

Before the
Federal Communications Commission
Washington, DC 20554

In the Matter of
Requests for Review of
Decisions of the
Universal Service Administrator by
Net56, Inc.
Palatine, IL
Schools and Libraries Universal Service
Support Mechanism
File Nos. SLD-602374, 685333
CC Docket No. 02-6

ORDER

Adopted: December 4, 2012

Released: December 4, 2012

By the Chief, Telecommunications Access Policy Division, Wireline Competition Bureau:

1. Consistent with precedent,1 we grant two requests from Net56, Inc. (Net56) seeking review of decisions by the Universal Service Administrative Company (USAC) under the E-rate program (more formally known as the schools and libraries universal service support program) to deny funding from Posen-Robbins School District 143.5's (Posen-Robbins) applications for funding years 2008 and 2009.2 For both funding years, USAC found that in selecting Net56 to provide Internet access, firewall services, web and email hosting services, and basic maintenance, Posen-Robbins violated multiple Commission rules.3 With respect to Posen-Robbins's funding requests for Internet access and basic maintenance of

1 See, e.g., Request for Review by Ysleta Independent School District of the Decision of the Universal Service Administrator, CC Docket Nos. 96-45, 97-21, Order, 18 FCC Rcd 26407, 26431 para. 53 (2003) (Ysleta) ("The Commission has determined that seeking competitive bids for eligible services is the most efficient means for ensuring that eligible schools and libraries are fully informed of their choices and are most likely to receive cost-effective services"); Request for Review by Macomb Intermediate School District Technology Consortium of the Decision of the Universal Service Administrator, CC Docket No. 02-6, Order, 22 FCC Rcd 8771, 8772 (2007) (Macomb) (applicants must select the most cost effective service offering); Request for Review of Decisions of the Universal Service Administrator by Net56, Inc., CC Docket No.02-6, Order, DA 12-1792 (Wireline Comp. Bur. rel. Nov. 7, 2012) (finding that the applicant, Harrison School District 36, properly allocated costs between E-rate eligible and ineligible services, paid its non-discounted share for services, and selected cost-effective services, inter alia) (Harrison School District 36 Order).

2 See Appendix. Section 54.719(c) of the Commission's rules provides that any person aggrieved by an action taken by a division of USAC may seek review from the Commission. 47 C.F.R. § 54.719(c) (2012).

3 See Letter from USAC, Schools and Libraries Division, to Net56, Inc. (dated June 3, 2010) (regarding Posen-Robbins's funding year (FY) 2008 FCC Form 471 application number 602374, funding request numbers (FRNs) 1724807 and 1724886) (Posen-Robbins FY 2008 Funding Commitment Decision Letter (FCDL) (denying funds for FY 2008); Letter from USAC, Schools and Libraries Division, to Tarra Batts, Posen-Robbins School District 143.5 (dated June 3, 2010) (regarding Posen-Robbins FY 2008 FCC Form 471 application number 602374, FRNs 1724807 and 1724886) (FY 2008 Further Explanation of Administrator's Funding Decision); Letter from USAC, Schools and Libraries Division, to Net56, Inc. (dated Mar. 9, 2010) (regarding Posen-Robbins FY 2009 FCC Form 471 application number 685333, FRNs 1908586 and 1908687) (Posen-Robbins FY 2009 FCDL) (denying funds for FY 2009); Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel for Net56, Inc. (dated

internal connections, USAC found that the contract Posen-Robbins signed with Net56 included ineligible products and services and did not cost allocate them.⁴ USAC also concluded that Posen-Robbins failed to pay its discounted share for eligible services.⁵ USAC made similar findings for Posen-Robbins's funding requests for firewall, web hosting, and email services, and also found that Posen-Robbins failed to select cost-effective eligible services.⁶

2. Based on our review of the record,⁷ we find that Posen-Robbins did cost allocate ineligible from eligible services and did pay its discounted share for eligible services. We also find that Net56 adequately demonstrated that the costs for the products and services in the funding requests were reasonable based on Posen-Robbins's circumstances and were therefore cost effective under Commission rules.⁸ We therefore grant and remand Net56's requests to the extent provided below.

3. In its decisions to deny funding to Posen-Robbins, USAC found that the contract between Posen-Robbins and Net56 failed to allocate costs between eligible and ineligible services.⁹ It is uncontested that Posen-Robbins provided to USAC a five-year Master Services Agreement (MSA) it signed with Net56 on January 28, 2008 that described both ineligible and eligible services without cost allocations.¹⁰ Net56 explains that the MSA provided by Posen-Robbins listed services Net56 could offer to Posen-Robbins, but did not obligate Posen-Robbins to purchase E-rate services.¹¹ Instead, Net56

May 26, 2010) (regarding Posen-Robbins FY 2009 FCC Form 471 application number 685333, FRNs 1908586 and 19088687) (FY 2009 Further Explanation of Administrator's Funding Decision). Subsequently, USAC also denied Net56's appeals of Posen-Robbins's funding year 2008 and 2009 funding denials. *See* Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Jun. 15, 2011) (Administrator's Decision on Appeal – Funding Year 2008-2009); Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Oct. 26, 2010) (Administrator's Decision on Appeal – Funding Year 2009-2010).

⁴ *See* FY 2008 Further Explanation of Administrator's Funding Decision at 5-7; FY 2009 Further Explanation of Administrator's Funding Decision at 4-5.

⁵ *See* FY 2008 Further Explanation of Administrator's Funding Decision at 6; FY 2009 Further Explanation of Administrator's Funding Decision at 5.

⁶ *See* FY 2008 Further Explanation of Administrator's Funding Decision at 1-4; FY 2009 Further Explanation of Administrator's Funding Decision at 1-3.

⁷ The Bureau must conduct a *de novo* review of requests for review of decisions issued by USAC. 47 C.F.R. § 54.723 (2012).

⁸ *See* 47 C.F.R. §§ 54.503(c)(2)(vii), 54.511(a) (2012). *See also* 47 C.F.R. §§ 54.504(c)(1)(xi), 54.511 (2008). *See also supra* n.1. In this order, we describe the requirements of the E-rate program as they currently exist, but because the order involves applications from funding years 2008-2009, and the Commission has re-organized the E-rate rules since then, where the Commission's rules have changed, we also cite to the relevant rules as they existed during the relevant funding years.

⁹ *See* FY 2008 Further Explanation of Administrator's Funding Decision at 5; FY 2009 Further Explanation of Administrator's Funding Decision at 4.

¹⁰ *See, e.g.*, FY 2008 Further Explanation of Administrator's Funding Decision at 5. *See also* Request for Review by Net56, Inc. of Decision of the Universal Service Administrator, Posen-Robbins School District 143.5, 2008 Funding Year, FRNs 1724807 and 1724886 at 3 (filed Aug. 5, 2011) (Net56 Appeal FY 2008); Request for Review by Net56, Inc. of Decision of the Universal Service Administrator, Posen-Robbins School District 143.5, 2009 Funding Year, FRNs 1908586 and 1908687, at 3 (filed Dec. 22, 2010) (Net56 Appeal FY 2009).

¹¹ *See* Letter of Appeal from Paul B. Hudson, Counsel to Net56 to Schools and Libraries Division-Correspondence Unit at 2-3 (dated Jul. 30, 2010) (Net56 USAC Appeal for FY 2008). *See also* Net56 Appeal FY 2008 at 3; Net56 Appeal FY 2009 at 4.

explained that the MSA only obligated Posen-Robbins to lease certain equipment.¹² Net56 explained that Posen-Robbins should have provided USAC with the contracts signed on February 1, 2008, and February 10, 2009, which were the applicable E-rate contracts between Net56 and Posen-Robbins for funding years 2008 and 2009.¹³ Net56 explains that it submitted these contracts when it appealed to USAC and again in its appeals to the Commission.¹⁴ The actual E-rate contracts covered a year of services each and had costs associated with Internet access, firewall services, web hosting and email services, and basic maintenance as well as documentation that allocated costs of ineligible and eligible services.¹⁵

4. We find that the record demonstrates that USAC considered the wrong contract in deciding to deny funding to Posen-Robbins for funding years 2008 and 2009. The record shows that Posen-Robbins did have E-rate contracts with Net56 which allocated eligible from ineligible services. The record also demonstrates that Posen-Robbins paid its share of the non-discounted portion of the eligible services, in accordance with the one-year E-rate contracts.¹⁶ Net56 explains that it used a financial company, American Capital Financial Services, Inc. (“ACFS”), to facilitate payments from Posen-Robbins to Net56 for E-rate eligible services.¹⁷ Net56 also states that it sought and received approval from USAC to use financiers, such as ACFS, to accept payments from applicants.¹⁸ The record shows that the contracts required Posen-Robbins to pay ACFS for eligible and ineligible services and goods, and ACFS would then remit part of Posen-Robbins’s payment to Net56 for the E-rate eligible services.¹⁹ Because the record reflects this process for payment continued through funding years 2008 and 2009, we find that Posen-Robbins did pay its share for E-rate supported services in accordance with Commission rules.

5. USAC also determined that certain services requested by Posen-Robbins in its requests for firewall services, email services, and web hosting services were ineligible for funding.²⁰ In its appeals,

¹² See Net56 USAC Appeal for FY 2008 at 3; Net56 Appeal FY 2008 at 5; Net56 Appeal FY 2009 at 6. See also Master Service Agreement between Net56, Inc. and Posen-Robbins School District 143.5 at Exhibit D (signed Jan. 28, 2008).

¹³ See Net56 USAC Appeal for FY 2008 at 2. See also Net56 Appeal FY 2008 at 3-4; Net56 Appeal FY 2009 at 3-5.

¹⁴ See Net56 USAC Appeal for FY 2008 at 2-3; Net56 Appeal FY 2008 at 3-4; Net56 Appeal FY 2009 at 3.

¹⁵ See Net56 USAC Appeal for FY 2008 at Attachment 2-4. See also Net56 Appeal FY 2008 at Ex. F; Net56 Appeal FY 2009 at Ex. C.

¹⁶ See Net56 Appeal FY 2008 at 5-6; Net56 Appeal FY 2009 at 5-7.

¹⁷ See Net56 Appeal FY 2008 at 5-6; Net56 Appeal FY 2009 at 6-7; Net56 USAC Appeal for FY 2008 at 3.

¹⁸ Letter from Paul B. Hudson, Counsel to Net56, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission at 1 (dated Aug. 15, 2011) (“Net56 . . . walked away from those discussions [with USAC] believing that it had been given a go-ahead”); *id.* at Attachment 2 (“I spoke with the USAC Ombudsman tonight and he said that it does not matter if you have the lease or the lease is assigned . . . Net56 can bill for services as is.”).

¹⁹ See Net56 USAC Appeal for FY 2008 at 5 and Attachment 4; Net56 Appeal FY 2008 at Ex. C; Net56 Appeal FY 2009 at 6 and Ex. C.

²⁰ See, e.g., FY 2008 Further Explanation of Administrator’s Funding Decision at 4 (listing the following services as ineligible for funding: “maintenance, operation and repair of school owned equipment located in the Net56 datacenter (co-located equipment), providing anti-virus services on co-located equipment, deployment of anti-virus at desktop, floating on-site support for district Staff to the Desktop, redesign of district website, Tier 1 and Tier 2 helpdesk support to desktop, business continuity plan, application hosting, accounting and student information system application support, SharePoint portal services, providing environmentally controlled atmosphere and generated backup power for co-located equipment and unlimited professional development on applications like

Net56 does not appeal USAC's eligibility determinations about certain of the services at issue.²¹ Because Net56 does not contest USAC's determinations with respect to eligibility of these services, we will not address them here.

6. Finally, we address USAC's determination that Posen-Robbins's funding requests for firewall, email and web hosting services were not cost effective.²² Applicants are required to request discounts based on their reasonable needs and resources and their bids for services should be evaluated based on cost-effectiveness.²³ In the instant matter, Net56 describes its service to Posen-Robbins, as well as other school districts and commercial clients, as a centralized solution that housed most of the equipment at the Net56 location, rather than on the applicant's premises.²⁴ For firewall services, Net56 provided a "robust and reliable" solution that used a specific switch and firewall software for all of its applicants.²⁵ Net56 explained that the pricing for services varied per applicant depending on bandwidth and other requirements.²⁶ For email and web hosting services, Net56 explained that it used a "network-based architecture" and provided costs associated with the equipment needed for these services.²⁷

7. USAC determined that Net56's services for firewall, email and web hosting services "exceed[ed] twice the cost of a commercially available solution" and were therefore not cost effective.²⁸ In reaching this decision, USAC used the MSA provided by Posen-Robbins and calculated costs for five

Microsoft Office Suite, SharePoint, Class Server"). USAC found that Posen-Robbins asked for a firewall at the Net56 data center, an ineligible location, and for e-mail and web retention and journaling, which were also ineligible for funding. *Id.* at 1-3. *See also* FY 2009 Further Explanation of Administrator's Funding Decision at 1-4.

²¹ *See* Net56 Appeal FY 2008 at 6-9; Net56 Appeal FY 2009 at 7-10. Net56 argues that "Net56 is simply asking to be able to receive at least a fraction of the contract price for a service that no one denies has already been provided in full." *Id.* at 8. *See also* Letter from Paul B. Hudson, Counsel to Net56, Inc., to Marlene H. Dortch, Secretary, Federal Communications Commission at 2 (dated Jul. 31, 2012) (Net56 July 31, 2012 Letter) ("Net56 notes that it is not seeking funding for certain functions that had been included in the contract prices but that USAC held were ineligible."). Net56 also states that it "does not concede ineligibility of that [sic.] any part of the services for which funding was sought, but forgoes such argument in this proceeding to expedite the Commission's consideration of the appeals." *Id.* at 2, n.1.

²² *See* FY 2008 Further Explanation of Administrator's Funding Decision at 1 (concluding that Net56's web hosting solution cost \$240,000 over the course of a five-year contract, whereas USAC estimated the cost of a theoretical premises-based solution to be \$28,500). For firewall services over five years, according to USAC, Net56's solution would cost \$246,900, while USAC's theoretical premises-based solution would cost \$100,000. *Id.* at 3. *Compare* FY 2009 Further Explanation of Administrator's Funding Decision at 2 (concluding that USAC's solution for firewall would cost \$140,000). Also, for e-mail services, USAC claims that Net56's solution would cost \$240,000 over the course of five years, while USAC's theoretical premises-based solution would cost \$28,500. *Id.* at 3. USAC did, however, find that Net56's prices for basic maintenance were cost effective. *Id.* USAC did not undertake a cost-effectiveness review for Net56's prices for Internet access. *Id.*

²³ *See supra* n.1.

²⁴ *See* Net56 July 31, 2012 Letter at 1-4; Email from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, attorney-advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated Sept. 13, 2012).

²⁵ *See* Net56 July 31, 2012 Letter at 3.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *See* FY 2008 Further Explanation of Administrator's Funding Decision at 1-4; FY 2009 Further Explanation of Administrator's Funding Decision at 1-3.

years.²⁹ USAC found that Posen-Robbins could have purchased equipment for school premises for significantly less than the leased option provided by Net56.³⁰ To arrive at its cost estimates for the commercially available solution, USAC conducted web searches for the purchase prices of specific network equipment and added an additional fifty percent of that price to estimate charges for installation and maintenance.³¹ Net56 argues that USAC's solution for Posen-Robbins severely understates the costs associated with a premises-based solution.³² For example, Net56 argues that USAC's solution fails to include costs for licenses, load balancers, additional bandwidth, obsolete equipment, hiring personnel, and training personnel to operate, monitor and maintain purchased equipment.³³ If Posen-Robbins wanted to use USAC's solution for firewall services, Net56 argues that Posen-Robbins would have had to purchase additional devices and at least an extra 100 Mbps of bandwidth.³⁴ Net56 argues that USAC's estimated price for the requested services would have been more expensive, and that Net56's leased solution was much more cost effective for Posen-Robbins.³⁵ Additionally, Net56 states that USAC mistakenly projected costs for five years, *i.e.* the contract length of the MSA, and instead, should have only used the one-year E-rate contract term.³⁶ Thus, Net56 argues that the prices for services and products to Posen-Robbins were cost effective.³⁷

8. The Commission has not established a bright line test for determining when costs for services are excessive.³⁸ The Commission has, however, noted that there may be instances where costs for prices or services are so exorbitant that they cannot be cost effective and gave the example of a router that is sold for two to three times the commercial market price.³⁹ Based on the information before us, that is not the case here, as the services requested by Posen-Robbins were not two to three times the estimated commercial market price.

²⁹ See FY 2008 Further Explanation of Administrator's Funding Decision at 1-4 (using the Posen-Robbins School District 143.5 – Net56, Inc. Master Service Agreement and Master Lease Agreement, which was signed January 28, 2008). See also FY 2009 Further Explanation of Administrator's Funding Decision at 1-3.

³⁰ See FY 2008 Further Explanation of Administrator's Funding Decision at 1-4; FY 2009 Further Explanation of Administrator's Funding Decision at 1-3.

³¹ See *id.*

³² See Email from Paul B. Hudson, Counsel to Net56, Inc., to Anita Patankar-Stoll, attorney-advisor, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission (dated Sept. 13, 2012).

³³ See *id.*

³⁴ See *id.*

³⁵ See Net56 July 31, 2012 Letter at 3.

³⁶ See *id.*

³⁷ See Net56 July 31, 2012 Letter at 2.

³⁸ See *Ysleta*, 18 FCC Rcd at 26432, para. 54 (“The Commission has not, to date, enunciated bright-line standards for determining when particular services are priced so high as to be considered not cost-effective under our rules.”)

³⁹ See *id.*

9. In this case, we find first that the record supports a determination that Posen-Robbins followed the Commission's rules in conducting its bidding and selection process.⁴⁰ Second, we are not persuaded that USAC took into account all the relevant costs when estimating the cost of a premises-based solution compared to Net56's leased solution for Posen-Robbins. Third, the record reflects that Net56 complied with the Commission's rules regarding lowest corresponding price, which requires service providers to provide applicants with prices no higher than the lowest price that it charges to similarly-situated non-residential customers for similar services.⁴¹ Net56 provided examples of prices for its commercial customers for Internet access, web and email hosting, and firewall services and compared them to the comparable prices that it charged to Posen-Robbins.⁴² Based on these factors and the record before us, we conclude that USAC erred in finding that the services Posen-Robbins purchased were not cost effective.⁴³

10. Lastly, on our own motion, we waive section 54.507(d) of the Commission's rules and direct USAC to waive any procedural deadline, such as the invoicing deadline, that might be necessary to effectuate our ruling.⁴⁴ We find good cause to waive section 54.507(d) because filing an appeal of a denial is likely to cause the applicant to miss the program's subsequent procedural deadlines in that funding year.

11. Therefore based on our review of the record, we grant the requests of Net56 with respect to Posen-Robbins's funding year 2008 and 2009 E-rate applications. On remand, we direct USAC to process the grant using the services and pricing found in Posen-Robbins's E-rate contracts dated February 1, 2008, and February 10, 2009, and reduce the funding request by the amount of any ineligible charges consistent with this order. To ensure that the underlying applications are resolved expeditiously, we

⁴⁰ See 47 C.F.R. § 54.503 (2012) (requiring applicants to seek competitive bids to procure E-rate services and providing instruction on the protocol for the bidding process). See also 47 C.F.R. § 54.504 (2008). See, e.g., FCC Form 470, Posen-Robbins School District 143.5 (posted Dec. 5, 2007); Letter from Posen-Robbins School District 143.5 to USAC (dated Mar. 15, 2010) (describing the bids received for FRNs 1724886 and 1724807 for FY 2008 and the criteria used to evaluate those bids, including "cost, understanding of needs, previous experiences, qualifications, financial stability, and references"); Posen-Robbins School District 143.5 Business Office Report, Board Meeting (dated Jan. 9, 2008) ("Based on all applicants/bidders that have submitted quotes for the services requested by the [D]istrict, Net56 has addressed our needs adequately. They have demonstrated their ability to provide top level service at a reasonable price."). See also Net56 Appeal FY 2008 at 2-4 (stating that for FY 2008, Posen-Robbins and Net56 entered into an E-rate contract on February 1, 2008, and Posen-Robbins posted its FCC Form 471 on February 6, 2008); Net56 Appeal FY 2009 at 3-5 (stating that for FY 2009, Posen-Robbins and Net56 entered into a contract on February 10, 2009, and Posen-Robbins posted its FCC Form 471 on February 12, 2009).

⁴¹ See 47 C.F.R. § 54.511 (b) (2008) ("Providers of eligible services shall not charge schools, school district, libraries, library consortia, or consortia including any of these entities a price above the lowest corresponding price for supported services, unless the Commission, with respect to interstate services or the state commission with respect to intrastate services, finds that the lowest corresponding prices is not compensatory. Promotional rates offered by a service provider for a period of more than 90 days must be included among the comparable rates upon which the lowest corresponding price is determined."). See also *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourth Order on Reconsideration, 13 FCC Rcd 2372, para. 133 (1997).

⁴² See Net56 July 2012 Letter at 4-5.

⁴³ See, e.g., *Harrison School District 36 Order* at 8, para. 14 (explaining how Net56 demonstrated that its costs for products and services were not unreasonable based on the needs and circumstances of Harrison School District 36 and that USAC erred in finding that the services were not cost-effective). We note that while we review the rationale for USAC's determinations, nothing in the *Harrison School District 36 Order* should be read to suggest that USAC bears the burden of proof.

⁴⁴ 47 C.F.R. § 54.507(d) (2012) (requiring non-recurring services to be implemented by September 30 following the close of the funding year).

direct USAC to complete its review of each application listed in the appendix and issue an award or a denial based on a complete review and analysis no later than 90 calendar days from the release date of this order. In remanding these applications to USAC, we make no finding as to the ultimate eligibility of the services or the underlying applications. We direct USAC to discontinue recovery actions relating to requests for review that are addressed herein. At this time, we find that there is also no evidence of waste, fraud or abuse in the record.

12. ACCORDINGLY, IT IS ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), the requests for review filed by Net56, Inc. as listed in the Appendix ARE GRANTED and the underlying applications ARE REMANDED to USAC for further consideration in accordance with the terms of this order.

13. IT IS FURTHER ORDERED, pursuant to the authority contained in sections 1-4 and 254 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151-154 and 254, and sections 0.91, 0.291, 1.3 and 54.722(a) of the Commission's rules, 47 C.F.R. §§ 0.91, 0.291, 1.3 and 54.722(a), that section 54.507(d) of the Commission's rules, 47 C.F.R. § 54.507(d), IS WAIVED for the parties to the limited extent provided herein.

FEDERAL COMMUNICATIONS COMMISSION

Trent B. Harkrader
Chief
Telecommunications Access Policy Division
Wireline Competition Bureau

APPENDIX

Petitioner	Application Number	Funding Year	Date Request for Review Filed
Net56, Inc. Palatine, Illinois (Posen-Robbins School District 143.5 Posen, Illinois)	602374 685333	2008 2009	Aug. 5, 2011 Dec. 22, 2010