

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 No. SLD-678753
CC Docket No. 02-6

ORDER

Adopted: December 19, 2012

Released: December 19, 2012

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

1. Consistent with precedent,1 we grant a request from Net56, Inc. (Net56) seeking review of a decision 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 for Country Club Hills School District 160’s (Country Club Hills) application for funding year 2009.2 In this appeal, we find USAC erred in finding that the applicant violated the Commission’s rules when selecting Net56 to provide Internet access, wide area network (WAN), firewall, and web and email hosting services.3

1 See Request for Review of Decisions of the Universal Service Administrator by Net56, Inc., CC Docket No. 02-6, Order, 27 FCC Rcd 13606 (Wireline Comp. Bur. 2012) (Net56/Harrison) (finding that the applicant cost allocated E-rate eligible services, paid its non-discounted share for services, and selected cost-effective services, inter alia); Request for Review of Decisions of the Universal Service Administrator by Net56, Inc., CC Docket No. 02-6, Order, DA 12-1951 (Wireline Comp. Bur. rel. Dec. 4, 2012) (Net56/Posen-Robbins). See also, 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, para. 2 (2007) (applicants must select the most cost-effective service offering).

2 See Request for Review by Net56, Inc. of Decision of the Universal Service Administrator, Country Club Hills School District, 2009 Funding Year, funding request numbers (FRNs) 1853415, 1853424, 1853437, at 4 (filed Aug. 30, 2010) (Net56 Appeal FY 2009). 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 Net56/Harrison, 27 FCC Rcd at 13612, para. 14; Net56/Posen-Robbins at para. 9. See also Letter from USAC, Schools and Libraries Division, to Net56, Inc. (dated Feb. 23, 2010) (regarding Country Club Hills’s funding year (FY) 2009 FCC Form 471 application number 678753, FRNs 1853415, 1853424, and 1853437) (Country Club Hills FY 2009 Funding Commitment Decision Letter (FCDL) (denying funds for FY 2009); Letter from USAC, Schools (continued...)

2. As with the two previous appeals involving Net56, we find that USAC erred in its determination that the applicant, in this case Country Club Hills, violated the Commission's rules by failing to cost allocate services in its contract with Net56, failing to pay its discounted share for eligible services,<sup>4</sup> and failing to select cost-effective eligible services.<sup>5</sup> In this instance, on appeal, USAC also found that Country Club Hills failed to retain documentation regarding its competitive bidding process.<sup>6</sup> We also grant Net56's appeal of that determination. As with the two previous appeals involving Net56, we find USAC incorrectly considered a five-year Master Services Agreement (MSA) between Net56 and the applicant, rather than the existing one-year contract for E-rate services.<sup>7</sup>

3. We find that USAC considered the wrong contract in deciding to deny funding to Country Club Hills for funding year 2009. The record shows that Country Club Hills did have an E-rate contract with Net56 which allocated eligible from ineligible services.<sup>8</sup> The record also demonstrates that Country Club Hills paid its share of the non-discounted portion of the eligible services, in accordance with the one-year E-rate contract.<sup>9</sup> As with the other Net56-related appeals, Net56 explains that it used a financial company, Millennium Leasing & Financial Services, Inc. ("Millennium"), to facilitate payments from Country Club Hills to Net56 for E-rate eligible services.<sup>10</sup> The record shows that Country Club Hills was required to pay Millennium for eligible and ineligible services and goods.<sup>11</sup> Millennium would then remit Country Club Hills's non-discount portion of the cost of the eligible goods and services to Net56 for the E-rate eligible services.<sup>12</sup> Because this payment process was in effect for funding year 2009, we find that Country Club Hills did pay its share for E-rate supported services in accordance with Commission rules.

4. USAC also determined that certain services requested by Country Club Hills in its requests for WAN, firewall, email, and web hosting services were ineligible for funding.<sup>13</sup> In its appeals, Net56 (Continued from previous page)\_\_\_\_\_

and Libraries Division, to Denise Peeks, Country Club Hills School District 160 (dated March 26, 2010) (FY 2009 Further Explanation of Administrator's Funding Decision). Subsequently, USAC also denied Net56's appeal of Country Club Hills's funding year 2009 denials. *See* Letter from USAC, Schools and Libraries Division, to Paul B. Hudson, Counsel to Net56, Inc. (dated Jun. 29, 2010) (Administrator's Decision on Appeal – Funding Year 2009-2010).

<sup>4</sup> *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4-7.

<sup>5</sup> *See id.* at 3.

<sup>6</sup> *See* Administrator's Decision on Appeal – Funding Year 2009-2010 at 2.

<sup>7</sup> *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4-7. Because it considered the MSA to be the contract for E-rate services between Country Club Hills and Net56, it also found that Country Club Hills and Net56 failed to allocate costs between eligible and ineligible services and that Country Club Hills did not pay its share of the E-rate supported services.

<sup>8</sup> *See* Net56 Appeal FY 2009 at 7 and Ex. C at Attachments 2-4.

<sup>9</sup> *See id.* at Attachments 2-3.

<sup>10</sup> *See id.* at 7 and Ex. C at Attachment 3.

<sup>11</sup> *See* Net56 Appeal FY 2009 at Ex. C at Attachment 3.

<sup>12</sup> *See id.*

<sup>13</sup> *See* FY 2009 Further Explanation of Administrator's Funding Decision at 4 (listing the following services as ineligible for funding: "maintenance and repair of school owned equipment located in the Net56 datacenter (co-located equipment), backup of hard drives of co-located equipment, providing anti-virus services on co-located equipment, providing environmentally controlled atmosphere and generated backup power for co-located equipment"). USAC found that a DNS/DHCP server that Country Club Hills included in its priority 1 funding request should have been requested in a priority 2 funding request. *Id.* at 2. USAC also found that Country Club Hills 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.

does not appeal USAC's eligibility determinations about certain of the services at issue.<sup>14</sup> Because Net56 does not contest USAC's determinations with respect to eligibility of these services, we will not address them here.

5. Next we address USAC's determination that Country Club Hills's funding requests for email and web hosting services were not cost effective.<sup>15</sup> 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.<sup>16</sup> In the instant matter, as in the other Net56-related appeals, USAC determined that Net56's services for email and web hosting services "exceed[ed] twice the cost of a commercially available solution" and were therefore not cost effective.<sup>17</sup> As we have previously explained, the Commission has not established a bright line test for determining when costs for services are excessive.<sup>18</sup> 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.<sup>19</sup> Here, 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 Country Club Hills. Based on the record before us, we conclude that the services requested by Country Club Hills were not two to three times the estimated commercial market price.

6. Moreover, as with the previous Net56 related cases, we find that the record supports a determination that Country Club Hills followed the Commission's rules in conducting its bidding and selection process.<sup>20</sup> The record also 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.<sup>21</sup> Net56 provided examples of prices for its commercial customers for web and email hosting services and

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<sup>14</sup> See Net56 Appeal FY 2009 at 7-9. 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)

<sup>15</sup> See FY 2009 Further Explanation of Administrator's Funding Decision at 3 (concluding that Net56's web hosting and email solution cost \$480,000 over the course of a five-year contract, whereas USAC's theoretical premises-based solution would cost \$57,000). USAC did not undertake a cost-effectiveness review for Net56's prices for Internet access or firewall services. *Id.* at 2.

<sup>16</sup> See *supra* n.1.

<sup>17</sup> See FY 2009 Further Explanation of Administrator's Funding Decision at 3.

<sup>18</sup> 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").

<sup>19</sup> See *id.*

<sup>20</sup> 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 (2009). See, e.g., FCC Form 470, Country Club Hills School District 160 (posted Dec. 15, 2008); Letter from Denise O. Peeks, Business Manager, Country Club Hills School District 160 to Marlene H. Dortch, Secretary, Federal Communications Commission at 1 (dated Mar. 2, 2011).

<sup>21</sup> See 47 C.F.R. § 54.511(b) (2012). See also 47 C.F.R. § 54.511(b) (2009) ("Providers of eligible services shall not charge schools, school districts, 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 price 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 5318, 5398, para. 133 (1997).

compared them to the comparable prices that it charged to Country Club Hills.<sup>22</sup> Based on these factors and the record before us, we conclude that USAC erred in finding that the services Country Club Hills purchased were not cost effective.<sup>23</sup>

7. Finally, we address USAC's allegation that Country Club Hills failed to retain required competitive bidding documents. Here, it is undisputed that Net56 was the only bidder, and the record demonstrates that Country Club Hills retained all necessary documents relating to Net56's bid. Therefore, we find that USAC erred in finding that Country Club Hills failed to retain required documentation.

8. 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.<sup>24</sup> 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.

9. Therefore based on our review of the record, we grant the request of Net56 with respect to Country Club Hills's funding year 2009 E-rate application. On remand, we direct USAC to process the grant using the services and pricing found in Country Club Hills's E-rate contract dated January 20, 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 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 also find that there is no evidence of waste, fraud or abuse in the record.

10. 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), that the request for review filed by Net56, Inc. IS GRANTED and the underlying application IS REMANDED to USAC for further consideration in accordance with the terms of this order.

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<sup>22</sup> See Net56 July 31, 2012 Letter at 4-5.

<sup>23</sup> See, e.g., *Net56/Harrison*, 27 FCC Rcd at 13612, 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).

<sup>24</sup> 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).

11. 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  
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