



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

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

**REPLY COMMENTS TO PUBLIC NOTICE REGARDING THE ELIGIBILITY OF
BUNDLED COMPONENTS UNDER THE SCHOOLS AND LIBRARIES PROGRAM**

SECA’s original Petition filed on July 27, 2012 asked the FCC to clarify expansion of the cellular eligibility model to other Priority 1 products and services. We acknowledged the cost allocation exemption for cell phone equipment originated from the industry-wide practice of offering *all* cell phone customers a free phone device when the customer signed a term contract for cellular service. This practice was not limited to E-rate recipients, or any particular class of customers. It applied to *all* customers and was not a practice created in response to the E-rate regulatory rules. The *Gift Rule Clarification Order* simply recognized this reality.

Several of the parties commenting on the FCC’s April 4, 2013 Public Notice continue to support the cellular phone exemption and SECA concurs.¹ On the other hand, Broadcore and its

¹ Sprint/Nextel stated, “Sprint has supported, and continues to support, the policy of allowing free/discounted equipment (with certain safeguards) without requiring a downward adjustment to the E-rate funding request.” Steven Kaplan, an E-rate consultant, stated, “In the case of cellular phone services, USAC applicants are allowed to receive a free, albeit ineligible device, because the public at large is given this same incentive from cellular service providers. The FCC has ruled that this is not a violation of the Gift Rule, and this author agrees.” While preferring that the current *Gift Rule Clarification Order* stand, Funds for Learning stated, “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.”

consultant, E-rate Provider Services LLC, and E-rate Central support the complete rescission of the exemption even for cell phone devices.

SECA believes that the exception for cell phones is straightforward and noncontroversial. An appropriate distinction can be made between cell phones that should not have to be cost allocated, and all other equipment including other devices sold by cellular carriers, such as tablets and iPads that should be required to be cost allocated.² The “other equipment” language is where confusion has arisen and should be pulled back. Specifically the following sentence and the excerpted language below from the now infamous Footnote 25, should be rescinded:

Similarly, service providers cannot offer special equipment discounts or equipment with service arrangements to E-rate recipients that are not currently available to some other class of subscribers or segment of the public.

Schools and libraries ... cannot accept other equipment with service arrangements that are not otherwise available to some segment of the public or class of users. Therefore, a service provider may not offer free iPads to a school with the purchase of telecommunications or Internet access services eligible under E-rate, if such an arrangement is not currently available to the public or a designated class of subscribers.

The deletion of this language will end the confusion and will ensure that the cell phone exemption is appropriately limited.

Cell phone devices should be a special exception to the cost allocation requirement and E-rate gift rules. Recognizing that the person on the street could obtain the identical benefit and discount of a free phone, it seems incongruous to require E-rate recipients to deduct the cost of the free phone from the prediscount price for the E-rate service. The deduction would penalize the E-rate applicant by artificially reducing the prediscount cost of the monthly cellular service to account for the value of the free product. It stood to reason that if the phone was free to all other customers besides E-rate recipients, then the offering of this free device was not intended to

² SECA does not support the extension of the cost allocation exemption to other equipment beside phone devices, such as iPads and tablets. These promotions are not ubiquitously offered to the public at large.

influence the E-rate recipient to select a particular vendor or to artificially inflate the price of E-rate funding. Since it was an industry wide practice, offering the free phone did not provide a competitive advantage to one vendor over another, and therefore, serve as an improper inducement to the applicant in the vendor selection process.

The lack of clarity arose when the FCC stated that other discounted equipment purchases would also be exempt from the cost allocation requirement if the promotion was made available to the public *or a designated class of subscribers*. Vendors seized on this language to create new bundled service offerings that included end user devices that previously had to be cost allocated. The difference between these bundles and the cell phone service bundling is that these new bundles were specifically created in response to the FCC Order *and* it is virtually impossible to prove that the pricing is not inflated to cover the cost of the “free” equipment. Moreover these bundles were not then currently available when the *Gift Rule Clarification Order* was issued by the ambiguous language that SECA proposes to be eliminated.

The cell phone exemption can be shown to have no inflationary effect on the prediscout eligible monthly cellular service cost. Longstanding industry wide marketing materials verify that the monthly price for E-rate eligible service is the same with or without the free device. The same cannot be said for newer bundled service offerings that include “free” end user equipment and that were created in response to and after issuance of the *Gift Rule Clarification Order*. There is a dearth of information concerning the baseline prices of the unbundled service that can be used for comparing the prices of new bundled service offerings. It is virtually impossible to prove whether the prices for the bundled offerings are inflated because all that a vendor would have to do is maintain parity between the bundled and unbundled prices for the same service.

Equally challenging would be the application of the language “designated class of subscribers.” This language is so open-ended that it is impossible to discern what it means. It is

unclear how narrow a designated class of subscribers could be drawn in order to qualify for the cost allocation exemption. In contrast, the cell phone exemption would apply because the policy is applicable to all customers – not just one particular designated class of subscribers.

Only one commenting party challenged the underlying concerns that prompted SECA to file the Petition for Clarification. In making this claim against SECA's Petition, Funds for Learning failed to address the evidence that SECA shared in its September 24, 2013 Reply Comments concerning price inflation of bundled VOIP handset service:

SECA knows of one national vendor that, in response to an RFP for hosted VOIP services, proposed the monthly price of interconnected VOIP that included bundled handsets at \$28/seat (or per line) for a three-year contract. The same service – interconnected VOIP – was priced at \$22 per month without VOIP handsets for the same three-year contract. Multiple school districts were offered the identical bundled pricing by this vendor.

In one proposal to a small district representing approximately 5000 students and five school buildings, the district sought 601 lines, which resulted in a difference of \$3,606 between the monthly price of VOIP service without handsets and the monthly price with handsets. This calculates to an annual difference of \$43,272. Over the life of the three year contract, this applicant's pre-discount price would have been \$129,816 higher had they selected the service offering that included the costs of the bundled VOIP handsets – and this is just one small district - If just 200 similarly sized applicants applied for E-rate discounts on such bundled services, Priority 1 demand would increase nearly \$26 million. Multiply that figure by the number of districts in the country in need of a new phone system and Priority 1 demand would be consumed by bundled VOIP service alone.

SECA's concern is not just hyperbole; it is a genuine concern rooted in fact. SECA remains prepared to file the detailed information under confidential seal should the FCC wish to examine the particular data. Indeed Broadcore agreed that bundling ineligible end user equipment in Priority 1 services may create additional upward pressure on demand.

Last, E-rate Central's comments concerning cost allocation raise important questions not just limited to the bundling issue. SECA concurs that it would be appropriate for the Commission to request USAC to review and revise its cost allocation procedures in order to ensure that the results

reflect the cost-effective pricing of equivalent eligible services. Additional advice should be offered to applicants and service providers to better inform stakeholders of the cost allocation requirements. The cost allocation procedures should be reviewed and approved by the Commission. Likewise the definition of “ancillary” should be clarified so that stakeholders are better informed of the “ancillary” boundary where cost allocation is not required. For example, there are a plethora of offerings from web hosting companies that include additional, ineligible functionality under the guise of it being “ancillary.”

In conclusion, SECA requests the FCC to clarify that the cost allocation exemption applies only to cell phone devices and clarifies the cost allocation procedures.

Respectfully Submitted by:

/s/ Gary Rawson

Gary Rawson, Chair
State E-Rate Coordinators' Alliance

Mississippi Department for Information Technology Services
3771 Eastwood Drive
Jackson, Mississippi 39211
601-432-8113
Gary.Rawson@its.ms.gov

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