non-pooling LECs file are based on company-specific costs and documentation, are available for review by the Commission, and may be challenged by interexchange carriers.[128] JSI, ICORE, and USTA argue that an independent audit requirement for non-pooling LECs would penalize small companies and would be inconsistent with the Commission's policy of reducing regulatory burdens.[129] Anchorage and JSI maintain that hiring an independent auditor to conduct the study would be expensive and might force small companies to remain in the pools.[130]

69. Ameritech recommends that, instead of requiring the non-pooling LECs to submit reports prepared by independent auditors, the Commission require small LECs to submit information similar to that which the Automated Report Management Information Systems ("ARMIS") requires.[131] NTCA opposes such a requirement. NTCA contends that it would be extremely burdensome for small LECs to compile ARMIS data and that the Commission has already correctly concluded that it should not require small LECs to file such data.[132]

3. Discussion

70. We impose no further obligations at this time on carriers that file their own tariffs. A requirement to obtain independent audits would have the greatest effect on smaller LECs. To meet that requirement, they would have to hire accounting firms at a substantial expense when compared to the interstate revenues they receive. To recover that expense, the smaller LECs would have to raise their rates substantially. Pool participants bear no similar cost burden, although they are subject to the NECA cost study review process. Instead, NECA recovers the costs of that process through its CL rates. Those costs have only a marginal impact on those rates.

71. We also do not require data submissions from smaller LECs similar to those larger LECs make for ARMIS. We decline to require such submissions at this time, again because of the expense this would impose on small LECs.

IV. INCENTIVE COMPENSATION

---

[128] Ameritech Comments at 5; Anchorage Comments at 1; Bell Atlantic Comments at 5; ICORE Comments at 13; JSI Comments at 7-8; USTA Comments at 6-7; VTA Comments at 3.

[129] JSI Comments at 8; ICORE Comments at 13-14; USTA Comments at 6.

[130] Anchorage Comments at 1; JSI Comments at 8.

[131] Ameritech Comments at 6.

[132] NTCA Reply Comments at 5.

A. Background

72. The incentive compensation plan NECA introduced in 1987 granted annual bonuses to certain NECA officers and employees for achieving performance objectives, including earning--and exceeding--NECA's authorized rates of return for the CL and traffic sensitive pools. Although NECA revised this plan in 1991, on average seven percent of NECA's executive compensation continued to depend on CL and traffic sensitive pool earnings. The independent auditor recommended that NECA reduce this type of compensation to avoid potential conflicts of interest for NECA officers and employees and, instead, create performance incentives for achieving compliance with the Commission rules.[133]

73. In the Notice, we observed that NECA's incentive compensation plan may reward rule violations, because it may offer inducements to make reported data conform with forecast data, regardless of the forecast's accuracy. We stated that incentive compensation plans having this effect are unacceptable. The precise details of NECA's plan remained unknown when we adopted our Notice, however. We, therefore, proposed to require NECA to submit the plan for our review. We also proposed, pending that review, to prohibit any incentive payments based on the rates of return earned by the CL and traffic sensitive pools. Finally, we invited comment on how NECA might assess the effectiveness of its incentive compensation plan in securing LEC compliance with our rules.[134]

B. Comments

74. GCI and ICORE believe NECA should submit its incentive compensation plan for Commission review.[135] GCI argues that the plan should not conflict with NECA's obligations and that interested persons should be allowed to comment on it.[136] ICORE maintains that incentives based on achieved pool returns could reward manipulation and may be inappropriate, but that it would be proper to reward increased productivity or substantial reductions in NECA's operating budget.[137]

75. Other commenters contend that Commission review of NECA's incentive

---

[133] Safeguards Report, supra at 10-11, 32.

[134] Notice, 8 FCC Rcd at 1509, paras. 40-41.

[135] GCI Comments at 5; ICORE Comments at 12.

[136] GCI Comments at 5.

[137] ICORE Comments at 12.

compensation plan would be intrusive.[138] After completion of the comment period, NECA filed its current incentive compensation plan with the Commission and placed that plan on the public record.[139] NECA states that this plan differs substantially from the plan the independent auditor reviewed and contains no improper incentives. NECA also states that the plan no longer rewards NECA officers or employees when the CL and traffic sensitive pools exceed the authorized interstate rate of return and that the incentives for achieving that rate of return are no greater than those for other performance objectives.[140]

76. The overall plan is now comprised of a short-term plan in which all NECA officers and employees participate and a long-term plan in which only NECA's president and four vice presidents participate. The compensation committee of NECA's Board administers both of these plans. The short-term plan rewards annual performance in relation to five goals: providing service to member companies; filing accurate tariffs and having high earnings; acting as a resource to members; achieving operational efficiency; and improving program quality. This plan specifies criteria for measuring NECA's performance in relation to these goals.[141] The plan also permits discretionary awards of up to 25 percent of the total potential incentive award, but specifies no criteria for such awards.[142]

77. NECA's compensation committee computes annual bonuses under the short-term plan by grading NECA's overall performance in relation to the specified criteria and adding any "discretionary" points the committee deems proper. This produces a single NECA-wide score. Each individual's bonus equals the product of this score and the individual's "incentive standard," which is a percentage of that individual's annual salary. According to NECA, the short-term plan is targeted to produce average annual bonuses ranging from 2.5 percent of annual salary for the lowest paid employees and 40 percent for NECA's president. The maximum short-term bonuses under this plan range are 50 percent higher than this average.[143]

---

[138] Bell Atlantic Comments at 5; SWBT Comments at 9; NTCA Reply Comments at 5-6; VTA Comments at 2; NECA Comments at 32.

[139] Letter from Robert E. Lloyd, NECA, to Bill Caton, Acting Secretary, FCC, CC Docket No. 93-6 (Sept. 21, 1994) (September Ex Parte Letter).

[140] NECA Comments at 28-32; NECA Reply at 18-21.

[141] For instance, one criterion under providing service to member companies is "[o]verall member satisfaction with NECA as measured by survey." September Ex Parte Letter, Attachment 3 (NECA 1994 Corporate Weights) at 2.

[142] Id., Attachments 2 (NECA's 1994 Compensation Plan) & 3 (NECA 1994 Corporate Weights).

[143] Id., Attachments 2 & 3.

78. The long-term plan rewards NECA's president and vice presidents for achieving qualitative and quantitative goals during three-year performance cycles. These goals include maintaining and enhancing the pooling and revenue distribution process, providing value-added services to NECA's members, and increasing corporate efficiency. The plan specifies criteria for measuring performance in relation to these goals. This plan also has a discretionary component equal to 20 percent of the potential long-term bonuses. The only criterion specified in the plan for discretionary awards is a statement that they are to be awarded for "[o]ther significant long term accomplishments."[144]

79. At the end of each three-year cycle, the compensation committee computes bonuses for the five executives under this plan using a system similar to that under the short-term plan. These bonuses are paid during the three years following the end of each cycle. The annual bonuses under this plan can range from 6.25 percent of annual salary for NECA's vice presidents to 12.25 percent of annual salary for its president.[145]

C. Discussion

80. The Bureau audit that gave rise to this rulemaking disclosed an apparent attempt to influence improperly the CL pool earnings for 1988. One effect of this apparent misconduct may have been that the bonuses paid under NECA's then current incentive compensation plan were larger than they otherwise would have been. Although NECA's current plan differs considerably from that prior plan, we remain concerned that the plan may contain improper incentives that could encourage or reward rule violations. To give each NECA officer and employee every incentive to prevent rule violations, we order NECA to show cause why it should not be required to amend that plan to eliminate any improper incentives.

81. In the Notice, we highlighted pool earnings as a possible improper incentive.[146] NECA defends its continued reliance on those earnings to determine incentive compensation on two grounds. First, NECA argues that since the Bureau audit, it has reduced the percentage of incentive compensation dependent on pool earnings from 50 percent to 25 percent.[147] However, of the incentive compensation payable under NECA's short-term plan, 25 percent is based on pool earnings and 25 percent is discretionary.[148] In addition, of the incentive compensation available under the long-term plan, 40 percent

---

[144] Id., Attachment 4 (Long Term Incentive Plan, Performance Goals and Measures, 1992-1994 Performance Cycle) at 3.

[145] Id. at 1-4.

[146] Notice, 8 FCC Rcd at 1509, paras. 40-41.

[147] Id., Attachment 1 (Summary NECA Annual Incentive Plan - 1994).

[148] Id., Attachment 2 at 3, 5.

is payable based on criteria that include pool earnings and 20 percent is discretionary.[149] In these circumstances, we cannot conclude that less than 50 percent of incentive compensation available under NECA's overall plan is dependent on pool earnings.[150]

82. NECA also argues that its new plan emphasizes factors such as the consistency of NECA's tariff filings with Commission rules and the accuracy of usage projections included in those filings.[151] While we agree that rule compliance and accuracy in usage projections are proper performance objectives, we are not convinced that the other factors NECA has added to the plan eliminate all incentives to manipulate pool earnings. For instance, the plan rewards accuracy in the revenue requirement projections included in NECA's tariff filings. Many of the NECA officers and employees who are responsible for developing these projections also control NECA's processes for recording the individual carrier operating results that determine whether the projections will be deemed accurate. Those recorded results, in turn, are a function of two factors: the pool participants' actual operations; and the cost studies NECA uses to translate the costs of those operations into CL and traffic sensitive revenue requirements. Although NECA has no control over the pool participants' actual operations, NECA officers and employees have extensive control over the cost study process.[152]

83. We reject the argument that Commission review of NECA's incentive compensation plan would improperly intrude into an area of management discretion. The apparent misconduct that led to this rulemaking appears to have arisen from NECA's attempt to conform reported data with forecast data, irrespective of a forecast's accuracy. As we found in the Notice, incentive compensation plans that motivate officers or employees to engage in such attempts are unacceptable.[153] We believe, however, that further review is necessary to evaluate NECA's incentive compensation plan to ensure that it provides no improper incentives. To facilitate this review, we order NECA to show cause why it should not be required to amend that plan to eliminate any incentive based upon common line or traffic sensitive pool earnings or that might otherwise induce NECA officers or employees to violate Commission requirements. NECA's response shall show in detail why each individual component of its incentive compensation plan will not induce any NECA officer or employee to violate Commission requirements. Pending further

---

[149] Id., Attachment 4 at 2-3.

[150] The short-term plan specifies no criteria for discretionary incentive compensation awards. Id., Attachment 2 at 5. The sole criteria stated in the long-term plan for discretionary awards is "[o]ther significant long-term accomplishments." Id., Attachment 4 at 4.

[151] Id., Attachment 1. We calculate NECA's CL and traffic sensitive rates by dividing the total CL and traffic sensitive revenue requirements by projected usage.

[152] See supra, Part III(E).

[153] Notice, 8 FCC Rcd at 1509, para. 40.

Commission order, NECA shall not make any incentive payments based on the rates of return earned by those pools.[154]

V. ORDERING CLAUSES

84. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-05, 218-20, and 403, that Part 69 of the Commission's rules, 47 C.F.R. Part 69, IS AMENDED, as specified in Attachment B.

85. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-05, 218-20, and 403, that NECA SHALL FILE an annual report as specified in paragraphs 68 and 69 of this Report and Order.

86. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-05, 218-20, and 403, that NECA SHALL SHOW CAUSE why it should not be required to amend its incentive compensation plan to eliminate any incentive based upon common line or traffic sensitive pool earnings or that might otherwise induce NECA officers or employees to violate Commission requirements.

87. IT IS FURTHER ORDERED, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-05, 218-20, and 403, that, pending further Commission order, NECA SHALL NOT MAKE any incentive payments based on the rates of return earned by the common line or traffic sensitive pools.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

[154] We take no position at this time regarding the reasonableness of NECA's incentive compensation plan and overall compensation packages.

APPENDIX A--COMMENT AND REPLY LIST

Comments:

1. Alltel Telephone Operating Companies (ALLTEL)
2. Anchorage Telephone Utility (Anchorage)
3. Ameritech Operating Companies (Ameritech)
4. American Telephone and Telegraph Company (AT&T)
5. Bell Atlantic Telephone Companies (Bell Atlantic)
6. Cathy, Hutton, & Associates, Inc., (CHA)
7. General Communication, Inc. (GCI)
8. ICORE, Inc. (ICORE)
9. National Association of Regulatory Utility Commissioners (NARUC)
10. National Exchange Carrier Association (NECA)
11. National Telephone Cooperative Association (NTCA)
12. Organization for the Protection and Advancement of Small Telephone Companies (OPASTCO)
13. Southwestern Bell Telephone Company (SWBT)
14. John Staurulakis, Inc. (JSI)
15. United States Telephone Association (USTA)
16. Virginia Telephone Association (VTA)

Replies:

1. ICORE
2. NECA
3. NTCA
4. SWBT
5. USTA

APPENDIX B--RULES

Parts 69 of the Commission's Rules and Regulations, 47 C.F.R. Part 69, is amended as follows:

1. Section 69.601 is amended by adding a new paragraph (c) to read as follows:

§ 69.601 **Exchange carrier association.**.

* * * * *

(c) All data submissions to the association required by this Title shall be accompanied by the following certification statement signed by the officer or employee responsible for the overall preparation for the data submission:

CERTIFICATION

I am (title of certifying officer or employee). I hereby certify that I have overall responsibility for the preparation of all data in the attached data submission for (name of carrier) and that I am authorized to execute this certification. Based on information known to me or provided to me by employees responsible for the preparation of the data in this submission, I hereby certify that the data have been examined and reviewed and are complete, accurate, and consistent with the rules of the Federal Communications Commission.

Date:____________________________

Name:___________________________

Title:_____________________________

(Persons making willful false statements in this data submission can be punished by fine or imprisonment under the provisions of the U.S. Code, Title 18, Section 1001).

2. Section 69.602 is amended to read as follows:

§ 69.602 **Board of directors.**

(a) For purposes of this Section, the association membership shall be divided into three subsets:

(1) The first subset shall consist of the telephone companies owned and operated by the seven Regional Bell Holding Companies;

(2) The second subset shall consist of all other telephone companies with annual operating revenues in excess of forty million dollars;

(3) The third subset shall consist of all other telephone companies.

All commonly controlled companies shall be deemed to be one company for purposes of this Section.

(b) There shall be fifteen directors of the association.

(c) Until 1996, three directors shall represent the first subset, three directors shall represent the second subset, and nine directors shall represent the third subset. In 1996 and thereafter, two directors shall represent the first subset, two directors shall represent the second subset, six directors shall represent the third subset, and five directors shall represent all three subsets.

(d) No director who represents all three subsets shall be a current or former officer or employee of the association or of any association member, or have a business relationship or other interest that could interfere with his or her exercise of independent judgment.

(e) Each subset shall select the directors who will represent it individually through an annual election in which each member of the subset shall be entitled to vote for the number of directors that will represent such members' subset.

(f) The association membership shall select the directors for the following calendar year who will represent all three subsets through an annual election in which each member of the association shall be entitled to one vote for each director position. There shall be at least two candidates meeting the qualifications in paragraph (d) of this section for each such director position:

(1) in any election in which the most recently elected

director for such position is not a qualified candidate;

(2) if there has been no election for such position having more than one qualified candidate during the present and the two preceding calendar years; and

(3) in any election for which the ballot lists two or more qualified candidates.

(g) At least one director representing all three subsets shall be a member of each committee of association directors.

(h) For each access element or group of access elements for which voluntary pooling is permitted, there shall be a committee that is responsible for the preparation of charges for the associated access elements that comply with all applicable sections in this Part.

(i) Directors shall serve for a term of one year commencing January 1 and concluding on December 31 of each year.

3. Section 69.605 is amended by adding a new paragraph (e) to read as follows:

§ 69.605 Reporting and distribution of pool access revenues.

* * * * *

(e) The association shall submit a report on or before February 1 of each calendar year describing the association's cost study review process for the preceding calendar year as well as the results of that process. For any revisions to cost study results made or recommended by the association that would change the respective carrier's calculated annual common line or traffic sensitive revenue requirement by ten percent or more, the report shall include the following information:

(1) the name of the carrier;

(2) a detailed description of the revisions;

(3) the amount of the revisions;

(4) the impact of the revisions on the carrier's

calculated common line and traffic sensitive revenue requirements; and

(5) the carrier's total annual common line and traffic sensitive revenue requirement.