GAO

United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

B-278820

February 10, 1998

The Honorable Ted Stevens
United States Senate

Dear Senator Stevens:

This letter is in response to your request dated November 28, 1997, asking us to review the Federal Communications Commission's implementation of section 254(h) of the Communications Act of 1934, as amended. 47 U.S.C. § 254(h). Subsection 254(h) provides the authority for the Commission to authorize universal service support benefits for eligible schools and libraries and rural health care providers.

Your request concerns those provisions of the Commission's orders implementing subsection 254(h) that led to the incorporation in Delaware of two not-for-profit corporations. These corporations were formed to administer certain functions of the universal service programs for schools and libraries and rural health care providers. The Chairman of the Commission selects or approves the board of directors for these entities and the operating expenses of the corporations are recovered from industry fees assessed to support universal service. You asked whether the Commission has the legal authority to establish such corporations. In addition, you asked us to describe the federal laws (for example, the Federal Advisory Committee Act), employment rules, and congressional oversight that govern the operation of the corporations.

We sought the views of the Commission about these and other questions, and by letter of January 5, 1998, the Commission provided its legal opinion.

Question 1: Was the Commission authorized to establish the Schools and Libraries Corporation and the Rural Health Care Corporation?

Answer: As explained more fully below, the Commission exceeded its authority when it directed the National Exchange Carriers Association, Inc. (NECA) to create the Schools and Libraries Corporation and the Rural Health Care Corporation. The Government Corporation Control Act specifies that "[a]n agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action." 31 U.S.C. § 9102. These entities act as the agents of the Commission and, therefore, could only be created pursuant to specific statutory authority. Because the Commission has not been provided such

authority, creation of the two corporations violated the Government Corporation Control Act.

Because the Commission has argued that it did not "establish or acquire" the corporations, we provide some background about the establishment of the corporations. More detail is contained in the attached Appendix.

Establishment of the Corporations

Section 254, as added by the Telecommunications Act of 1996[1], among other things, made the Commission's universal service mandate more explicit and extended the reach of universal service support to schools, libraries, and rural health care providers. The section requires the Commission, acting on the recommendations of a Federal-State Joint Board, to define universal service and develop specific, predictable, and equitable support mechanisms. The provision expands both the base of companies that contribute to the universal service fund and the category of customers who benefit from the universal service support programs.

Section 254 is silent on how the Commission is to administer the universal service programs, including the programs for schools and libraries and rural health care providers. In the Universal Service Order released on May 8, 1997, the Commission, consistent with the Joint Board's recommendation, determined that it would create a Federal Advisory Committee to recommend a neutral, third-party permanent administrator of the universal service programs. In the interim, the Commission appointed the National Exchange Carrier Association, Inc. (NECA) the temporary administrator, subject to changes in NECA's governance.[2] NECA was established in 1983, at the direction of the Commission, as an association of local exchange carriers (LECs) to administer the interstate access tariff and revenue distribution process.[3] Prior to that time, AT&T had acted as a tariff filing agent for the entire industry and had also performed most of the administrative functions in connection with the settlements pooling arrangement.[4] Since NECA's creation, the Commission

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[1]Pub. L. 104-104, 110 Stat. 56 (1996).

[2]Federal-State Joint Board on Universal Service, First Report and Order, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1996) (Universal Service Order).

[3]MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase I, FCC 82-579 (rel. February 28, 1983).

[4]With the imminent breakup of AT&T, the Commission believed that AT&T could no longer perform this function in the post-divestiture environment.

has assigned it the responsibilities for administering the existing universal service fund and other explicit support mechanisms.

On July 18, 1997, the Commission released NECA's Governance Order and directed NECA to create an independently functioning not-for-profit subsidiary to be designated the Universal Service Administrative Company (USAC) that would temporarily administer the universal service support program for high-cost areas and low-income consumers, as well as perform billing and collection functions for all of the universal service programs, including the programs for schools and libraries and the rural health care providers.[5]

The Commission also directed NECA to create two unaffiliated, not-for-profit corporations to be designated the Schools and Libraries Corporation and the Rural Health Care Corporation. The Commission concluded that such entities were critical to the successful implementation of the schools and libraries and rural health care programs. Moreover, to ensure continuity in and efficient administration of these programs, the Commission concluded that the corporations should continue to perform their designated functions even after the date on which the permanent administrator is appointed. Thus, the Commission removed these entities from the scope of the functions that will be performed by the temporary and permanent administrator.

NECA was directed to incorporate the corporations under the laws of Delaware and to take such steps as are necessary under Delaware and federal law to make the corporations independent of, and unaffiliated with, NECA and USAC. NECA was further required to submit to the Commission for approval the proposed articles of incorporation, bylaws, and any documents necessary to incorporate the independent corporations in order for the Commission to determine prior to their establishment that the requirements of the Order had been satisfied.

This Order and the subsequent incorporation documents provide that the corporations were organized by the Commission to carry out functions connected with the provision of universal service support to schools, libraries, and rural health care providers. These functions include the administration of the application process for schools and libraries and rural health care providers and the establishment of a website on which applications will be posted. See 47 C.F.R. §§ 69.618(a), 69.619(a).

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[5]Changes to the Board of Directors of the National Exchange Carrier Association, Inc. and Federal-State Joint Board on Universal Service, Report and Order and Second Order on Reconsideration, CC Docket No. 97-21 and No. 96-45, FCC 97-253 (rel. July 18, 1997)(NECA Governance Order).

The certificate of incorporation of the Rural Health Care Corporation specifies that the purpose of the corporation ". . . is defined in the Federal Communications Commission's . . . rules at 47 C.F.R. § 69.618, as it exists today and as it may be amended." The certificate of incorporation further states that the corporation may engage in other activities "so long as it is consistent with FCC Orders and Rules."[6] In its letter to our Office of January 5, the Commission stated that it did not envision these entities "operating outside the scope of the activities set forth in the Commission's orders." Commission letter at 9.

Under Commission rules the boards of directors of these entities are comprised of members either selected or approved by the Chairman of the Commission. The size and composition of the boards is set by the Commission, as is the term of office. The Commission Chairman must approve the removal of any director as well as a resolution to dissolve the Corporation. The Chief Executive Officer (CEO) of these corporations must be approved by the Chairman of the Commission. Authority to enter into contracts must be in compliance with Commission rules. All of these requirements have been included in the corporations' by-laws.

Authority to Establish the Corporations

It is the Commission's view that it has authority to establish the Schools and Libraries Corporation and the Rural Health Care Corporation under sections 4(i) and 254 of the Communications Act of 1934, as amended. Section 4(i) of the Act provides that:

> "The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i).

[6]A similar provision is contained in the Schools and Libraries Certificate of Incorporation. See 47 C.F.R. § 69.619(a).

Although we recognize the breadth of section 4(i),[7] the provision is constrained by the later passage of the Government Corporation Control Act. Under the Control Act:

> "[a]n agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action." 31 U.S.C. § 9102.

Section 4(i) does not provide the specific statutory authority needed by the Commission to meet the requirements of the Control Act. Nor do we find that section 254 provides this authority.[8] Indeed, the Commission does not suggest that either of these provisions is broad enough to overcome the requirement of the Control Act. Rather, in a letter to our office dated January 5, 1998, the Commission contends that the Control Act is not implicated because the Commission did not "establish or acquire" the Schools and Libraries Corporation or the Rural Health Care Corporation in this case. According to the Commission, NECA established these corporations as a condition of becoming the temporary administrator.

We disagree. The Control Act requirement that a Federal agency possess specific authorization to "establish or acquire" a corporation to act as an agency could not be avoided by directing another organization to act as the incorporator. In our view, the Control Act prohibits an agency from creating or causing creation of a

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[7]Courts have characterized this section as analogous to Article 1, Section 8, Clause 18 of the Constitution, which authorizes Congress to make all laws that "shall be necessary and proper" for carrying out its enumerated powers and "all other powers" vested in the federal government. Mobile Communications Corp. of America v. FCC, 77 F.3d 1399, 1404 (D.C. Cir. 1996), cert. denied, 117 S. Ct. 81 (1996); New England Tel. & Tel. v. FCC, 826 F.2d 1101, 1107-08 (D.C. Cir. 1987); North American Telecommunications Ass'n v. FCC, 772 F.2d 1282, 1292 (7th Cir. 1985); see also United States v. Southwestern Cable Co., 392 U.S. 157, 181 (1968).

[8]The Telecommunications Act of 1996 did provide the Commission with specific authority "to create or designate" one or more impartial entities to administer telecommunications numbering and to make such numbers available on an equitable basis. 47 U.S.C. § 251(e)(1). It also established a body corporate to be known as the Telecommunications Development Fund. This fund provides grants to small businesses to enhance competition in the telecommunications industry, among other things. The provision establishing the fund specifies the composition of the board of directors, as well as its meetings and functions. 47 U.S.C. § 614. However, with respect to the provision of universal service, Congress provided no authority to establish such entities.

corporation to carry out government programs without explicit statutory authorization.

Prior to enactment of the Government Corporation Control Act in 1945, there was no requirement for specific authority to create corporations. As the Supreme Court noted in Lebron v. National Railroad Passenger Corporation, "[b]y the end of World War II, Government-created and -controlled corporations had gotten out of hand, in both their number and their lack of accountability." Lebron v. National Railroad Passenger Corporation, 513 U.S. 374, 389 (1995).

Partly in response to this proliferation of corporations, a Joint Committee of Congress conducted a 2-year study and issued a "Report on Government Corporations" in 1944.[9] The report concluded that from simple beginnings the government corporation concept had evolved into a rationale for a maze of quasi-governmental corporations with little accountability. The inevitable results of this growth, noted the report, was the impairment of control by the Congress. Id. at 2. The report went on to find that the corporations had little congressional or executive branch supervision, few fiscal controls, and in many instances were in competition with the private sector. Specifically, the report stated: "There is no effective over-all control. Alone, or in certain groups, these corporations are autonomous."[10] The Committee called for over-all public control to be established.[11]

Legislative control of government corporations actually occurred in two stages during 1945. In February of that year, legislation required the General Accounting Office (GAO) to audit the financial transactions of all government corporations.[12] In December, the more comprehensive Government Corporation Control Act superseded these audit requirements.[13]

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[9]U.S. Congress, Joint Committee on Reduction of Nonessential Federal Expenditures, Report on Government Corporations, Senate Doc. 227, 78th Cong., 2d Sess. (Washington: U.S. Govt. Print. Off., 1944).

[10]Id. at p. 27.

[11]For a complete history of the Control Act, see, Managing the Public's Business: Federal Government Corporations prepared for the Senate Committee on Governmental Affairs by the Congressional Research Service by Ronald C. Moe, S. Prt. 104-18 (April 1995).

[12]Public Law 4, § 5, 59 Stat. 5 (1945).

[13]In 1982, Pub.L. 97-258 codified the 1945 Act's provisions. See 31 U.S.C. §§ 9101-9110.

The Act was intended to make the corporations accountable to the Congress for their operations while allowing them the flexibility and autonomy needed for their commercial activities. Under the Act, the Bureau of the Budget (now Office of Management and Budget) controlled the corporations' budgets, Treasury controlled financial transactions, and GAO performed financial auditing.[14]

The Act also specified that without explicit congressional authorization, no corporation should be acquired or created by "any officer or agency of the Federal Government or by any Government corporation for the purpose of acting as an agency or instrumentality of the United States . . . ." § 304(a), 59 Stat. 602. In addition, the Act required that all corporations then operating under state charters were to be dissolved and reincorporated under federal law. The House Report accompanying the legislation stated:

> "The committee does not consider the practices of chartering wholly owned Government corporations without prior authorization by the Congress or under State charters to be desirable. It believes that all such corporations should be authorized and chartered under Federal statute. The bill provides that in the future all corporations which are to be established for the purpose of acting as agencies or instrumentalities of the United States must be established by act of Congress or pursuant to an act of Congress specifically authorizing such action." H.R. Rep. No. 79-856, at 11 (1945).

The Congress enacted legislation whose applicability was to be encompassing. The requirement for specific legislative foundation for corporations to act as agents of the United States was not to be thwarted by having another party act as the incorporator. In fact, the identity of the incorporator was not the determinant of the statue's applicability; the act expressly prohibits the "acquisition" of corporations to act as instrumentalities of the United States. As the Supreme Court noted in Lebron, the purpose for providing that government corporations could not be established (or acquired) without specific legislation ". . . was evidently intended to restrict the creation of all Government-controlled policy-implementing corporations, and not just some of them." Id. at 396. Thus, if an entity was to be established for the purpose of carrying out government functions under the control of an agency, legislation would be necessary. In other words, an agency on its own could not create or cause to be created a "captive corporation" to carry out government functions and designate such an entity as "private."

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[14]Primary auditing responsibilities were shifted in 1990 (Pub.L. 101-576) from GAO to the individual corporate Inspectors General appointed under the Inspector General Act of 1978.

As discussed above and detailed in the attached Appendix, the Schools and Libraries Corporation and the Rural Health Care Corporation were clearly created to carry out governmental functions in connection with the Commission's responsibilities under section 254. We note that even the corporations, themselves, do not deny that they were established by the Commission. For example, the Rural Health Care Corporation, in its Request for Proposals for Program Administration Services defined itself as:

> ". . . a not-for-profit organization created by the Federal Communications Commission (FCC) to administer funds allocated to rural health care providers to aid in improving the telecommunication infrastructure at rates reasonable and acceptable to urban health care providers." (emphasis added).

NECA simply acted as the incorporator for the convenience of the Commission. There is no nexus between NECA's role as temporary administrator and the creation of these corporations. By the Commission's own rules, these entities were removed from the mandates of both the temporary and permanent administrator. Under the circumstances, we conclude that the Commission violated the Government Corporation Control Act by directing the establishment of the Schools and Libraries Corporation and the Rural Health Care Corporation to act as its agents in carrying out functions assigned by statute to the Commission.

Question 2: What federal laws (for example the Federal Advisory Committee Act), employment rules, and congressional oversight apply to the operation of the corporations?

Answer 2: The Commission's Order required that private corporations be established. As such, they are not subject to statutes that impose obligations on federal entities and federal employees in the areas of employment practices, procurement, lobbying and political activity, ethics, and disclosure of information to the public. On the other hand, each of the corporations is subject to federal statutes applicable to private corporations, unless outside the coverage of the statute. For example, we note that the Federal Advisory Committee Act (FACA) would not apply to these corporations since these entities are primarily operational in nature.[15]

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[15]The Federal Advisory Committee Act (FACA) was enacted to control the establishment of advisory committees to the federal government and to allow the public to monitor their existence, activities and costs. FACA's legislative history, relevant court cases, and General Services Administration regulations suggest that coverage is limited to those committees that provide advice and are not operational in nature. See, H.R. Rep. No. 92-1017, at 4 (1972); S. Rep. No. 92-1098, at 8 (1972); (continued...)

Finally, as established by the Commission, Congress has no direct oversight over the corporations. The corporations do not provide budget information directly to Congress, but rather are accountable to the Commission, which in turn, is accountable to the Congress.[16]

We trust this is responsive to your inquiry.

Sincerely yours,

Robert P. Murphy
General Counsel

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[15](...continued)
Judicial Watch, Inc. v. Clinton, 76 F.3d 1232 (D.C. Cir. 1996); and 41 C.F.R. § 101-6.10004(g).

[16]A Memorandum of Understanding between the Department of Treasury, the Commission, and NECA, dated April 1997, provides the concepts and guidelines for reporting cash transactions and accrual-based balances of the Universal Service Fund to meet the fiscal needs of the U.S. Treasury. The Congressional Budget Office and the Office of Management and Budget have interpreted the language of the Telecommunications Act of 1996 to mean that payments into the Universal Service Fund should be counted as federal revenues and payments from the fund as federal outlays. This is because the transfers of income between various classes of telephone users would not occur but for the exercise of the sovereign power of the federal government. Furthermore, portions of the Universal Service Fund, most notably its Lifeline and Linkup Programs, have already been included in the federal budget. "Federal Subsidies of Advanced Telecommunications for Schools, Libraries, and Health Care Providers" prepared by the Congressional Budget Office (January 1998).

APPENDIX

Universal Service

Historically, universal service has meant access to basic telephone service, sometimes called "plain old telephone service" or "POTS." As evidence of the importance of providing universal service, the Commission points to section 1 of the Communications Act of 1934, which provides that the purpose of the Act is to:

> ". . . make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities and reasonable charges. . .." 47 U.S.C. § 151.

Universal service has been achieved through a combination of implicit and explicit subsidies at the federal and state levels. Implicit subsidies are provided through elevated interstate and intrastate access charges, elevated prices for business services, average rates over broad geographic areas, and elevated prices for advanced services, such as Caller ID and call forwarding.[1] In addition to implicit subsidies, the Commission and some states also provide explicit support mechanisms directed at increasing network subscribership by reducing rates in high-cost areas and at making basic telephone services available for low-cost consumers.[2]

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[1]FCC has defined "implicit subsidies" to mean that a single company is expected to obtain revenues from sources at levels above "costs" (i.e., above competitive prices levels), and to price other services allegedly below costs. Such intra-company subsidies are typically regulated by states. On the federal level, the primary implicit subsidies are the geographic averaging of interstate long distance rates and interstate access charges. In section 254(g) of the Communications Act, as added by the Telecommunications Act of 1996, 47 U.S.C. § 254(g), Congress expressly directed that the geographic averaging of interstate long distance rates continue. See Federal-State Joint Board on Universal Service, First Report and Order, CC Docket No. 96-45, FCC 97-157 (rel. May 8, 1996) (Universal Service Order).

[2]"Telephone Subscribership in the United States," a 1998 report by the FCC's Common Carrier Bureau that was based on Census Bureau figures for November 1997 found that almost 94% of households have telephone services. However, the rates vary based on income, age, household size, race, geographic location, and other factors. See also Common Carrier Bureau, FCC, Preparation for Addressing Universal Service Issues: A Review of Current Interstate Support Mechanisms (Feb. 23, 1996).

Section 254, as added by the Telecommunications Act of 1996[3], for the first time provided explicit statutory support for the Commission's responsibility to assure universal service. Universal service is defined as:

> ". . . an evolving level of telecommunications services that the Commission shall establish periodically . . . , taking into account advances in telecommunications and information technologies and services." 47 U.S.C. § 254(c)(1).

The Joint Board in recommending and the Commission in defining the services that are to be supported by universal support mechanisms are to consider the extent to which such telecommunications services (a) are essential to education, public health, or public safety; (b) have, through the operation of market choices, been subscribed to by a substantial majority of residential customers; (c) are being deployed in public telecommunications networks by telecommunications carriers; and (d) are consistent with the public interest, convenience, and necessity. 47 U.S.C. § 254(c)(1). Under the Universal Service Order, the Commission defined the "core" or "designated" services that will be supported by universal service support mechanisms as: single-party service; voice grade access to the public switched network; Dual Tone Multifrequency signaling or its functional equivalent; access to emergency services; access to operator services; access to interexchange service; access to directory assistance; and toll limitation for qualifying low-income consumers.

In addition to the services included in the general definition, section 254 authorizes the Commission to designate additional services for schools, libraries, and health care providers for the purposes of subsection 254(h). Subsection 254(h) has two main parts. Subsection 254(h)(1) provides that any public or nonprofit health care provider that serves rural areas is entitled to receive upon a bona fide request "telecommunications services which are necessary for the provision of health care services" at rates comparable to those charged in urban areas of the same state. 47 U.S.C. § 254(h)(1)(A). Schools and libraries, on the other hand, are entitled to receive upon a bona fide request services "at rates less than the amounts charged for similar services to other parties." 47 U.S.C. § 254(h)(1)(B).

Subsection 254(h)(2) directs the Commission to establish competitively neutral rules to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms, health care providers, and libraries. In addition, the rules are to define the circumstances under which a telecommunications carrier may be required to connect its network to qualified

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[3]Pub. L. 104-104, 110 Stat. 56 (1996).

elementary and secondary schools, libraries, and health care providers. 47 U.S.C. § 254(h)(2).

The legislative history of the provision sheds some light on the intended scope of the programs. The Conference Report provides that:

> "For example, the Commission could determine that telecommunications and information services that constitute universal service for classrooms and libraries shall include dedicated data links and the ability to obtain access to educational materials, research information, statistics, information on Government services, reports developed by Federal, State, and local governments, and information services which can be carried over the Internet." S. Rep. No. 104-230, at 133 (1996); H.R. Rep. No. 104-458, at 133 (1996).

On May 8, 1997, the Commission released its Universal Service Order that, among other things, outlined a plan to implement subsection 254(h). With respect to schools and libraries, the plan provided discounts ranging from 20 to 90 percent on all commercially available telecommunications services, Internet access, and internal connections. The level of discounts would be based on a school's or library's level of economic disadvantage and its location in an urban or rural area. The Commission concluded that there should be established an annual cap of $2.25 billion on universal service expenditures for eligible schools and libraries.

With respect to public or nonprofit rural health care providers, the Commission's Order provided that these entities would be eligible to receive universal service support not to exceed an annual cap of $400 million. A health care provider may obtain telecommunications services at rates comparable to those paid for similar services in the nearest urban area with more than 50,000 residents, within the state in which the rural health provider is located. Rural health care providers will receive support for both distance-based charges and a toll-free connection to an Internet service provider. Each health care provider that lacks toll-free access to an Internet service provider may also receive the lesser of 30 hours of Internet access at local calling rates per month or $180 per month in toll charge credits for toll charges imposed for connecting to the Internet.

Administration

Section 254 is silent on how the Commission is to administer the universal service programs, including the programs noted above for schools and libraries and for rural health care providers. In its March 1996 Notice of Proposed Rulemaking and Order Establishing the Federal-State Joint Board on Universal Service, the Commission sought comment on the best approach to administer the universal service mechanisms fairly. The Commission noted that the fund could be

administered by a non-governmental entity or the funds could be collected and disbursed through state public utility commissions.[4]

Consistent with the Joint Boards' recommendations that were released in November 1996,[5] and the record in the proceeding, the Commission decided to create a Federal Advisory Committee (Committee), pursuant to the Federal Advisory Committee Act (FACA), 5 U.S.C. App. 2, § § 4(a) and 3(2)(c), whose sole responsibility would be to recommend to the Commission through a competitive process a neutral, third-party administrator to administer the universal service program. The Commission also noted that because the needs of educational institutions are complex and substantially different from the needs of other entities eligible for universal support, it would require the administrator, after receiving recommendations submitted by the Department of Education, to select a subcontractor to manage exclusively the application process for eligible schools and libraries. Additionally, the Commission adopted the Joint Board's recommendation that the National Exchange Carrier Association, Inc. (NECA), be appointed the temporary administrator, subject to changes in NECA's governance that would make it more representative of the telecommunications industry as a whole.

NECA was established in 1983, at the direction of the Commission, as an association of local exchange carriers (LECs) to administer the interstate access tariff and revenue distribution process.[6] Prior to that time, AT&T had acted as a tariff filing agent for the entire industry and had also performed most of the administrative functions in connection with the settlements pooling arrangement.[7] Since NECA's creation, the Commission has assigned it the responsibilities for administering the existing high-cost and low income support mechanisms.

The Joint Board noted that NECA's current membership of incumbent local exchange carriers, its board of directors composed primarily of representatives of incumbent local exchange carriers, and its advocacy positions in several

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[4]Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing a Joint Board, CC Docket No. 96-45, FCC 96-93 (rel. Mar. 8, 1996) (Universal Service NPRM).

[5]Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45, FCC 96J-3 (rel. Nov. 8, 1996) (Recommended Decision).

[6]MTS and WATS Market Structure, Third Report and Order, CC Docket No. 78-72, Phase I, FCC 82-579 (rel. February 28, 1983).

[7]However, with the imminent breakup of AT&T, the Commission believed that AT&T could no longer perform this function in the post-divestiture environment.

Commission proceedings may appear to non-LEC carriers as evidence of NECA's bias toward ILECs. Accordingly, the Board recommended that prior to appointing NECA the temporary administrator, the Commission should permit NECA to add significant, meaningful representation for non-incumbent LEC carrier interests to the NECA's Board of Directors. The Joint Board also recommended that NECA be eligible to compete in the process for selecting a permanent administrator if changes to NECA's membership and governance rendered NECA a neutral, third party.

The Commission conducted a separate proceeding to deal with the issue of NECA's governance. By a letter dated October 18, 1996, NECA requested that the Commission modify the size and composition of NECA's Board of Director by adding six directors from groups that would have a substantial stake in the new universal service programs.[8] On January 10, 1997, the Commission issued a Notice of Proposed Rulemaking and Notice of Inquiry addressing NECA's proposal and the Joint Board's recommendation that NECA be allowed to alter its governance structure. The NPRM tentatively concluded that in order for NECA to be eligible to serve as temporary administrator, NECA's Board must become more representative of the telecommunication industry as a whole.[9]

Also, on January 10, 1997, NECA requested that the Commission consider a revised proposal based on NECA's finding that it might not be possible to develop a satisfactory governance proposal within the context of a single administrative organization. Under NECA's January proposal, NECA recommended establishing a separate subsidiary to administer the universal support programs. As envisioned by NECA, this wholly owned subsidiary, designated as the Universal Service Administrative Company, would have a representative board of directors based on the Commission's recommendation and would include some representation from the current NECA Board.[10]

In June, subsequent to the Commission's Universal Service Order, NECA filed a discussion paper with the Commission that highlighted the advantages of single over

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[8]Letter from Bruce Baldwin, NECA, to Reed Hundt, Chairman, FCC, October 18, 1996.

[9]Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Notice of Proposed Rulemaking and Notice of Inquiry, CC Docket No. 97-21, FCC 97-2 (rel. Jan. 10, 1997), errata, mimeo 71784, CC Docket No. 97-21 (rel. Jan. 15, 1997) (NECA NPRM and NOI).

[10]Letter from Bruce Baldwin, NECA, to Reed Hundt, Chairman, FCC, January 10, 1997.

multiple subsidiary approach. NECA proposed the creation of board committees that would have specific program responsibilities, including a committee for the high cost and low income program, a committee for the schools and libraries program, and a committee for the rural health care program. As proposed by NECA, these committees would have final decision-making authority with respect to defined aspects of program administration.[11]

On July 18, 1997, the Commission released its NECA's Governance Order that created a three-company structure for administration of new universal service programs. Under this Order, the Commission directed NECA to create an independently functioning not-for-profit subsidiary to be designated the Universal Service Administrative Company (USAC) that would temporarily administer the universal service support program for high-cost areas and low-income consumers, as well as perform billing and collection functions for all of the universal service programs, including the programs for schools and libraries and the rural health care providers.[12] The Commission also reconsidered, on its own motion, its decision in the Universal Service Order that a subcontractor manage the application process for schools and libraries.[13] Instead, the Commission directed NECA to create two unaffiliated, not-for-profit corporations to be designated the Schools and Libraries Corporation and Rural Health Care Corporation to administer portions of the schools and libraries and rural health care universal service programs (collectively referred to as the corporations).[14] The Commission also reconsidered the scope of

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[11]Letter from Robert Haga to William F. Caton, Acting Secretary, FCC, June 23, 1997, recording an ex parte meeting between NECA personnel and Commissioner Quello and Commission staff.

[12]The Commission agreed that expanding NECA's board would not assure neutrality. The Commission noted the concern expressed by commenters that NECA may be precluded from confining authority of newly added non-ILEC directors to matters relating solely to the administration of universal service support programs. Alternatively, if non-ILEC directors were allowed to participate in ILEC matters, there might be an issue of the duty owed by non-ILEC and non-carrier directors to NECA's membership on LEC issues unrelated to universal service.

[13]The Commission stated that the creation of private corporations ". . . will provide for greater accountability and more efficient administration of the schools and libraries and rural health care programs than would the approach adopted earlier because a subcontractor, unlike the Corporations, would not be directly accountable to the Commission." (emphasis added).

[14]The Commission stated that it was unpersuaded by NECA's argument that a single

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functions that will be performed by the temporary administrator and the permanent administrator, by concluding that the corporations should continue to perform their designated functions even after the date on which the permanent administrator is appointed.[15]

The Commission argued that the creation of the two non-profit corporations was critical to the successful implementation of the schools and libraries and rural health care support mechanisms. This was because the programs were new and involved potentially large number of participants and beneficiaries and could require special expertise.

Establishment of the Corporations

Under the NECA Governance Order, the Commission outlined the functions of the corporations and designated the size and composition of their respective boards. The Commission directed that the Board of Directors of the Schools and Libraries Corporation will consist of seven members, including three schools representatives, one libraries representative, one service provider representative, one independent director, and the CEO of the corporation. Similarly, the Commission directed that the Board of Directors of the Rural Health Care Corporation will consist of five members, including two rural health care representatives, one service provider representative, one independent director, and a CEO.

The Chairman of the Commission selects or approves all of the members of the board of directors for the universal service corporations. The Chairman of the Commission will select the independent board member for the Schools and Libraries Corporation. In addition, under the Commission's Order, the three directors on the USAC Board of Directors representing schools and the one director representing libraries will be appointed to the Schools and Libraries Board of Directors. The USAC Board will also select the service provider from its board of directors to serve on the Schools and Libraries Board of Directors. The six board members of the Schools and Libraries Corporation will submit a CEO candidate to the Chairman for approval. The CEO will also sit on the board of directors.

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[14](...continued)
structure would be more efficient, avoid duplication of functions, or produce greater cost savings.

[15]Changes to the Board of Directors of the National Exchange Carrier Association, Inc., and Federal-State Joint Board on Universal Service, Report and Order and Second Order on Reconsideration, CC Docket No. 97-21 and No. 96-45, FCC 97-253 (rel. July 18, 1997)(NECA Governance Order).

A similar process was mandated for the selection of the board of directors of the Rural Health Care Corporation. The Chairman of the Commission will select, based on nominations, one of the two board member to represent rural health care providers. Additionally, the Chairman of the Commission will select an independent board member. The USAC Board of Directors is to select from its members the other director representing rural health care providers and a service provider. These four board member will submit a CEO candidate to the Chairman of the Commission for approval. The chosen CEO will serve on the board of directors.

Not only does the Commission direct the USAC Board to appoint certain of its board members to serve on the independent corporations' boards of directors but these USAC Board members are, in the first instance, also selected by the Chairman of the Commission. Under the NECA Governance Order, the Commission directed that USAC's Board will be comprised of: three directors representing ILECs; two directors representing long distance carriers (IXCs), one director representing commercial mobile radio service providers, which includes cellular, Personal Communications Services, paging, and Specialized Mobile Radio companies; one director representing Competitive Local Exchange Carriers; one director representing cable operators; one director representing information service providers; three directors representing eligible schools; one director representing eligible libraries; one director representing eligible rural health care providers; one director representing low-income consumers; one director representing state telecommunications regulators; and one director representing state consumer advocates.

Members of the industry or non-industry groups that will be represented on the USAC Board submit nominees selected by consensus to the Chairman of the Commission. The Chairman will review the nominations and select the members of the USAC Board. If a group fails to reach consensus and submits more than one nominee, the Chairman will select the individual to represent the group. Similarly, if no nomination is submitted, the Chairman will select the individual from the appropriate industry or non-industry group.