

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

In the Matter of)	
)	
Schools and Libraries Universal Service)	CC Docket No. 02-6
Support Mechanism)	GN Docket No. 09-51
)	

**COMMENTS OF FUNDS FOR LEARNING, LLC
on the
THE ELIGIBILITY OF BUNDLED COMPONENTS
UNDER THE SCHOOLS AND LIBRARIES PROGRAM
(DA 13-592)**

Under E-rate program rules as they stand today, schools and libraries may accept for free and with no cost allocation requirement cell phones and anything else ineligible for E-rate discounts that a service provider “bundles” with something eligible, so long as the free offer falls within the scope of the *Gift Rule Clarification Order* – i.e., the service provider is making the same *bona fide* offer to the public or to another class of users. After receiving complaints, unsubstantiated in our opinion, that this policy will (1) lead to an avalanche of contracts to purchase bundles of eligible and ineligible services at inflated prices and (2) that it is too difficult to understand and administer, the Commission decided to reconsider it.

Ultimately, the Commission concluded that that the E-rate program would be better served by adopting a one-size-fits-all approach, one that would require schools and libraries to account via the confusing, time consuming, and all-too-often arbitrary [our adjectives not the Commission’s] cost allocation process for anything ineligible that they purchase as part of a “bundle” -- regardless of the circumstances. We respectfully disagree.¹

¹ See our earlier comments on this issue at <http://apps.fcc.gov/ecfs/document/view?id=7022009805>.

The Commission should not adopt the proposed rule because:

- It is based on untested, unsupported assumptions about how much “free” ineligible services have been costing and will cost the E-rate program in the future.
- No one appears to know how much or even approximately how much money this new rule will save the E-rate program or whether it will even save the program any money at all.
- It is based on suppositions about the current rule’s lack of clarity, which is at best exaggerated and at worst completely wrong.
- It will undoubtedly create more, rather than less, confusion among E-rate stakeholders.
- It will add even more administrative delay to a process that is already filled with long, frustrating, and costly administrative delays.
- It will put an end to longstanding, legitimate marketing practices that benefit schools and libraries and will prohibit companies from establishing new ones.
- It will force service providers to discriminate against schools and libraries by charging them more for certain equipment than they charge other similarly situated customers, which in turn may raise lowest corresponding price rule issues.

Cost Allocation is a Difficult, Confusing, Oftentimes Arbitrary, and Frequently Contentious Process That the Commission Should Strive to Decrease, Not Increase.

To begin with, we are convinced that the proposed policy, if adopted, will engender far more confusion than the existing one has or ever will, even though clarity is one of the Commission’s stated objectives. Inevitably, applicants, service providers and USAC will wind up spending countless hours discussing and then arguing about how to reasonably account for free promotional products, especially cell phones, which service providers have been subsidizing heavily for years. Eventually, many of these disputes will land in the Commission’s lap, which will add more delay to an already too slow commitment and funding process.

For cost allocation purposes, what will USAC accept as the fair market value of a

cell phone for example? The retail price? The price that the service provider charges to the public and every other class of customer if they agree to a one-year contract? If an applicant is going to receive numerous phones, should it be the retail price minus the provider's standard volume discount? What if it is an old model – should it be the average price that people are paying for it on eBay? Will applicants have to account for the full fair market value in one year, even if they agree to a multi-year agreement?

If a cell or VoIP service provider offers free phones to any government or business customer that agrees to sign a two-year service contract, but is prohibited from making the same free phone offer to schools and libraries, that provider's government and business customers are obviously going to wind up paying far less for a total telecommunications package than what that provider's school and library customers will have to pay for exactly the same bundle. If and when that happens, will that be a violation of the Commission's lowest corresponding price rule? Is this something that service provider's should be concerned about? Is this an issue that the Commission is going to need to address, one way or the other?

The E-rate program is complicated enough. The free cell phone issue in particular is a Pandora's box that has remained very tightly closed since the program began, and it should remain that way. This is an aspect of the program that isn't broken, and it would be a mistake to try to fix it.

The Current Rule is Not Confusing. What's Making it Confusing is Overanalysis.

Apparently the Commission agrees with SECA that the current rule, which allows ineligible products to be bundled for free with eligible services, if the service provider is making the same offer to the public or a "designated class of subscribers," is unworkable because of what SECA has described as the "climate of uncertainty" surrounding it.² But this uncertainty, we submit, is entirely of SECA's and USAC's own making, and simply because those two organizations happen to find something confusing does not mean that it actually is.

² SECA's Reply Comments at <http://apps.fcc.gov/ecfs/document/view?id=7022020867>.

SECA, for example, cites USAC's request for guidance on the definition of "class of subscribers" as evidence of the uncertainty surrounding the rule. USAC wondered whether all schools and libraries could be considered a "class of subscribers." If they could be, USAC cautioned, then any time a service provider offered something for free to all schools and libraries, any school or library could receive something for free without having to cost allocate it.³ We do not understand the logic in this at all. Of course "schools and libraries" cannot constitute a "class of subscribers" for purposes of applying the cost allocation exemption.

The Commission's free services advisory, the basis for this exemption, states that "a cost allocation is not required when the free product or service is available to the public or a class of subscribers broader than just E-rate recipients." (Emphasis added).⁴ Obviously, the "designated class of subscribers" has to be a group that does NOT include schools or libraries. Including schools and/or libraries in the definition of "designated class of subscribers" would turn the entire rule on its head and make it absolutely pointless. The whole point of this rule, which is very easy both to understand and apply in our opinion, is to stop service providers from ginning up special offers exclusively for E-rate customers, while making sure that schools and libraries can still take full advantage of *bona fide* offers that service providers are making to OTHER classes of potential customers -- colleges and universities, for-profit companies, and non-profit organizations for example.

The important question, which we have commented on before, is whether the policy that the Commission clarified in Footnote 25 actually works. That is, does it enable E-rate applicants to enjoy the same opportunities in the marketplace to save

³ *Id.* ("USAC seeks guidance on what can be considered a "class of subscribers" and what constitutes "available to the public" for the purposes of the E-rate gift rules. For example, are all libraries and elementary and secondary schools considered a "class of subscribers" such that a special equipment discount or free equipment offered only to libraries and elementary and secondary schools would allow a school or library participating in the E-rate program to accept free or discounted equipment from a service provider?")

⁴ See *Free Services Advisory*, <http://www.usac.org/sl/applicants/step02/free-services-advisory.aspx>

money on equipment and services as classes of subscribers who are not eligible for E-rate discounts, while reasonably protecting the E-rate subsidy system from inappropriate price manipulation? We believe that it does:⁵

By allowing E-rate applicants to take advantage of only *bona fide* deals -- ones that service providers offer simultaneously to at least one other designated class of users (state and local government or higher education customers for example) -- Footnote 25 guarantees that companies will not be able to cook up suspicious offers exclusively for K-12 and public library customers. All it takes to guard against overly aggressive service providers who do not actually target anyone besides E-rate customers is a simple verification process. To verify the legitimacy of a company's offer, USAC can (1) ask questions like the ones we have already discussed and (2) request documentation sufficient to show that the company offered the same deal to at least one other class of users besides E-rate applicants. That should not be a difficult issue to audit.

In deciding to retreat from an approach that made perfect sense, the Commission appears to have been influenced by warnings from SECA and others, which are misleading in our opinion, that the exemption would be a nightmare both to administer and to administer consistently. In this regard, the Commission noted:⁶

... determining whether a bundled service offering is a commercially common practice within the industry, and not a unique offering of an individual service provider, and that the bundled arrangement is currently available to the public and not just to a designated class of subscribers, would require both USAC and ultimately the Commission to perform analysis of individual service provider offerings on a case-by-case basis. We agree that it would be difficult to administer this exemption on a consistent basis without posing a drain on E-rate resources, because it could require additional personnel and market trend analysis that USAC is not prepared for or structured to perform. (Emphasis added.)

We think the case for concern is very much overstated. First, to determine whether a particular offer is exempt, USAC would never have to determine whether it is a “commercially common practice within the industry,” rather than a unique offering of an individual service provider.” That is not the litmus test for the exemption. The *Gift Rule Clarification Order* does not say that a free offer has to be a “commercially common practice” to be exempt. It is much simpler than that. All the *Order* says is that for the

⁵ FFL Comments. <http://apps.fcc.gov/ecfs/document/view?id=7022009805>.

⁶ FCC Public Notice DA 13-592 (April 9, 2013) (“Public Notice”) at para. 8 (footnotes deleted)

offer to be exempt, it must be one that the provider in issue was simultaneously offering either to the public or to some other group of subscribers besides schools and libraries.

Simply because a particular offer is not, or is not yet, a “commercially common practice within the industry” does not automatically render it non-exempt. Some company has to be first out of the blocks, and some companies are simply more creative marketers than others. The determinative question, therefore, is not whether the offer happened to be a commercially common practice, but whether the company named in the funding request was marketing its offer exclusively to E-rate applicants or, at the same time, either to the public or to another class of subscribers. To answer that question, it is important to note, USAC would never have to engage in “market trend analysis,” which means that we can completely take off the table any concerns that the Commission might have had about USAC having to do that kind of work. We honestly do not understand why, in this context, a market trend analysis was mentioned.

Second, USAC handles countless matters on a case-by-case basis. It reviews numerous issues, diving in deeply whenever individual circumstances warrant closer scrutiny. Determining whether a company offered free phones, computers, tablets or anything else of substantial value only to E-rate applicants or to both E-rate applicants and at least one other class of subscribers is not, we submit, all that difficult an issue to investigate and resolve quickly.

USAC’s job is to do fact-finding and document collection. On a case-by-case basis, all USAC’s staff would have to do is request documentation showing that the bundled offer in issue warranted the cost allocation exemption. The burden of document retention would fall, of course, on the applicant, which means that the applicant, and not USAC, would have to do the heavy lifting. In any event, USAC is unlikely to find a plethora of applicants with cost allocation exemption issues waiting to be reviewed, so handling this issue on a case-by-case basis is unlikely to add very much to USAC’s workload. What will also help the process is that applicants will know to request and keep on file all of the documentation it might eventually need to prove its case, because USAC will have included these instructions on its website and in its trainings and training

materials. If, during the application review process, an applicant could not produce evidence to support the exemption, it would not be entitled to one.

To make the review process easier for everyone, USAC could advise applicants to ask for and save documentation such as this:

- Copies of the service provider’s advertising and marketing materials.
- Documentation showing all markets in which materials were distributed.
- Lists of customers who accepted the same offer.
- Lists of Internet and email inquiries.
- Inside sales logs.

Finally, when the Commission’s states that it is concerned “that it would be difficult to administer the exemption issue on a consistent basis without posing a drain on E-rate resources, because it could require additional personnel,” it is forgetting just how incredibly difficult and labor intensive it will be for USAC to work its way through a mountain of cost allocation issues that involve a myriad variety of free and discounted cell phones, VoIP phones, other devices and components, and special service offerings. On the other hand, if the rule remains the same, USAC’s and the Commission’s difficult cost allocation workload will decrease.

In Proposing This New Rule, the Commission is Putting Entirely Too Much Faith in the Notion, Unsupported by any Data or other Objective Evidence, that it Will Save the Program a Substantial Amount of Money.

The Commission believes that “to the extent that the real cost to the provider of the ‘free’ or reduced price ineligible component results in a more expensive bundle, the money saved by not paying for the entire bundle will result in more funds being available to other E-rate recipients for E-rate eligible services.”⁷ If there is evidence to support this, we have yet to see it.

How much money are free, ineligible, bundled components actually costing the E-rate program? Does anyone know? Or is the real driving force behind this referendum on marketing practices the notion that no company ever really gives away anything for free, so whatever is being bundled for free must actually be costing the program

⁷ *Public Notice* at para.7.

something? Is it righteous indignation that is driving this particular cause or is it facts? Where is the data? Where is the evidence that long-term service contracts that come with free phones, regardless of the technology that they use to operate, are costing applicants more than contracts for the same amount of time without free phones? Sure, one would think that those kinds of arrangements without free phones “should” cost less, but do they really? If they do, how much less? Will a cell service provider reduce its monthly service fee from \$40 to \$35 per phone simply because there are no free or discounted phones included in the deal? We doubt it. How many bundled contracts is the program actually funding? How many is it likely to fund? What is the projected cumulative impact on funding?

Yes, free “stuff” *might be* costing the program *something*, and in some cases it probably is, but that is a very weak foundation upon which to support a rule change that will have as profound and direct an impact in the marketplace for telecommunications services as this one will – especially where historically free and highly discounted cell phones are concerned.

The Real Financial Threat to the Program is Coming From Elsewhere

The real financial threat to the program is not the potentially hidden cost of “free stuff,” *which no one has yet to enumerate*, but rather, the program’s Priority One and Two services framework. That is where the Commission should be focusing its attention. With P2 funds for infrastructure all but dried up and K-12 budgets tighter than ever, many schools and school districts are left with no choice but to make telecom and technology decisions that in many cases are not their first choice, but which they know will receive funding. Procuring Internet access via expensive P1 cell service, rather than through much more cost effective P2 wireless infrastructure, is one example.⁸ Paying yearly for P1-managed VoIP service, rather than investing for the long term in P2 VoIP

⁸ We agree with AT&T, however, that the Commission should not prohibit applicants from choosing cellular Internet access over wireless infrastructure. Applicants should be free to make that choice -- if that is what they actually believe will best serve their individual educational needs and objectives, irrespective of the priority funding system, and so long as the choice represents the most cost effective means of meeting their technology goals. *Reply Comments of AT&T on the FY2013 Draft Eligibility List.* <http://apps.fcc.gov/ecfs/comment/view?id=6017108272>

infrastructure, which for many applicants makes far more economic sense, is another. It is this kind of regulatory driven decision-making that is incredibly costly to fund, not to mention completely at odds with one of the program’s basic tenets – namely, that schools and libraries should be given “maximum flexibility to purchase the package of services they believe will meet their communication needs most effectively.”⁹

We do not share SECA’s belief and now, apparently, the Commission’s belief that the amount of E-rate money going out the door every year to help pay for a relatively small amount of bundled ineligible goods and services, which are supposed to be free, could possibly be having the kind of serious and substantial negative impact on funding that they “believe” it is having.¹⁰ We are curious as to what, exactly, makes SECA’s belief so believable.

SECA says it is concerned about “permitting an increasing number of ineligible services to be provided as part of a bundle with eligible services” because it “will result in the inability to fund all priority one fund requests.” Is that what is actually going to cause the inevitable shortfall? In very small part perhaps, but the greatest danger of all comes from the “blank E-rate check” that the program places in the hand of every E-rate applicant every year, combined with the system of “priority” funding mentioned before.

In Funding Year 2013, for example, a single applicant requested \$0.61 billion or 25% of the entire amount of the \$2.38 billion annual funding available. That is not a belief. That is a fact. And that is a very big problem. In Funding Year 2012, another applicant received \$6.34 million to provide 3G/4G cellular Internet access to 15,000

⁹ *Report and Order*, FCC 97-157 (1997) at para. 29.
http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-97-157A1.pdf. See Reply Comments of Phillip B. Gieseler at <http://apps.fcc.gov/ecfs/document/view?id=7022020747> (“The Commission has inadvertently departed from an important original principal for E-rate, namely that applicants should be choosing the communication technology solutions that they, the applicants, find to be in their own best interest.”)

¹⁰ See *Public Notice* at para. 7 and n. 18. (“Some stakeholders believe that not requiring cost allocation for bundling ultimately shifts funding from eligible services to ineligible services. See, e.g., Reply Comments of SECA on the *SECA Petition Public Notice*, filed Sept. 24, 2012, at 2. They also express concern that permitting an increasing number of ineligible services to be provided as part of a bundle with eligible services will result in the inability to fund all priority one fund requests.”)

students in grades 4 through 9. This \$6.34 million “grant” was “one of the largest awarded in the country during this year’s funding cycle,” this applicant boasted on its website. That too is a fact. And that, too, is a very big problem. The data and the Internet reveal copious similar examples of requests like these that the E-rate program simply cannot afford and should no longer abide. Therefore, what the Commission cannot afford to do is to “sweat the small stuff.”

We have said so before in our comments, albeit not so directly, that the hue and cry to change the Commission’s common sense, limited exception to the free-services rule is a well-intentioned red herring – but make no mistake about it, a red herring it is. While this matter may be deserving of some of the Commission’s attention, by no means does it deserve the amount it is receiving. The Commission’s policy-making focus and limited resources should be directed toward rule-related problems that are much more serious and fundamentally fund threatening, and which everyone agrees are real and substantial.

Unlike the extremely speculative and amorphous nature of the alleged “free ineligible services” problem, which, to the best of our knowledge, no one has even tried to put a price tag on, we know for a fact that there is a much graver problem out there that is slowly and steadily eating the program to death. It is the “blank check” mentality that permeates the program. It is the “take as much as you possibly can” mentality that some applicants have. It is the “take only as much as you reasonably need and can use” mentality that many applicants do not have. It is the unwillingness to take bold action to stop outliers from raking in more than their fair share of a limited pool of funding. It is the outlandish amounts of funding that some applicants apply for and receive, some of them year after year. This really is a problem, and it is a problem supported by hard, cold data, much of which we have already shared with the Commission.¹¹

¹¹ See the following *Ex Parte Notices*: <http://apps.fcc.gov/ecfs/comment/view?id=6017172639>; <http://apps.fcc.gov/ecfs/comment/view?id=6017169681>; and <http://apps.fcc.gov/ecfs/comment/view?id=6017154704>

Summing Up

In short, no data or any other substantial evidence has been presented to support the conclusion that the common sense exceptions to the Free Services Rule that the Commission articulated in Footnote 25 of its *Gift Rule Clarification Order* needs to be changed. The Commission is retreating from a rule that is well reasoned and, in truth, not all that difficult to understand and apply. It is proposing to adopt in its place a rule that will be difficult to understand and apply, and which will, moreover, put an end to legitimate, long-standing cellular service marketing practices and inhibit the marketing and growth of new telecommunications technologies. The proposal, we believe, is an ill-advised, overreaction to empty claims that nothing is ever actually free, and that the real cost of schools and libraries accepting anything ineligible for free, whatever that may be, is something that the E-rate program cannot afford. Rules should not be based on assumptions, and especially not a rule like the proposed one that single out schools and libraries for economic discrimination in the marketplace.

Free and Discounted Cell Phones Should be Exempt From Cost Allocation No Matter What Policy the Commission Ultimately Decides to Adopt.

If the Commission decides to go forward with adopting the proposed new rule, we urge the Commission to exempt free and deeply discounted cell phones from any cost allocation requirement. No one would dispute that those kinds of offers are and have been for quite some time a commercially common practice within the industry. It is clearly not a marketing scheme that someone cooked up just to take advantage of the E-rate program, and, moreover, there has always been a *de facto* exemption for cell phones from the free services rules anyway. Nor is anyone likely to dispute that by subjecting free and discounted cell phones to the cost allocation process, the Commission will open up a hornet's nest of contentious, difficult-to-resolve issues, and, in addition, cost schools and libraries, whose budgets are already hurting, an enormous amount of money. We are firmly convinced that no matter how one approaches a cost benefit analysis involving the exemption of free and discounted cell phones from the cost allocation process, the benefits of exemption will outweigh the cost every single time.

Alternatives to the Commission's Proposal

"We also seek comment on any alternatives to our proposal. To the extent commenters believe that other interpretations would better serve the Commission's goals, including other proposals that might improve program efficiency while protecting E-rate funds, commenters should provide detailed descriptions of their proposals in their comments."

In our Supplemental Comments, which we have filed separately, we have provided an outline of our alternative proposal, along with a more detailed presentation.

The E-rate program is not broken. But as everyone knows, it is going broke. No question, the E-rate program needs, and most assuredly deserves, much more funding. But what it needs even more is a single, fundamental, common-sense change to its framework, one that USAC's Task Force on the Prevention of Waste, Fraud and Abuse recommended in its report ten long years ago, namely, individual applicant budgets (in other words, individual applicant funding caps). To be perfectly blunt, no one in his or her right mind hands anyone a blank check. But that is exactly what the E-rate program does year after year, and it is time to put a stop to it. This is the only way to ensure that these scarce, precious funds get distributed equitably and get used wisely. It is the best way to "improve program efficiency while protecting E-rate funds."

A budget system would make it possible to restore funding for Internal Connections for every school and library that applies. It would enable applicants to apply for funding for what they actually need and to spend it on any school or library in their respective systems that they conclude needs it, regardless of its discount rate. Budgets will force applicants to think much more carefully about where and on what they spend their E-rate dollars. It will force applicants to think much more long term and strategically. Budgets will motivate applicants to drive much harder bargains than they do now with their service providers, as they will no longer have blank checks with which to work.

More and more, applicants are seeing the writing on the wall. Alberto M. Carvalho, Superintendent of Miami-Dade Public Schools, understands both the problem and its magnitude. As he explained recently to Commissioner Rosenworcel, applicant

budgets are “a logical solution to a very serious problem.” More specifically, he said: ¹²

The FFL plan, as presented, retains the E-Rate Program's fundamentally important aspects, including the discount matrix. Additionally, it addresses the two problematic issues: funding predictability and equitable distribution of funds - "the blank check". These are issues that M-DCPS has wrestled with over the years.

A key feature of this plan would provide applicants an anticipated annual funding budget based on a per-student budget basis at the District level. This is a simple and logical solution to a very serious problem and one we fully support, as discussed with Commissioner Rosenworcel. Operating within a budget is something every organization understands. It allows for school districts to plan and use the E-Rate funds more effectively.

The skyrocketing need for broadband combined with a regulatory framework that tolerates, if not outright encourages, a “take as much as you want” mentality are rapidly bleeding the E-rate program to death. That is why it is time, as Senator Rockefeller and Commissioner Rosenworcel have each pronounced recently, for major change – for E-rate 2.0.

The guiding force behind E-rate 2.0 should not be, as the children in AT&T's ubiquitous television commercials would have us believe, that “more” is always better. Instead, the Commission should rip a page from the Rolling Stone's songbook and build the next iteration of the E-rate program on the very apt insight of Mick Jagger and Keith Richards who so keenly observed: ***“You can't always get what you want, but if you try sometimes, you just might find, you get what you need.”***

¹² See *Ex Parte Notice* filed by Miami-Dade Public Schools (March 4, 2013) at <http://apps.fcc.gov/ecfs/document/view?id=7022127287>

Alternate Proposal Overview



- Keep current discounts and eligible services
- Eliminate “unlimited” funding requests
- Allow applicants to set their own priorities
 - › Discounts used for any service category, any site
 - › Offer all applicants access to a meaningful amount of E-rate support every year
- Promote equitable distribution of funding
- Increase cap to \$4.5 billion/year

© 2013 Funds For Learning, LLC

Respectfully submitted,

FUNDS FOR LEARNING, LLC

John D. Harrington
Chief Executive Officer
Jharrington@fundsforlearning.com
405-341-4140

Funds For Learning, LLC
2575 Kelley Pointe Parkway Suite 200
Edmond, OK 73013

May 23, 2013