Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 89-2

In the Matter of:

Amendment of Part 69 of the Commission's Rules Relating to the Common Line Pool Status of Local Exchange Carriers Involved in Mergers or Acquisitions

NOTICE OF PROPOSED RULE MAKING

Adopted: January 10, 1989; Released: January 17, 1989

By the Commission:

I. INTRODUCTION

1. On April 1, 1989, fundamental changes in the mandatory common line pooling arrangements that have governed the recovery of the non-traffic sensitive (NTS) costs of exchange carriers will be implemented pursuant to recommendations that were developed by the Federal/State Joint Board in CC Docket No. 80-286 (Joint Board) and subsequently adopted by this Commission.[1] These changes, which are described in more detail below, enable local exchange carriers (LECs) to leave the National Exchange Carrier Association (NECA) common line cost and revenue pool if they choose to do so, subject to certain conditions. That Joint Board recommended that we examine further the effect of mergers and acquisitions among LECs on the pooling status of surviving companies.[2] We accordingly initiate this Rule Making proceeding to consider what effect a LEC's involvement in a merger or acquisition should have on its participation in the complex revised pooling arrangements that will soon be implemented as part of the overall access charge plan.

II. BACKGROUND

2. On March 31, 1987, the Joint Board released a *Recommended Decision* in which it provided a study of the effects of the implementation of subscriber line charges (SLCs) and other recommendations it had prepared, and this Commission had adopted, relating to the recovery of NTS costs. The Joint Board *Recommended Decision* concluded that the record demonstrated that its earlier recommendations had advanced the four goals of the access charge proceeding by promoting economic efficiency, eliminating pricing discrimination, and deterring bypass, while preserving universal service. That *Recommended Decision* also developed and proposed recommendations for further action to advance these goals. This Commission adopted the Joint Board's conclusions and integrated recommendations in our *NTS Recovery Order*, with certain minor modifications in the proposed implementation schedule for SLC increases.[3]

3. Those recommendations included significant modifications in the existing common line tariff and pooling system.[4] Under the approach proposed by the Joint Board and adopted by this Commission, LECs would be permitted to withdraw from the NECA common line tariff and pool, and file carrier common line (CCL) tariffs based on their own costs, subject to certain conditions. These conditions include the "affiliate withdrawal requirement," which provides that carriers that choose to leave the pool and file their own common line tariffs remove all their study areas, and that departing holding companies remove all their affiliated companies.[5] Moreover, under the new rules. once a company (or group of affiliated companies) elects to leave the NECA common line pool and file its own common line tariff, it may not choose to participate in the NECA common line pool at a later date. Thus, this election opportunity is restricted by a "one-way" requirement.[6]

4. LECs leaving the pool will be obligated to make payments to the common line pool to keep the pooled CCL rates at the nationwide average level that would have resulted if all LECs had remained in the pool. The Joint Board concluded that this would enable large companies to establish more cost-based CCL rates without adversely affecting the rates charged by the smaller carriers that remain in the pool. Thus, LECs that withdraw from the NECA pool are required to contribute long-term support (LTS) to LECs that remain in the NECA pool, so as to enable pooling companies, which generally will be smaller, higher cost companies, to tariff a CCL charge equal to the charge that would have resulted if all LECs had remained in the pool.[7] In addition, four years of transitional support (TRS) payments will be provided to qualifying LECs that withdraw from the pool. In order to qualify for TRS, a LEC must be a net recipient from the pool in 1988 and must withdraw from the NECA tariff and pool in accordance with a schedule that provides the largest companies one opportunity and smaller companies two opportunities to leave the pool and qualify to receive TRS.[8] TRS would be paid by those non-pooling companies that were net contributors to the pool in 1988.

5. Although the parties who filed comments with the Joint Board did not directly address the issue of the common line pooling status of companies involved in a merger or acquisition, after the close of the comment period in that proceeding LEC industry representatives proposed a resolution of this issue in an *ex parte* presentation.[9] That proposal would have permitted a LEC that acquired another LEC with a pooling status different from its own to determine at its option whether the acquired LEC should retain its current pooling status or convert to the status of its new affiliate(s).[10] The draft proposal also contained language providing a process to challenge any election that would have a substantial impact on the long-term support obligations of carriers that had left the pool.[11] The industry representatives asserted that their proposal would maintain the marketability of small LECs in the new depooled environment.

6. The *Recommended Decision* observed that the record in that proceeding was not sufficiently detailed to permit the Joint Board to recommend adoption of the industry *ex parte* proposal, and noted that no parties had had an opportunity to comment on the plan. Thus, the Joint Board recommended that the proposal be examined and resolved in a separate Commission proceeding. Our *NTS Recovery Order* noted that we planned to consider what, if

any, adjustment should be made to the prescribed pooling arrangements to ensure that those arrangements do not inadvertently and unreasonably affect the marketability of small LECs.[12] We accordingly initiate this Rule Making proceeding to consider the issues regarding the pooling status of LECs that have been involved in a merger or acquisition.

III. DISCUSSION

A. General Considerations

7. The pooling modifications we have adopted are governed by rules that are not only complex, but closely interrelated. These pooling arrangements are also an integral part of our overall access charge system. Accordingly, we must be sensitive to the fact that whatever actions we take to address the seemingly narrow pooling issues raised by a LEC's involvement in a merger or acquisition could affect other aspects of our NTS recovery program. Thus, whatever rules we adopt in this Rule Making proceeding must serve the four fundamental goals of our access charge proceeding: promoting economic efficiency, eliminating pricing discrimination, deterring bypass, and preserving universal service.

8. Apart from these broad goals, we have identified several more specific considerations that we believe should be addressed in determining what pooling options should be made available to LECs involved in a merger or acquisition. First, whatever rules we develop relating to the pooling status of companies involved in such transactions should be as "neutral" as possible in terms of their effect on the underlying business decisions. Thus, the goal is to craft rules that will deter companies from structuring transactions in ways that are not based on sound business considerations, but are instead designed to circumvent or manipulate our pooling requirements. At the same time, we wish to ensure that our pooling rules do not adversely affect the marketability of small telephone companies and do not impede transactions that offer legitimate advantages to the companies and consumers involved. A structure that unnecessarily restricts the pooling flexibility of LECs in a merger or acquisition situation could deter business activity that would improve the efficiency of the affected LECs and benefit consumers.

9. Second, the approach adopted should not have the potential to cause material or unexpected changes in the complex pooling structure that has been developed. That structure should be protected against unacceptable disruptions in transitional or long-term support flows, or in the pool's common line revenue requirement. We seek to design rules that will not enable merger or acquisition activity to serve as a mechanism that LECs can use to shift their affiliates in or out of the pool in a way that would slowly erode the benefits that would otherwise flow from the pooling modifications. And third, LECs should not be accorded flexibility to an extent that would cause major problems for NECA in administering the common line pool and associated TRS and LTS arrangements, or for our review of the LECs' tariff filings. We invite comment on whether these concerns accurately describe the factors that should guide our decisions in this proceeding.

10. We further note that the current rules governing the revised pooling arrangements do not adequately address issues relating to the pooling status of LECs involved in a merger or acquisition, and will require some modification to accommodate these circumstances. For example, our affiliate withdrawal rule, which requires carriers that choose to leave the pool to remove all their study areas, and departing holding companies to remove all their affiliated companies at that time, would indicate that all companies involved in the transaction should acquire the same pooling status. On the other hand, the fact that our rules have a "one-way" restriction -- a company that has left the pool is not permitted to reenter the pool -- would indicate that a non-pooling LEC acquired by a pooling LEC would have to stay out of the pool, rather than take on the pooling status of its new affiliate(s). Moreover, while these rules suggest that when two companies with different pooling positions merge, the surviving entity should be outside the pool, there is no clear method for determining what the pooling status of the surviving entity should be, or what changes would be appropriate in the LTS and TRS obligations and/or benefits of the affected LECs.

B. The Industry Proposal

11. As discussed above, LEC industry representatives have advanced a proposal to address these issues.[13] In their *ex parte* presentations, these representatives expressed concern that, unless our rules are revised to provide for more pooling flexibility in the event of purchases, exchanges, or consolidations among LECs, our requirements would impede voluntary sales or exchanges that are desirable for sound business and customer service reasons. Those industry representatives proposed that, if a telephone company acquires property or is the survivor to a merger with a LEC having a common line pooling status different from its own, that company should have a new choice as to whether the acquired property would convert to the acquiring (or surviving) company's pooling status, or retain its pre-transaction status. These industry representatives further proposed that this approach should not be allowed to cause a substantial increase in the LTS obligations or in the CCL charges of LECs that have left the pool, and suggested that any challenge to a transaction based on the expected impact on access charges must be sufficiently timely so as not to delay the transaction.[14]

12. As the LEC representatives observed, the flexible approach they proposed would help maintain the marketability of small companies, and would protect subscribers in the transferred areas from pooling elections that are no longer appropriate under the new ownership. This proposal does, however, have several significant drawbacks. First, this approach could potentially have a substantial adverse impact on the revenue requirement of the common line pool, and thus on the LTS obligations of the non-pooling LECs. If, for example, a pooling company acquired one or more large non-pooling receiver companies (companies that had been net recipients in the common line pool prior to their departure), the acquiring company would be permitted to bring those receiver LECs back into the pool. This could greatly, and suddenly, increase the revenue requirement of the pool. Similarly, if a LEC in the pool decided to merge with a company or group of companies outside the pool, the transaction could be structured to have the surviving entity either inside or outside of the pool. This could potentially encourage a large, depooled receiver company that might want to return to the pool to seek out companies remaining in the pool as merger partners merely as a means of getting back in the pool. These scenarios could

result in a significant impact on the pool's revenue requirement, and indirectly on the support obligations of the non-pooling companies. The undesirable incentives that result from such an approach also raise certain questions.

13. The LEC Unity 1A representatives sought to address the concerns relating to the effects on the NECA pool by suggesting a procedure for challenging transactions that would have a substantial impact on the LTS obligations, and hence the CCL charges, of non-pooling LECs. However, the challenge procedure they proposed is vague and undefined, and could well lead to uncertainty and controversy in virtually every transaction that contemplates any change in pooling status. Moreover, this approach would put the burden on parties challenging the election to show that the election would have a significant impact on the CCL charges of non-pooling companies, whereas we tentatively conclude that the burden should properly be on companies involved in a merger or acquisition to show that any pooling changes that result would not adversely affect the overall pooling structure.

14. We are also concerned that the broad scope of flexibility in this proposal could cause administrative difficulties in the future and could result in a substantial number of holding companies having some of their affiliates in, and some out, of the NECA common line pool. Such an outcome could considerably complicate NECA's rate calculation and billing functions and our tariff review process. Adoption of the proposal could also require NECA to make an unreasonable number of adjustments to the LTS and TRS obligations and/or benefits of LECs involved in transactions with companies with a different pooling status.[15] Furthermore, this result could create undesirable incentives for LECs with companies in different pooling positions to allocate costs improperly among study areas according to whether the study areas are inside or outside of the pool.

15. For the reasons detailed above, we consider that the problems associated with the Unity 1A proposal outweigh its advantages. Accordingly, we tentatively conclude that this approach would not be the best solution to the issues addressed in this Notice. We describe below an approach that may achieve the goals we have identified above while avoiding many of the difficulties raised by the Unity 1A proposal.

16. We recognize that the issues raised in this Notice are unusually complex, not only because we are attempting to accommodate the large variety of potential business transactions, but also because any rules we adopt will affect many aspects of our somewhat complicated and interrelated pooling arrangements. We accordingly seek comment on both the broad principles and the specific mechanics of the approach we propose. In addition, we seek comment on alternative proposals that differ from the approach we discuss below that might also serve our goals.

C. Proposed Requirements That Would Apply To A LEC Involved In A Merger or Acquisition With A Company Having A Different Common Line Pooling Status

17. We note at the outset that the flexibility proposed in this Notice only addresses situations in which a pooling company acquires a non-pooling company or vice versa,[16] or two companies with different pooling positions merge. Thus, if a company remaining in the pool acquires or merges with another pooling company, or a non-pooling company with another non-pooling company, the acquired or merged entity would not have the option to change its pooling status except pursuant to our existing rules.[17] We recognize, however, that a transaction between two companies outside the pool could affect the LTS and/or TRS arrangements of the participating LECs, and we discuss this possibility below in the context of the broader discussion of the LTS and TRS ramifications of merger and acquisition activity.[18]

18. In a merger or acquisition transaction between two companies with different pooling situations, the participating companies theoretically could seek several different outcomes for the pooling status of the new company or companies. First, they could decide to have both newly-affiliated companies (or the surviving entity) outside the pool. Second, they could conclude that the best course would be for the company outside the pool to reenter the pool, which would require them to seek modification of our "one-way" restriction to accommodate the special circumstances of a merger or acquisition situation in some way. Or third, they could decide that it would be desirable to have the acquiring LEC and the acquired LEC retain their respective pre-transaction pooling positions for either a transition period or for a longer time, and could request this Commission to modify our affiliate withdrawal rule to permit such an option. We address each of these scenarios in turn.

1. All LECs Involved In The Transaction Desire To Leave The Pool.

19. Under our proposed approach, if the acquiring LEC (or the surviving entity in a merger context) determines that all of the newly affiliated companies should leave the common line pool it could do so. The only relevant constraint on this option would be that the effective date for any such change in common line pooling status must coincide with the effective date of the annual tariff filing following consummation of the relevant transaction.[19] We also propose to apply this same requirement to any of the authorized changes in pooling status associated with a merger or acquisition that are discussed in this Notice.

20. This situation -- two LECs involved in a merger or acquisition both desiring to leave the pool -- presents the least difficulties regarding the pooling status of the affected companies. A decision by both companies to leave is consistent with our existing requirements, including the affiliate withdrawal rule and the requirement that a company may not reenter the pool once it has left.[20] This situation does, however, have the potential to create complications concerning the LTS and TRS arrangements of the companies involved. Our rules provide that after the transition period LTS obligations will be allocated based upon the percentage of lines attributed to each non-pooling carrier.[21] We believe that these rules will accommodate mergers and acquisitions. However, one issue that arises if we permit companies to leave the pool during the transition period because they are acquired by or merge with a non-pooling company is what LTS or TRS arrangements would apply to the new entity or entities outside the pool.

21. Our rules currently provide that one of the conditions that a LEC must meet in order to be eligible to receive TRS (in which case it would not pay LTS during the transition period) is that it must announce its intention to leave the pool according to a two-step schedule which ends December 31, 1989.[22] If a company leaves the

pool after the specified dates so that it is no longer eligible for TRS, and that company is acquired by or merges with a LEC outside the pool that is already subject to certain LTS or TRS arrangements, a question arises as to whether such a company should become eligible to receive TRS, or whether (and under what circumstances) it should have to pay LTS.

22. We propose that the following rules should apply to the calculation of LTS and TRS payments when a non-pooling company (Company A) acquires or merges with a pooling company (Company B), and the surviving entity leaves the pool. The first scenario to consider is when the non-pooling Company A was obligated to pay both LTS and TRS (and was not receiving TRS) prior to the transaction. In this circumstance, we propose that the new entity (or affiliated entities) would likewise be obligated to pay LTS and TRS according to a formula that adds together the 1988 Base Years of the separate pre-transaction companies.[23]

23. The second scenario is when Company A had been receiving TRS based on Company A's 1988 Base Year (and had therefore not been required to pay LTS or TRS). In this case, we propose that TRS payments not be adjusted to reflect the effect of the merger or acquisition involving Company B. Thus, the new entity or affiliated entities would receive TRS based only on Company A's 1988 Base Year; 1988 data from Company B would not be included in the formula. Moreover, in this situation, if Company B had been a net recipient in the NECA pool at the time of its departure, we would not propose to require the surviving entity or entities to pay LTS or TRS during the transition period.[24] However, if Company B had been a net contributor to the pool, we propose to require the surviving entity or entities to pay LTS and TRS based on the 1988 Base Year of Company B during the transition period.[25] We propose this disparate treatment for companies leaving the pool pursuant to a merger or acquisition during the transition period because we consider that the LTS/TRS obligations for such companies could deter transactions that may be in the public interest. We seek comment on whether this approach best serves our goals, or whether we should always require such a company to pay TRS and LTS, even if it departs the pool in a merger or acquisition context.

24. In our view, this general approach for handling the LTS and TRS arrangements in this context comes close to maintaining the pre-transaction status quo, and appears to best serve the interests of administrative simplicity, minimizing the impact on the overall pool support structure, protecting the interests of small LECs, and equitable treatment for all concerned. We recognize, however, that there are many possible means of addressing the effects that mergers or acquisitions might have on existing LTS and TRS arrangements, and we seek comment on the details of the approach we suggest and on other proposals.

25. A related issue that is also not directly addressed in our present rules is the question of what LTS and TRS arrangements should apply when two companies outside the pool are involved in a merger or acquisition. For the reasons discussed above, we propose that, if the companies involved are all LTS and TRS contributors, their new LTS and TRS obligations should (effective on the date the annual access tariffs take effect) be calculated based on the combined 1988 Base Years of the companies. Similarly, if all the companies involved are TRS recipients, their new TRS benefits should be based on the combined 1988 Base Years of the companies. This approach would apply throughout the transition period; after that time the LTS obligation would be based on the combined access lines of the affiliated companies as is currently provided for in our rules. *See* 47 C.F.R. § 69.612. If, however, a company that is an LTS/TRS contributor acquires or merges with a TRS recipient LEC, we propose that, for the duration of the transition period, the new entity continue to contribute to the LTS and TRS funds according to the 1988 Base Year formula of the pre-transaction contributor LEC, and continue to receive TRS according to the 1988 Base Year formula of the pre-transaction recipient LEC. (Of course, an appropriate netting arrangement could be developed.) While we recognize that this could mean that a single company would be contributing to the LTS and TRS funds at the same time that it is receiving TRS, we believe that this result is justified because it would only be for a limited period, would appear to be easiest to administer, and would further our goal of neutrality with regard to the marketability of LECs. We invite comment on these proposals.

2. All LECs Involved In The Transaction Desire To Be In The Pool.

26. LECs with different pooling positions might also seek to have the LEC outside the pool reenter the pool, either through a merger with the LEC already in the pool or by being acquired as an affiliate of the pooling company. We recognize that allowing a company that has left the pool to reenter the pool at a later date is inconsistent with our "no pool reentry" principle. We consider, however, that it would be appropriate to apply a somewhat less restrictive rule in the circumstances of a merger or acquisition so that companies would not be deterred from negotiating an otherwise desirable business transaction simply because their different pooling positions might require them to utilize separate corporate structures or administrative procedures that they considered less efficient. Providing for limited additional flexibility in this context can help to avoid this problem by enabling the acquiring or surviving LEC(s) to consolidate its operations and to take advantage of the benefits of participation in the NECA common line pool and tariff if that is deemed best for the overall company and its customers. Furthermore, it would be easier for NECA to administer and for this Commission to review the tariff filings of the affected LECs if all their affiliates had the same pooling status.

27. We do, however, consider that certain safeguards must be applied when LECs seek to reenter the pool in a merger or acquisition context in order to protect against any major adverse impact to the pool, and indirectly to the LTS obligations of non-pooling LECs. We also wish to prevent LECs from structuring transactions in a particular manner for the primary purpose of circumventing our rules. The revenue requirement of the NECA common line pool could, for example, be severely and suddenly affected if a large receiver holding company outside the pool merged with a small LEC in the pool; such a transaction could well be crafted primarily for the purpose of getting the large non-pooling holding company back in the pool. In addition, if a large non-pooling contributor company should seek to reenter the pool through a merger or acquisition with a pooling LEC, it would be necessary to assess whether that change would cause a significant increase in the LTS and TRS obligations of the remaining non-pooling LECs.

28. In order to address these concerns, we propose that, if a non-pooling company wishes to reenter the pool because it is involved in a merger or acquisition with a LEC in the pool, it must seek and obtain a waiver from this Commission[26] before it would be allowed to reenter the pool.[27] To obtain such a waiver, LECs would have to demonstrate that the overall pooling structure would not be materially harmed. Specifically, the petitioning companies would have to show that the reentry of the non-pooling LEC(s) into the pool would not have a substantial adverse effect on the revenue requirement of the pool, and would also not significantly increase the LTS and/or TRS obligations of the remaining non-pooling LECs.[28] In evaluating such waiver requests, the Bureau would also take into account the comparative benefits that would flow to the public from consolidating the companies' operations within the NECA common line pool.[29]

29. We acknowledge that a waiver proceeding could itself inject an element of uncertainty into a proposed merger or acquisition, but we consider that this approach is necessary to protect the integrity of the overall pooling structure. Moreover, we are of the view that these types of waiver requests can be processed expeditiously if a decision to grant the waiver would not have a substantial impact on our pooling structure, and that a procedure can be developed that would safeguard confidential information relating to planned business transactions.[30] We generally seek comment on whether any special procedures might be appropriate for processing such waiver requests.

3. The LECs Involved In The Transaction Desire To Retain Their Respective Pre-transaction Pooling Positions.

30. Finally, a LEC acquiring another company with a different pooling status may desire to have each party to the transaction retain its pre-transaction pooling position for either a transition period or for an indefinite period of time. Although an acquisition context presents somewhat different issues than the initial decision to leave the pool, such an option would be inconsistent with the principles underlying our affiliate withdrawal rule, which we have concluded is essential to the success of our pooling modifications.[31]

31. We are concerned that whatever approach we adopt to address the pooling status of companies involved in mergers or acquisitions not be used as a vehicle for circumventing our affiliate withdrawal rule. Just as is the case with the initial pooling election, companies contemplating a merger or acquisition would have the incentive to structure transactions that would result in high-cost areas being in the pool, and low-cost areas out of the pool, if the rules we develop here permitted such manipulation. Over time, these types of transactions could undermine the benefits of the pooling modifications in the same manner as they could in the context of the initial decision to depool by enabling LECs to shift the majority of high-cost areas into the pool and low-cost areas out of the pool.

32. We are also concerned that an approach that affords companies an unlimited ability to leave acquired properties in a different pooling status from the acquiring LEC could create administrative difficulties for NECA insofar as it would have to undertake entirely separate CCL rate or support flow calculations for affiliates with different pooling positions. It could, moreover, cause additional problems for this Commission in reviewing tariffs or other data submissions for affiliated companies because the type of filing would differ from one affiliate to another depending on whether they are inside or outside of the pool.

33. We nevertheless consider that it would again be appropriate to provide for some flexibility in this respect to achieve sufficient neutrality regarding the marketability of telephone companies. A sudden change in the pooling status of a company (particularly one receiving substantial benefits from pool participation) could have an adverse effect on its marketability. We accordingly propose that, when LECs with different pooling positions are involved in an acquisition, those LECs should be permitted to retain their pre-transaction pooling positions for a three-year transition period following the consummation of the transaction. The affected LEC(s) would be required to change their pooling status so as to have all the affiliated companies leave the pool effective on the first annual tariff filing date that falls more than three full years after completion of the transaction.[32] Making this additional pooling option available to LECs should help ensure that our pooling rules do not interfere with acquisitions that would benefit the participating companies and the overall public interest.

34. An alternative approach would be to permit the acquired LEC to remain in the pool indefinitely if its costs are greater than a fixed percentage of the nationwide average. For example, if our rules were to provide that companies with costs over 150 percent of the nationwide average that are acquired by a non-pooling LEC could stay in the pool indefinitely (or until its costs drop below the specified level), the higher cost companies that would be in greatest need of the risk sharing and administrative savings offered by participation in the pool would be able to avail themselves of this protection. Moreover, this kind of limitation might reduce the number of companies that would be eligible to retain a pooling status different from their affiliates to a manageable figure that would not cause unreasonable administrative difficulties for NECA or for this Commission in preparing or reviewing the relevant tariff materials.

35. We believe that, if we adopt one of these two alternatives for affording LECs some limited flexibility to leave an acquired LEC in a different pooling position under specified conditions, this step would help to ensure that our rules do not adversely affect the marketability of LECs. Either of these approaches would protect against sudden disruptive changes in the complex pooling structure, and would also minimize manipulation of our pooling requirements that could, over the long term, cause fundamental shifts in the makeup of the pool that would threaten the benefits of the pooling modifications. Furthermore, these options would minimize the potential administrative difficulties that could occur if LECs were permitted unlimited flexibility to retain separate pooling positions for acquired companies.[33] We tentatively conclude that, of these two alternatives, the three-year "transition period" proposal described in paragraph 33 best serves these goals. However, we also invite comment on whether we should instead adopt the alternative described in paragraph 34, which would allow a pooling LEC to remain in the pool if its costs exceeded a specified percentage of the nationwide average.

36. In summary, we tentatively conclude that the overall approach described in the preceding paragraphs will further the goals and address the concerns at issue in this

proceeding. We believe that our proposals are responsive to the marketability concerns expressed by representatives of small telephone companies. Our approach would allow a LEC that acquires another LEC with a different pooling status to choose whether to leave the acquired property in the separate pooling status under certain circumstances, or to choose to consolidate its operations outside the pool. Moreover, our tentative plan provides a means for LECs out of the pool to seek approval to reenter the pool in a merger or acquisition situation, yet protects against any major adverse impact to the pool by ensuring that acquired or merged LECs can only reenter the pool if such LECs demonstrate that the overall pooling arrangement will not be materially harmed by their action. This proposal should also minimize the administrative burdens that NECA and this Commission would have to confront as the result of merger and acquisition activity among LECs after our pooling modifications become effective.

37. We seek comment on the principles we have identified as guiding our proposed approach, and on the extent to which our proposal serves those goals. In addition, we ask commenting parties to discuss logistical or administrative considerations involved in implementing our proposal, and to identify any practical implementation issues or other problems relating to the feasibility of the approach we propose. To the extent parties suggest alternatives to the approach described above, we ask that such a party describe the details of its proposal and explain how the proposal would differ from our proposed approach and how it furthers our goals.

38. The proposal contained herein has been analyzed with respect to the Paperwork Reduction Act of 1980 and found to contain no new or modified form, information collection and/or recordkeeping, labeling, disclosure, or record retention requirements that are applicable to the public, and will not increase or decrease burden hours on the public.

39. We certify that the requirements contained in the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612, are not applicable to the rules that may result from this proceeding.[34]

IV. PROCEDURAL MATTERS

40. Pursuant to Sections 1, 4(i)-(j), and 403 of the Communications Act of 1934, as amended, and Section 553 of the Administrative Procedure Act, NOTICE IS HEREBY GIVEN of a proposal to amend Part 69 of this Commission's Rules.

41. All interested persons may file comments on the proposal discussed in this Notice no later than February 16, 1989, and reply comments may be filed not later than March 3, 1989. In accordance with the provisions of Section 1.419 of our rules, an original and five copies of all statements, briefs, comments, or reply comments shall be filed with the Secretary, Federal Communications Commission, 1919 M Street, Northwest, Washington, D.C. 20554. All such filings will be available for public inspection in the Dockets Reference Room at the Commission's Washington, D.C. offices.

42. For purposes of this non-restricted notice and comment Rule Making proceeding, members of the public are advised that *ex parte* presentations are permitted except during the Sunshine Agenda period.[35] The Sunshine Agenda period is the period of time which commences with the release of a public notice that a matter has been placed on the Sunshine Agenda and terminates when the Commission (1) releases the text of a decision or order in the matter; (2) issues a public notice stating that the matter has been deleted from the Sunshine Agenda; or (3) issues a public notice stating that the matter has been returned to the staff for further consideration, whichever occurs first. During the Sunshine Agenda period, no presentations, *ex parte* or otherwise, are permitted unless specifically requested by the Commission or staff for the clarification or adduction of evidence or the resolution of issues in the proceeding.[36]

43. In general, an *ex parte* presentation is any presentation directed to the merits or outcome of the proceeding made to decision-making personnel which (1) if written, is not served on the parties to the proceeding, or (2) if oral, is made without advance notice to the parties to the proceeding and without opportunity for them to be present.[37] Any person who submits a written *ex parte* presentation must provide on the same day it is submitted a copy of same to the Commission's Secretary for inclusion in the public record. Any person who makes an oral *ex parte* presentation that presents data or arguments not already reflected in that person's previously-filed written comments, memoranda, or filings in the proceeding must provide on the day of the oral presentation a written memorandum to the Secretary (with a copy to the Commissioner or staff member involved) which summarizes the data and arguments. Each *ex parte* presentation described above must state on its face that the Secretary has been served, and must also state by docket number the proceeding to which it relates.[38]

FEDERAL COMMUNICATIONS COMMISSION

Donna R. Searcy
Secretary

FOOTNOTES

[1] *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Recommended Decision and Order*, 2 FCC Rcd 2324 (1987) (hereinafter *Recommended Decision).*

[2] *Recommended Decision* at n. 194.

[3] MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, *Report and Order*, 2 FCC Rcd 2953 (1987) (hereinafter *NTS Recovery Order), aff'd on reconsideration*, 3 FCC Rcd 4543 (1988) (hereinafter *NTS Recovery Reconsideration Order), petition for review pending, Public Service Commission of the District of Columbia v. FCC*, D.C. Cir. No. 88-1661 (Petition filed Sept 12, 1988).

[4] *Id.* at paras. 111-135.

[5] *See Recommended Decision* at para. 130. The Joint Board reasoned that to provide otherwise would likely cause LECs to remove only their low-cost study areas while leaving high-cost areas in the pool, and might establish improper incentives relating to the allocation of common costs between study areas in the pool and those that are withdrawn. It concluded that these results would diminish or even defeat the benefits to be gained from the pooling modifications. *See also NTS Recovery Reconsideration Order* at paras. 47-58.

[6] *See NTS Recovery Reconsideration Order* at n. 17.

[7] *See id.* at paras. 100 & 111.

[8] The rules implementing this recommendation provide that the larger (Level I) companies must have made an election by August 30, 1988, to leave the pool on April 1, 1989, in order to qualify to receive TRS, while smaller (Level II) companies can only qualify to receive TRS if they make their election to leave the pool by August 30, 1988, to leave the pool on April 1, 1989, or by December 31, 1989, to leave the pool on July 1, 1990. *See* 47 C.F.R. §§ 69.2(t)-(w), 69.3(e)(9) & 69.612(b) (1987); Access Tariff Filing Schedules, *Report and Order*, FCC 88-283 (released Sept. 14, 1988) (hereinafter *Access Tariff Scheduling Order)*. Companies may leave the pool on an annual basis after these dates, but will be ineligible to receive TRS. *See* 47 C.F.R. § 69.612(b).

[9] *See Notice of Ex Parte Meeting* between federal Joint Board staff and Counsel to the National Rural Telephone Association and United States Telephone Association (USTA), MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, filed January 14, 1987 (hereinafter January 1987 *Ex Parte* Submission).

[10] Representatives of the USTA Unity 1A Coordinating Committee's Mergers and Acquisitions Subcommittee also discussed this proposal in an *ex parte* meeting with Commission staff on March 10, 1988. *See* Letter from M. Humphrey to Acting Secretary, FCC, dated March 10, 1988.

[11] *See infra* note 14.

[12] *See NTS Recovery Order* at para. 42.

[13] *See supra* notes 9 & 10.

[14] The draft amendment submitted by these LEC representatives on behalf of the LEC industry Unity 1A Mergers and Acquisitions Subcommittee provides as follows:

> Subsequent to the initial election for individual common line tariff filings, companies, that are survivors to a merger or that acquire properties, having a common line tariff status that is different than their own, shall on acquisition, either elect to retain the tariff status of the purchased property, or to convert it to the status of the purchasing entity. Note: It is not the intention of this provision that such an election shall have a substantial impact on the access charges that any carrier that does not participate in the Association tariff must recover in its common line tariff as its share of the long term support revenue requirement of the common line pool. Any challenge based on the expected impact on access charges must be sufficiently timely so as not to delay the transaction.

See January 1987 *Ex Parte* Submission at 2.

[15] *See supra* para 4.

[16] We propose to treat exchanges of LECs or study areas between separately-owned companies as if each of the participating companies had acquired the LEC or study area it received in the transaction. However, we request comments on whether such exchanges should be subject to any requirements that differ from the general approach we propose to apply to acquisitions described below.

[17] For example, our rules presently provide that LECs in the pool will have one opportunity each year to opt to leave the pool. *See* 47 C.F.R. § 69.3(e)(9) (1987). However, a company would not be eligible to receive TRS unless it left on certain dates as specified in our rules (*see supra* note 8), and a merger or acquisition would not create a new opportunity for a pooling company to leave the pool and be eligible to receive TRS.

[18] *See infra* para. 25.

[19] This timing requirement is designed to control the administrative problems involved in any change in pooling status, and is consistent with the requirements of the traffic-sensitive pool. It is also consistent with the existing rules for withdrawal from the common line pool, which afford carriers one opportunity each year after 1989 to leave the pool (although a company would of course not be eligible to receive TRS if it decided to leave after the specified August 30, 1988, and December 31, 1989, pool election dates for Level I and Level II companies, respectively).

[20] Under our present rules, if the pooling company that desires to leave the pool is an average schedule company, it would be no longer be considered an average schedule company once it leaves the common line pool. *See* 47 C.F.R. § 69.605(c)(2) (1987).

[21] Thus, if carrier A has 10 percent of the non-pooled access lines in a given year, it will bear 10 percent of the annual pool support obligations. *See* 47 C.F.R. § 69.612 (1987).

[22] *See supra* note 8. Non-pooling LECs receiving TRS do not incur LTS obligations until after the TRS transition period is concluded.

[23] We note that, under Section 69.612 of our rules, the formula for calculating LTS and TRS payment obligations differs depending on when a company leaves the pool. Thus, if a LEC elects to leave the pool on the election dates specified for its size category in our rules (*see supra* note 8), its LTS and TRS obligations (or TRS support as the case may be) are calculated based on the company's 1988 Base Year data throughout the transition period (the four-year period during which TRS is paid). By contrast, the LTS and TRS obligations of any company that opts to leave the pool after its specified Level I or Level II election dates are calculated based on the number of access lines of the company. This dual approach could obviously create substantial difficulties if a company decides to leave the pool during the transition period, but after the specified dates, to merge with a LEC that had already left the pool. We accordingly propose that any LTS and TRS obligations of companies that opt to leave the pool during the transition period, but after the appropriate Level I or Level II election dates because the companies are acquired by or merge with a non-pooling company (that had left by the prescribed election dates) should be calculated based on the combined 1988 Base Years of the LECs that make up the new entity (or affiliated entities) outside the pool. This approach should reduce the administrative problems that NECA and the affected companies would encounter if NECA and the LECs were required to calculate the LTS and TRS obligations of affiliated companies, or even of a single merged company, according to different formulas.

[24] If Company B left the pool on its own after the election dates set for Level I or II companies, it would normally be required to pay TRS and LTS. *See* 47 C.F.R. § 69.612(a)(1) (1987).

[25] If appropriate, a netting arrangement could be developed to offset the LTS obligation of (former) Company B with the TRS payments being received by (former) Company A.

[26] The Common Carrier Bureau would normally act in the first instance upon such waiver requests pursuant to delegated authority.

[27] Of course, if a LEC reenters the pool, any LTS obligations or TRS benefits it may have been subject to outside the pool will no longer apply as of the effective date of the pooling status

change. An issue may, however, arise regarding LTS or TRS arrangements if only part of a company outside the pool is acquired by or merged with a company in the pool. Under these circumstances, it may be appropriate to reduce the LTS and TRS obligations, or the TRS benefits as the case may be, of the portion of the non-pooling company left outside the pool. We seek comment on this suggestion.

[28] An overall increase in the LTS obligations of the remaining non-pooling LECs could be indirectly caused by an increase in the revenue requirement of the pool due to the reentry of a large receiver company into the pool, or could also possibly occur when a large contributor company reenters the pool, and the remaining non-pooling LECs must each pay a greater percentage of the total LTS and TRS obligations. If the waiver request involves the reentry of a TRS recipient into the pool, the fact that the remaining non-pooling contributor LECs would no longer be obliged to pay TRS to the reentering LEC for the duration of the transition period would obviously have to be considered in evaluating the overall impact.

[29] In the event the requested waiver is denied, the companies involved would have the option of structuring the transaction so that both companies leave the pool, or so that both companies remain in their respective pre-transaction pooling positions in accordance with the rules that apply to such situations as discussed in the next section (*see infra* paras. 33-35).

[30] We recognize, for example, that some proposed business transactions could be time-sensitive or could involve commercial information that the participants would not wish to have made publicly available, and we specifically seek comment on an effective mechanism for handling waiver requests that relate to such situations.

[31] As we recently reiterated in the *NTS Recovery Reconsideration Order*, the affiliate withdrawal requirement is important because, without this rule, the potential benefits of depooling could be significantly reduced or eliminated since a holding company would likely leave its high-cost companies or study areas in the pool, while withdrawing its lower cost companies or study areas. This result would likely bring only administrative changes to the current mandatory pooling structure because the LTS flows would approach existing pool flows, and companies would lose many of the advantages of the pooling modifications, such as the flexibility to charge CCL rates closer to costs outside the pool, and increased incentives to reduce costs and improve the efficiency of their operations. Moreover, we observed that a holding company that decides to leave the pool has several means available to it to protect its high-cost affiliates from suffering a severe adverse impact from a decision to leave the common line pool. *See NTS Recovery Reconsideration Order* at paras. 47-58.

[32] We view this option as a means of affording pooling companies with a transition period that will enable them to adjust more easily to the prospect of departing the pool in a merger or acquisition context. We do not consider that companies that take advantage of this option should be allowed at the end of the transition period to seek permission for their affiliates to reenter the pool pursuant to the waiver procedures described above. *See supra* paras. 28-29. We seek comment on this proposed approach.

[33] We note that, under any of the possible approaches described above that would permit acquired companies to retain separate pooling positions under certain circumstances, the LTS and TRS arrangements that applied to the non-pooling company before the transaction would continue to apply until the acquired entity leaves the pool to join its affiliates, at which time the LTS and TRS rules designed to address such departures would apply. *See supra* paras. 22-23.

[34] In accordance with the provisions of Section 605 of that Act, a copy of this certification will be sent to the Chief Counsel for Advocacy of the Small Business Administration at the time of publication of this *Notice of Proposed Rule Making* in the Federal Register. Because of the nature of local exchange and access services, we have concluded that small telephone companies are dominant in their field of operation and therefore are not small entities as defined by the Regulatory Flexibility Act. *See* MTS and WATS Market Structure, 93 FCC 2d 241, 338-89 (1983). Thus, we are not required by the terms of that Act to apply the formal procedures set forth herein. We are nevertheless committed to reducing the regulatory burdens on small telephone companies whenever possible consistent with our public interest responsibilities. Accordingly, we have chosen to utilize, on an informal basis, appropriate procedures to analyze the effect of proposed regulations on small telephone companies. As part of our analysis of the issues discussed in this Notice, we will consider the impact on small telephone companies, *i.e.*, those serving 50,000 or fewer access lines. Our proposed changes would not have an adverse effect on those companies and should benefit such carriers through increased flexibility in common line pooling arrangements in the context of merger and acquisition activity.

[35] *See generally* 47 C.F.R. § 1.1206(a) (1987).

[36] *See* 47 C.F.R. §§ 1.1202(f) & 1.1203.

[37] *See* 47 C.F.R. § 1.1202(b).

[38] *See* 47 C.F.R. § 1.1206.