.102581	-1.2%
33	Wabash Tel Co	4564	C	341088	0.084681	0.084681	0.0%

Note 1: Composite Rate = (LS2 + Info Surcharge + RIC + 2 X Tandem Switched Termination + 10 X TSF + Tandem Switching Charge). If the EC uses a different rate structure, then the equivalent of these charges are used.

Note 2: For "Sett Type", "C" = Cost Company & "A" = Average Schedule

Note 3: "SAC" = Study Area Code

Note 4: ECs #16, 24, & 43 are excluded from analysis since they were not required to file new rate for 7/1/95

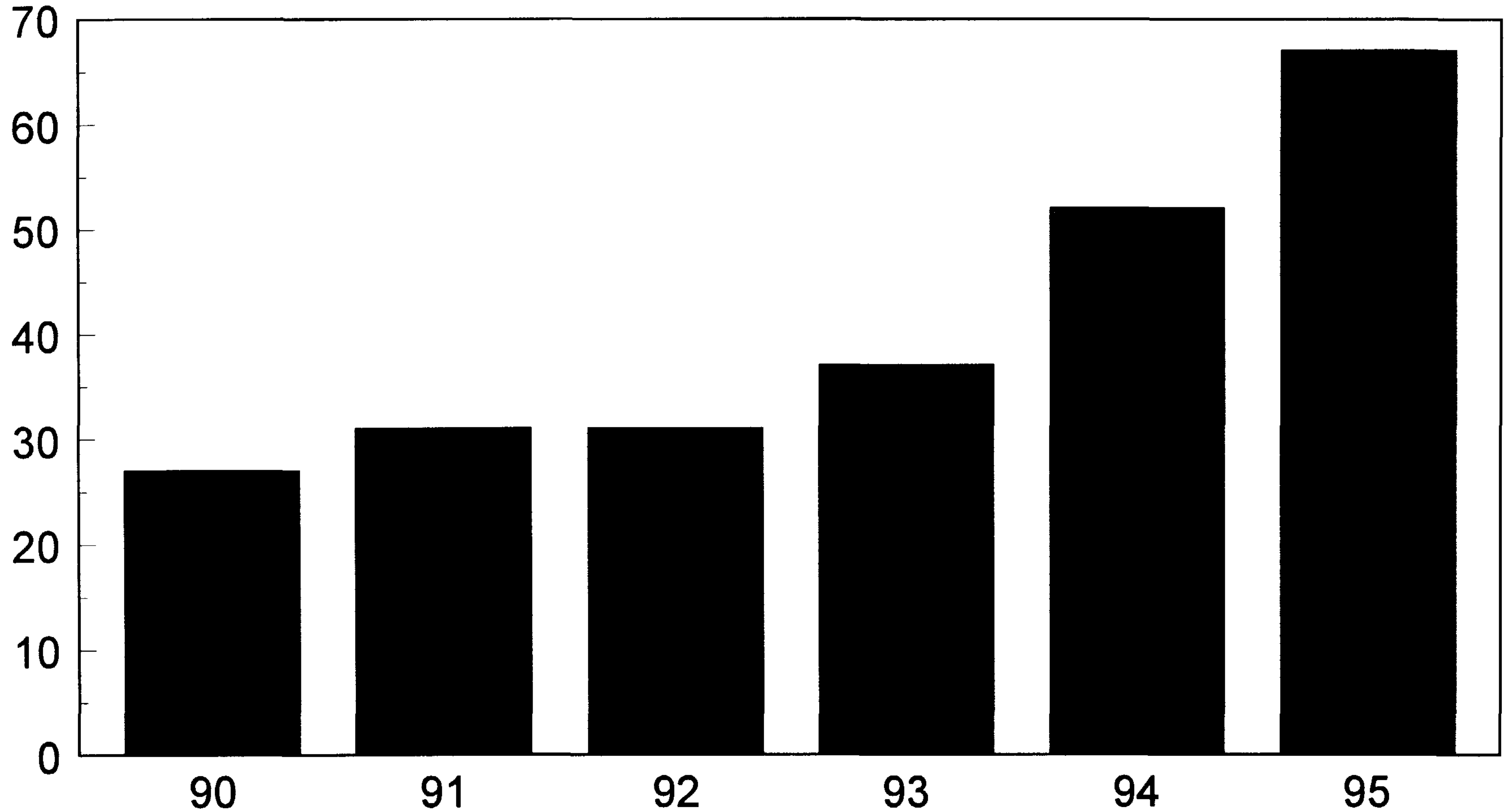
TS RATE FOR NON - POOLING ECs

FCC SECTION 61.39

		USF LOOPS	1994 TYPE	SAC	Composite CUR Rate	Composite PRO Rate	Percent Changes
34	Bloomingdale Home Tel Co	577	A	320742	0.111580	0.101470	-9.1%
35	Buffalo Valley Tel Co	17116	C	170151	NECA	0.059772	N/A
36	Denver & Ephrata Tel & Telegraph	45586	A	170165	0.045465	0.043602	-4.1%
37	Lexington Tel Co	26588	A	230483	0.048212	0.047428	-1.6%
38	Mankato CitizensTel Co	31131	A	361427	0.051103	0.050095	-2.0%
39	Merchants & Farmers Tel Co	554	C	320788	0.105027	0.096236	-8.4%
40	Mid- Comm Inc	7870	A	361375	0.094369	0.083227	-11.8%
41	Wilton Tel Co	2513	C	120050	NECA	0.051636	N/A
42	Atlantic Tel Membership Corp	25318	C	230468	0.033058	0.022372	-32.3%
43	Coastal Utilities Inc.	26549	C	220356	0.037010	0.033565	-9.3%
44	Farmers Tel Coop	43315	C	240520	0.028910	0.026307	-9.0%
45	Hargray Tel Co	37960	C	240523	0.047306	0.052141	10.2%
46	Millington Tel Co	22268	C	290571	0.033677	0.021146	-37.2%
47	Mt. Horeb Tel Co	3503	C	290571	0.070011	0.061203	-12.6%
48	Pineland Tel Co	10306	C	220377	0.040314	0.029104	-27.8%
49	Bixby Tel Co	6442	C	431969	NECA	0.030982	N/A
50	Clifton Forge Waynesboro Tel Co	30990	A	190226	NECA	0.050485	N/A
51	Electra Tel	1700	C	442069	NECA	0.083188	N/A
52	Florala Tel Co	3841	C	210291	NECA	0.040825	N/A
53	Gulf Tel Co	8047	C	210329	NECA	0.023974	N/A
54	Haxton Tel Co	1481	C	462190	NECA	0.083188	N/A
55	Lafourche Tel Co	12559	C	270433	0.049678	0.076919	54.8%
56	Magazine Tel Co	843	A	401710	0.066020	0.101685	54.0%
57	MCTA Inc	9830	C	123321	NECA	0.058019	N/A
58	Merrimack County Tel Co	5794	C	120047	0.068364	0.054655	-20.1%
59	Mokan Dial Inc .KS	2699	C	411807	NECA	0.083188	N/A
60	Mokan Dial Inc MO	650	C	421807	NECA	0.083188	N/A
61	Pioneer Tel Assn	13348	C	411817	NECA	0.096406	N/A
62	Southern Kansas Tel Co	4013	C	411833	0.127724	0.134192	5.1%
63	ST.Joseph Tel & Tel Co	24971	C	210339	NECA	0.027279	N/A
64	Taconic Tel Co	22109	C	150084	0.046529	0.046253	-0.6%
65	Union Tel Co	3262	A	512297	0.116582	0.156204	34.0%
66	Tatum tel Co	784	C	442150	NECA	0.083188	N/A
67	Vista - United	10242	C	210330	0.033180	0.028743	-13.4%
	61.39 TOTALS				0.050616	0.0489653	
	61.39 TOTALS FOR ECs WITH CURRENT & PROPOSED RATES				0.050616	0.048306	-4.6%

Note: Current and Proposed rates are weighted by the number of USF Loops

COMPANIES ELECTING 61.39 STATUS
(CUMULATIVE BY YEAR)



Data Taken as of July 1 of each year shown

Attachment B