

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

In the Matter of

**Schools and Libraries Universal Service Support Mechanism
CC Docket No. 02-6**

**A National Broadband Plan For Our Future
GN Docket No. 09-51**

Petition for Clarification – Cost Allocation

The E-Rate Management Professionals Association, Inc. (E-mpa™) is a (501)(c)(6) trade association whose purpose is to promote excellence and ethics in E-rate professional management and consulting through certification, education and professional resources. E-mpa™ serves as an advocate for the critical role served by E-rate management professionals and consultants. The organization strives to strengthen and support the E-rate program by acting as a self-governing body of E-rate management professionals and consultants. E-mpa™ provides assurance to stakeholders by maintaining the highest standards, developing and promoting best practices, and requiring ethical conduct for all members.

The members of our association provide E-Rate Program consultation and management services to E-Rate program participants. Our combined client list represents schools and libraries ranging from the small rural remote school district to very large urban school districts. Therefore, we have an excellent perspective of the current and future Broadband needs of our clients throughout the United States. We have access to the most recent and competitive marketplace pricing for E-Rate eligible services due to our review of our applicants' competitive bidding process. This knowledge positions our group to provide real-time insight into the current, and more importantly, the future broadband needs of our clients.

Introduction

The E-Rate Management Professionals Association is submitting this petition for clarification regarding the cost allocation of bundled ineligible equipment.

E-mpa applauds the release of the FCC's Order regarding cost allocation Released May 23, 2014, DA 14-172¹ ("*2014 E-rate Bundled Components Order*"), which clarified the issue of the eligibility of bundling ineligible hardware with eligible Priority 1 services, such as free or discounted handsets with cellular service plans, or free or discounted Voice over IP (VoIP) handsets with a longer-term hosted VoIP contract. While E-mpa takes no position regarding the substance of the decision, E-mpa appreciates the unambiguous prohibition against the practice, beginning in Funding Year (FY) 2015.

History

As stated in the *2014 E-rate Bundled Components Order*, "The *2010 Clarification Order* permitted, under limited circumstances, E-rate applicants to seek E-rate support for purchases of eligible services bundled with ineligible components without providing a cost allocation separating out the value of the ineligible components."² The *2010 Clarification Order* was issued as a response to questions submitted to the FCC regarding the gift rules in the FCC's 6th Report and Order, released September 28th, 2010³. In footnote 25 of the *2010 Clarification Order*, the Commission expanded on their statement that service providers could not offer special equipment discounts or equipment with service arrangements to E-Rate recipients if the offer is not currently available to some other class of subscribers or segment of the public:

"For example, many cell phones are free or available to the general public at a discounted price with the purchase of a two-year service contract. Schools and libraries are free to take advantage of these deals, without cost allocation, but 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."⁴

Prior to the *2010 Clarification Order*, cellular handsets had to be cost-allocated from any cellular telephone service order that included them. Petitioners had made the case that because any customer who walked into a cellular phone store could sign a two-year contract,

¹ http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-14-712A1.pdf (*2014 Cost Allocation Order*)

² *Id.*

³ *Schools and Libraries Universal Service Support Mechanism and A National Broadband Plan for Our Future*, Sixth Report and Order, CC Docket 02-6, FCC 10-175 at paras. 87-90, 106-107 (rel. Sept. 28, 2010) (*Sixth Report and Order*); see also 75 Fed. Reg. 75393.

⁴ See *Schools and Libraries Universal Service Support Mechanism, A National Broadband Plan for Our Future*, CC Docket No. 02-6, GN Docket No. 09-51, Order, 25 FCC Rcd 17324 (Wireline Comp. Bur. 2010) (*2010 Clarification Order*).

and receive a free basic handset, (or a discount off of a more fully featured phone or smartphone), customers receiving E-Rate discounts should not be penalized for taking advantage of the same. In the *2010 Clarification Order*, the FCC agreed with this reasoning, and not only carved out an exception for cellular handsets, but added language expanding this exception to other types of end user products beyond cellular phones, if the offer was widely available to a larger class of users⁵. Pursuant to that language, providers of services other than cellular services, specifically voice over IP service providers, notified applicants that they could receive E-Rate funding for offerings that contained bundled ineligible equipment, generally in exchange for a multiyear contract.

In the *2014 E-Rate Bundled Components Order*, the Commission rescinded this exception in full, in essence resetting the guidance to before *The Sixth Report and Order*. Effective with FY2015, no ineligible end-user hardware will be permitted to be bundled into any Priority 1 service without cost-allocation. In short, applicants will again be required to pay out of general budget for all handsets and tablets, beginning July 1, 2015.

Discussion

E-mpa has identified several issues that need clarification in regards to the *E-Rate Bundled Components Order*. We believe guidance from the Commission will help both applicants and service providers as they begin preparing for FY2015.

E-mpa notes that the issue of adjudicating existing contracts has not been addressed. Current program guidelines prohibit paying for goods or services outside of the current funding year, often requiring the proration/amortization of such costs over multiple years. Manufacturer's warranties are an example of this. An applicant is allowed to purchase a five-year warranty on a particular product, but current program rules require the warranty to be prorated and funded on a yearly basis. For this example, a five-year warranty would be discounted or reimbursed 20% per year for five years.

In the case of bundled handsets, whether cellular devices, tablets or hosted VoIP handsets, a free or discounted device was provided with the service. The applicant was generally required to sign a long-term commitment to purchase the service from the service provider. Specifically, the handset was provided (generally) upon contract signing, and remained the property of the applicant after the contract term had expired.

⁵ *Id.*

The issue becomes clear when the contract term and the amortization requirement are juxtaposed. For example, if the contract term is three years, and the price of the cellular handset or VoIP phone is \$90.00, one could determine that the phone is amortized at \$30.00 per year for the three-year term. Cellular contracts, in particular, would be difficult to manage because cell phones are often issued mid-year, which would require a monthly allocation basis, not a yearly allocation basis. When program rules allowed for the inclusion of free ineligible hardware, this was not an issue, but once the program rules were changed, the amortization requirement becomes problematic, and raises the following questions:

- How should affected contracts be identified?
- What is a fair price for the now ineligible equipment?
- What cost-allocation and amortization methodology should be employed?
- What audit and verification requirements will USAC be required to implement, and what timeframe do they have to put procedures in place to support the change in policy?
- What will the Financial Impact be to Applicants?

Identifying Contracts

It is difficult to quantify the number of contracts, signed in the period between the effective date of the *2010 Clarification Order* and the close of the FY 2014 filing window, but between cellular contracts and applicable hosted VoIP contracts, E-mpa estimates that there are thousands of contracts that could be affected. Further, E-mpa believes that current USAC systems are unlikely to be set-up to easily retrieve the information, necessitating a significant manual data collection effort, diverting personnel resources from other more critical tasks, such as invoicing and applications processing.

Pricing Ineligible Equipment

General USAC procedures rely upon MSRP for pricing guidance.

End-user telecommunications equipment is rarely sold at MSRP, thus, requiring applicants to buy a prorated portion of equipment at MSRP would be especially onerous. Any expenditures would be potentially significant, and unanticipated.

There are many different equipment models; maintaining an accurate database might prove challenging.

The following questions need to be addressed:

- What is the cost-allocation basis when MSRP changes during the term of the contract?
- Is MSRP the recommended method for determining the price of ineligible bundled equipment?
- What pricing should be used if the Applicant signs a three or five year contract?
- Will the Service Provider be required to notify the Applicant regarding the bundled ineligible equipment prior to the funding year each year?

Cost-Allocation Methodology

Unfortunately, each applicant meeting the guidelines would need separate and individual adjudication. An applicant who signed a contract for new cellular service in FY 2014 would be adjudicated differently than an applicant who signed a contract for new cellular service in FY 2013. Likewise, an applicant who signed a new three-year contract for cellular service in FY 2014 would be adjudicated differently than an applicant who signed a new five year contract for cellular service in FY 2014.

Further, the following questions seem likely to arise:

- Could an applicant cancel its contract and award a different contract to the same provider, and escape the amortization requirement?
- Could a service provider “gift” less than \$20.00 per year per applicant personnel if the handset value is sufficiently minimal?

Financial Impact to Applicants

Based on conversations with applicants on the topic at hand, E-mpa believes that applicants who entered into a multi-year contract in good faith with a service provider have not budgeted for ongoing ineligible equipment expenses. To put it bluntly, they were unprepared for this ruling, and finding unbudgeted funds to cover these unanticipated expenses will be difficult. In some cases, applicants who signed multi-year contracts in FY2014 may have, pursuant to the FCC’s guidance in this matter, unanticipated and in some cases significant expenses for multiple years to come.

Recommendation

E-mpa therefore strongly urges the Commission to provide a “safe harbor” to applicants and service providers by clarifying that no cost-allocations will be required for any ineligible equipment bundled in with any contracts signed prior to July 1st, 2014. E-mpa believes that there is a daunting amount of administrative effort required for little financial benefit to the program, and urges the Commission to act swiftly to obviate this potentially onerous requirement.

Summary

E-mpa has posed the considerations above not as an exhaustive list, but merely as an illustration of the types of issues likely to arise. E-mpa is concerned that the Commission will require the program administrator (USAC) to force these charges to be made visible and cost-allocated out of the remainder of any ongoing contracts. While a case could be made that the rules of the program would support such a stance, E-mpa believes such a ruling would be costly, burdensome, challenging to adjudicate, and ultimately of little financial benefit to the program.

Without reasonable guidelines in place, E-mpa projects that the administrative burden to applicants, service providers, and the program administrator will be substantial and that in many cases will outweigh any potential savings to the program.

E-mpa also projects that cost-allocating existing contracts would create a significant, unanticipated financial burden to applicants, and force them to divert precious resources away from other priorities. Finally, aside from costly and burdensome, E-mpa projects this requirement, if enacted, would be extremely complicated and confusing, and runs counter to the Commission’s stated goal of simplifying the program.

Respectfully submitted by:

E-Rate Management Professionals Association

Fred Brakeman

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