E-Rate Central

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May 17, 2013

Ms. Marlene H. Dortch, Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: Comments on the Eligibility of Bundled Components under the Schools and Libraries Program
DA 13-592 and CC Docket No. 02-6

Dear Ms. Dortch:

E-Rate Central submits these Comments in response to the FCC's Public Notice released April 9, 2013 (designated DA 13-592), seeking comment on the eligibility of bundled components.

As noted in its Public Notice, The State E-Rate Coordinators' Alliance ("SECA") initially raised this issue with the Commission in a petition for clarification filed in July 2012. E-Rate Central applauds the FCC for moving forward on the issue, first by requesting comments on SECA's petition last August — on which E-Rate Central also commented — and now, more broadly, with a request for comments on a proposal to require cost allocation on all bundled services.

At the outset, it should be noted that E-Rate Central agrees with the FCC's *Gift Rule Clarification Order* (DA 10-2355) that widespread commercial practices of providing free or discounted wireless devices with contracted cellular service should not be considered gifting violations.

The more important issue, however, is not gifting; it is "eligibility creep." What required clarification was footnote #25 indicating that applicants could take advantage of free or discounted cellphones (or any wireless devices such as tablets) without cost allocation. By eliminating the need to cost allocate, footnote #25 would essentially make these end user devices eligible. More disturbingly, footnote #25 suggested that the costs of other bundled products and services, previously deemed ineligible, could be discounted without cost allocation as long as the bundles were being offered broadly "to the public or a designated class of subscribers." The first indication that this exception might apply beyond bundled cellular services, was the offering of bundled VoIP phones by Jive Communications — an offering that USAC and the FCC subsequently appeared to agree was covered by footnote #25. Taken further, this could mean that other inherently bundled products and services — e.g., content engine equipment or online application services — would be deemed fully eligible without cost allocation.

Assuming that the Commission does not want to get rid of cost allocation altogether, E-Rate Central sees two options for dealing with bundled services.

One option would be to more narrowly and carefully define the conditions under which bundling would be allowed without cost allocation. This was the essence of the conditions proposed by SECA in its petition for clarification and by E-Rate Central in its initial comments — conditions that the Commission rightly determined would be somewhat difficult to administer. The second option, which is proposed in this Public Notice, is to require cost allocation for any bundle of eligible and ineligible services.

E-Rate Central agrees that the FCC's proposed option, requiring cost allocation of all bundled services, is a simple and conceptually sound approach. As indicated in the Public Notice, however, it is time to reexamine the general approach to cost allocation. More specifically, it must be recognized that cost allocation for bundled cellular services is not without its own administrative difficulties.

General Cost Allocation Procedures:

The first paragraph in the Cost Allocations for Services in the Reference Section of the SLD's website reads as follows:

> When a product or service contains ineligible components, a cost allocation may be used so that support can be provided for the eligible portion. A cost allocation is appropriate when a clear delineation can be made between the eligible and ineligible components. Several methods of cost allocation can be used, but they must meet the criteria of being based on tangible criteria that provide a realistic result. The price for the eligible portion must be the most cost-effective means of receiving the eligible service.

Although straight-forward in principle, E-rate cost allocation in practice has often appeared to focus on the "tangible criteria" component of this principle — and almost <u>any</u> tangible criteria at that — rather than on the "realistic" and "cost-effective" components.

As an example, E-Rate Central is concerned with the high percentage cost allocations (80-90%) attributed to webhosting of web-based applications packages when compared with the standalone pricing of basic webhosting.

E-Rate Central proposes that the Commission request USAC to review and revise its cost allocation procedures with the specific aim of assuring that the results reflect the cost-effective pricing of equivalent eligible services. These procedures should be reviewed and approved by the Commission, and should be subjected to periodic random reviews of specific product/service allocations.

Similarly, E-Rate Central suggests that USAC be requested to clarify for Commission review a workable definition of "ancillary" within the context of eligible E-rate services. E-Rate Central agrees that end-user devices should not be considered ancillary.

Bundled Cellular Allocation Procedures:

As indicated above, E-Rate Central concurs with the Commission's proposal to require cost allocation of bundled services. While E-Rate Central agrees that this is a conceptually simple approach, we recognize that the procedural aspects of cost allocation are more complex. As such, the Commission should be prepared to address the administrative side of cost allocation.

Consider, for example, the cost allocation aspects of bundled cellular services. There are several questions to be addressed.

Question 1: How do you determine the standalone price of mobile devices? In the cellular market, this has recently become easier with the advent of T-Mobile's unbundled pricing structure. T-Mobile's website provides carrier-driven pricing for a wide range of mobile devices. Other carriers may offer a different line of devices, but the product lines should be comparable in function and price.

Question 2: Given that most bundled cellular plans are based on multi-year agreements, how should cost be allocated on an individual funding year basis? For illustrative purposes, assume that a bundled service includes a $360 device under a two-year agreement at $60 per month. There are two options for cost allocating out the price of the device, namely:

1. Cost allocate out the entire cost of the device in year one. On this basis, the eligible pre-discount allowance for the first year would be $360 ($60 x 12 - $360). For year two, the full bundled service price of $720 ($60 x 12) would be eligible.
2. Amortize out the cost of the device over the two year period. On this basis, the price of the device would equate to $15 per month ($360 / 24). Thus the eligible pre-discount service cost would be $45 per month ($60 - $15), or $540 per year.

Over the two year period, the pre-discount costs of the eligible service would be the same, i.e., $1,080 ($360 + $720 under option #1 or $540 + $540 under option #2).

But this illustration makes the important, but unrealistic, assumption that service is initiated on the first day of the first funding year. While an applicant may apply for cellular service on a full year basis, service may not actually begin until well after July 1st. This means that cost allocation must be applied and reviewed not only at the application level, but at the invoicing level. Under option #1, for example, if service did not start until January 1st, the eligible pre-discount cost in the first funding year would be $0 ($60 x 6 - $360). If service did not start until April 1st, option #1 would require a carry-over of the ineligible portion of the cost allocation into the following funding year.

For this reason, E-Rate Central supports an amortized monthly allocation process (i.e. option #2).

But there are more questions.

Question 3: If the FCC proposes to require cost allocation of bundled services effective FY 2014, how will cellular service initiated prior to FY 2014 be treated? Consistent with E-rate Central's preference for amortized monthly allocations, we believe such allocations should applied beginning in FY 2014 for both existing and new cellular services.

Question 4: Up to this point, we have addressed cost allocation issues with respect to a single user. More typically, an applicant's cellular service encompasses multiple users, with different devices and with different term agreements for individual users.[1] Under this scenario, how would cost allocation be applied? Or more specifically, must cost allocation be applied on a user-by-user basis or on a consolidated basis? If the latter, how?

E-Rate Central believes that the answer to this question should include a carrier-specific safe harbor cost allocation percentage based on a weighted average of that carrier's bundled product offering. This allocation percentage would be applied on a monthly pre-discount for all of that carrier's bundled service offerings effective July 1, 2014.

Conclusions:

E-Rate Central agrees that the FCC's proposal to require cost allocation of all bundled services is the most straight-forward approach to avoiding the "eligibility creep" which was developing as a result of a broadening interpretation of footnote #25 of the FCC's *Gift Rule Clarification Order*.

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[1] A separate E-rate issue related to services of this type that the FCC may wish to clarify is whether such any services involving overlapping term agreements should be considered a contract or month-to-month service. E-Rate Central believes that term pricing agreements do not, in and of themselves, constitute contracts. If they did, each agreement, whether it be for a single cellular user or a T-1 circuit, would have to be treated as a separate contract to be funded as a separate FRN. A better approach to overlapping service agreements would be to treat them as MTM services.

While cost allocation is simple in concept, E-Rate Central believes that USAC must develop, subject to FCC review, more market-based cost allocation procedures. Cost allocation of bundled cellular services, in particular, may require the development of safe harbor percentages for bundled carrier services.

E-Rate Central greatly appreciates the Commission's effort to address SECA's petition for clarification of footnote #25 and, more broadly, other bundled service issues.

Sincerely,

Winston E. Himsworth
Executive Director