Federal Communications Commission
Washington, D.C. 20554

December 1, 2008

Mr. Brian Talbott
Chairman of the Board
Board of Directors
Universal Service Administrative Company
2000 L St. NW, Suite 200
Washington, DC 20036

Dear Mr. Talbott:

With this letter, we follow up on our earlier request to have the Universal Service Administrative Company ("USAC") strengthen its internal control structure and improve the efficiency and effectiveness of its operations as the Universal Service Fund ("USF") Administrator. As explained below, we approve USAC's proposal subject to certain modifications and clarifications. USAC should implement this performance-based executive compensation program no later than January 1, 2009.

In our letter of July 9, 2008, we directed the USAC Board of Directors to establish a new committee charged with administering the compensation programs for USAC's executives and corporate officers. We also required USAC's Board of Directors to develop a plan to ensure executive compensation is based on performance. We received a draft version of the plan and we approve the plan USAC proposed, in part, based on the expectations described below and with certain modifications to the performance measurements as discussed below. USAC submitted a proposal and certain additional information describing USAC's existing performance evaluation and executive compensation practices.

As an initial matter, we clarify that nothing about our direction to establish a performance-based compensation plan waives, amends, or otherwise changes the Commission's existing rules addressing USAC's executive compensation. In the proposal USAC submitted, USAC's outside consultant suggested that the existing rules provide a "compensation cap" on USAC's executives and that allowing USAC executives to receive compensation beyond the level provided to the executives of the United States Government would be desirable and would help improve performance. We emphasize that USAC should not seek to establish an executive compensation program that would allow its employees to exceed the annual rate of pay provided for in the Commission's existing rules. At this time, USAC's executive compensation is capped at $191,000.[1] Nothing about this letter or our previous letter should be interpreted to allow or support changing the Commission's rules to permit compensating USAC employees in excess of the existing cap.

[1] "All officers and employees of the Administrator may be compensated at an annual rate of pay, including non-regular payments, bonuses, or other compensation, in an amount not to exceed the rate of basic pay in effect for Level I of the Executive Schedule under 5 U.S.C. 5312." *See* 47 C.F.R. § 54.715 (b).

In its October 30, 2008 submission, USAC proposed using four overarching performance measures upon which to base its executive compensation. These are based on our July 9, 2008 letter and include maintaining improper payment rates attributable to USAC or USAC contractor error rates at one percent or less, operating within the established budget with the exception for expenditures required as a result of Commission directives, receiving a clean financial audit opinion with no material findings and no major internal control deficiencies, and processing requests for administrator action within prescribed time period. USAC submitted sample performance evaluation "scorecards" for eleven executives to illustrate how these big picture performance measurements would translate into an evaluation and compensation for these positions. We approve USAC's proposal with the following clarifications and modifications.

First, we clarify that the requirement to link executive compensation to performance applies to "merit increases" and performance evaluations for USAC's executives. In supplemental material that USAC submitted, USAC explained that it provides "merit-based" salary increases. USAC further explained that it provides "lump sum merit payments" to certain employees and that, in 2008, USAC used lump sum merit payments nineteen times covering 11% of its employees. We clarify that, for the purpose of this and the July 9, 2008 letter, we use the term "bonus" broadly to include merit increases, lump sum merit payments, awards, deferred compensation, or any similar benefit provided to USAC executives. Thus, starting in 2009, USAC should evaluate, rate, and compensate its executives using the criteria specified in our letters and the compensation plan.

Second, USAC should incorporate feedback from the Board of Directors into the performance evaluations and compensation of USAC's executives. USAC's executives report to the USAC Board of Directors, which is ultimately responsible for ensuring USAC performs its mission as specified by the Commission in its rules, order, and directives. Thus, the opinion of the USAC Board of Directors concerning executive performance should be one component of USAC's executive evaluation and compensation system. In providing its feedback on the performance of USAC executives, the USAC Board of Directors should consider whether the executive has been fully responsive to the requests and concerns of the Commission.

Third, USAC should ensure that major internal control deficiencies, including any material weaknesses or significant deficiencies identified by the Commission's financial statements auditors, are considered in evaluating, rating, and compensating its executives. USAC should also consider audit results for audits in addition to its financial statements audit or the Commission's financial statements audit. For example, the audit required by the Commission's Part 54 rules should also form a component of USAC's executive compensation.

Fourth, USAC's executive evaluation and compensation system should more expressly consider and address USAC's resolution of audit recommendations and findings. USAC should promptly work toward resolving any audit findings and to implement corrective action. Any failure to implement corrective action in a timely manner should result in a decrease in the executive/officer bonus or merit increase.

Fifth, USAC's executive compensation system should be more aggressive at establishing an incentive-based system for deterring improper payments. USAC proposes including a measure for the rate of improper payments attributable to USAC or USAC's contractor errors. We agree that one measure should be a low rate of improper payments, but this should not be limited to USAC or USAC's contractor errors. The goal should be "Maintain low Improper Payment rates" and should include all improper payments to universal service fund beneficiaries.

Sixth, USAC should be more aggressive at promoting high quality customer service to program stakeholders and the Commission. Instead of a requirement to only respond to a program stakeholder, USAC should focus on resolving the stakeholder's issue. Thus, USAC should consider the executive's success at ensuring 90 percent of complaints are resolved within five business days. In addition, USAC should adopt a goal for its executives to reduce or otherwise limit the number of "repeat complaints," *i.e.*, complaints by the same customer concerning the same issue or problem. Because high repeat complaint rates indicate a failure to resolve a customer's complaint in a timely manner, USAC's executives should be evaluated and compensated in part on their success at maintaining low repeat complaint rates. Similarly, failing to respond to requests from Commission management in a timely manner could have negative repercussions for Commission plans and activities. As a result, USAC's executive compensation systems should consider failures to respond promptly to Commission requests in evaluating and compensating executives.

Seventh, USAC should consider compliance with the Commission's rules and with the Memorandum of Understanding (MOU) in evaluating and compensating its executives. Any failure to comply with the Commission's rules or the requirements of the MOU should be considered as one component of an executive's evaluation and compensation.

Eighth, USAC's Chief Executive Officer (CEO) and Chief Operating Officer (COO) are the most senior USAC management executives charged with ensuring USAC operates in accordance with the Commission's rules, requirements, and expectations. They are the top leaders within USAC's management and are responsible and accountable for the organization's performance. As such, the evaluation and compensation plans for USAC's CEO and COO should incorporate performance measures contained in the performance plans of their subordinates.

Finally, we recognize and appreciate that USAC's Board of Directors implemented the Commission's July 9, 2008 instruction on an accelerated schedule and that, with additional time and consideration, may have included additional or modified performance goals for USAC's executives. As a result, we understand that USAC's executive compensation plan will require fine-tuning going forward. For example, the performance goal "operate within established operation budget" may not be the ideal goal for promoting an improved internal control structure, preventing improper payments, and providing high quality customer service. Likewise, developing site visits and education programs, reducing the time to fill vacancies, reducing turnover, implementing IT systems upgrades, completing the on-line Form 497, and other similar goals listed may be more appropriate for an annual job performance appraisal under

USAC's procedures than as key components included in the performance goals for executives and officers that are used to form the basis for compensation, bonuses, merit increases, lump sum merit payments, awards, or similar benefits. Thus, USAC's Board of Directors should continue its work in this area and submit for our review and approval, no later than September 1, 2009, a revised plan for evaluating and compensating USAC's executives in 2010.

USAC should incorporate these modifications and clarifications to its executive compensation plan and submit a revised draft to the Commission within 30 days of the date of this letter. Absent any serious Commission concerns that warrant correction or consideration, we expect that USAC will implement the modified executive compensation plan no later than January 1, 2009. We expect that the Commission's Office of Inspector General will, in the course of its oversight in 2009, evaluate USAC's implementation of these directions to ensure compliance and to ensure the plan works in an efficient, effective manner.

Again, we appreciate the work of the Board of Directors on implementing a performance-based evaluation and compensation program for USAC's executives. If you have any questions about the issues raised in this letter, please do not hesitate to contact me. You may also contact Mr. Joseph Hall at (202) 418-1919.

Sincerely,

Anthony J. Dale
Managing Director

cc: USAC Board
Kent Nilsson, Inspector General
Dana R. Shaffer, Chief Wireline Competition Bureau