

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  
 )  
 )

**THIRD REPORT AND ORDER AND  
SECOND FURTHER NOTICE OF PROPOSED RULEMAKING**

**Adopted:** December 17, 2003

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By the Commission: Chairman Powell, Commissioners Abernathy, Copps, and Adelstein issuing separate statements.

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**I. INTRODUCTION AND SUMMARY**

1. In this Third Report and Order and Second Further Notice of Proposed Rulemaking, we address several matters related to the administration of the schools and libraries universal service mechanism (also known as the e-rate program). First, in the Third Report and Order, we adopt rules that will limit the ability of schools and libraries to engage in wasteful or fraudulent practices when obtaining internal connections. Specifically, we conclude that eligible entities should be precluded from upgrading or replacing internal connections on a yearly basis. Instead, our rules will permit a particular eligible entity to receive support for discounted internal connections services no more than twice in every five years. We will permit, however, entities to receive discounts on basic maintenance associated with internal connections on a yearly basis, but clarify our rules regarding permissible maintenance costs to ensure that such discounts are appropriately narrow. We also prohibit a school or library from transferring equipment purchased with universal service discounts, as part of eligible internal connections services, for a period of three years except in limited circumstances.<sup>1</sup> These rules will advance the goals of the schools and libraries program by making support for internal connections regularly available to a larger number of applicants and by discouraging waste, fraud, and abuse. We also adopt a rule creating a more formal process for updating annually the list of services eligible for support. In addition, we codify the Universal Service Administrative Company's (USAC or the Administrator) current practices for allocating costs of services between eligible and ineligible components consistent with Commission rules and requirements, codify a prohibition on the provision of free services to entities receiving discounts, and codify with one modification procedures for service substitutions. We also clarify existing requirements for eligibility of certain equipment and services. Finally, we adopt rules to implement our prior decision to carry forward unused funds from the schools and libraries mechanism for use in subsequent funding years. All rule changes and clarifications shall be implemented upon the effective date of this Order, unless specified otherwise.

<sup>1</sup> Although the schools and libraries support mechanism provides discount support for services, many supported services have component parts. In this Order, references to "equipment" will refer, for simplicity, to equipment components of eligible internal connections services.

2. In the Second Further Notice, we seek comment on several issues, including whether we should change (1) the discount matrix used to determine the level of discounts for which applicants are eligible, (2) the current competitive bidding process, (3) the definition of “rural area” used in the program, (4) the definition of Internet access, (5) current rules relating to wide area networks, and (6) current procedures for recovery of funds. We also seek comment on measures to limit waste, fraud, and abuse and improve the Commission’s ability to enforce the rules governing the program. Finally, we seek additional comment on how to ensure the goals of section 254 continue to be met.

3. This order is one of a series of orders designed to simplify program administration, ensure equitable distribution of funds, and protect against waste, fraud, and abuse. In taking these additional steps today, we draw on information from a number of sources, including issues raised in a public forum held in May 2003 on ways to improve the schools and libraries support mechanism,<sup>2</sup> the Office of the Inspector General’s semi-annual reports,<sup>3</sup> beneficiary audit reports, and the recommendations of USAC’s Waste, Fraud, and Abuse Task Force.<sup>4</sup> We remain committed to making ongoing changes to ensure that this program continues to benefit school children and library patrons across America.

## II. PROGRAM OVERVIEW AND BACKGROUND

4. Under the schools and libraries universal service support mechanism, eligible schools, libraries, and consortia that include eligible schools and libraries, may receive discounts for eligible telecommunications services, Internet access, and internal connections.<sup>5</sup> Prior to applying for discounted services, an applicant must conduct a technology assessment and develop a technology plan to ensure that any services it purchases will be used effectively.<sup>6</sup> The applicant then must submit to the Administrator a completed FCC Form 470, in which the applicant sets

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<sup>2</sup> Forum on Improving Administration of the Schools and Libraries Universal Support Mechanism (May 8, 2003) (*E-Rate Public Forum*).

<sup>3</sup> Semiannual Report to Congress, April 1-September 30, 2003, Office of the Inspector General, Federal Communications Commission, at 3-15; Semiannual Report to Congress, October 1, 2002-March 31, 2003, Office of the Inspector General, Federal Communications Commission, at 4-12; Semiannual Report to Congress, April 1-September 30, 2002, Office of the Inspector General, Federal Communications Commission, at 2-10 (filed October 31, 2002) (collectively, *Semi-Annual Reports of the Inspector General*).

<sup>4</sup> See Task Force on the Prevention of Waste, Fraud, and Abuse, Universal Service Administration Company (filed November 26, 2003) (*Task Force Recommendation*).

<sup>5</sup> 47 C.F.R. §§ 54.502, 54.503.

<sup>6</sup> *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Report and Order, 12 FCC Rcd 8776, 9077-78 paras. 572-74 (1997) (*Universal Service Order*). A technology plan must meet five requirements: (1) clear goals and a realistic strategy for using telecommunications and information technology to improve education or library services; (2) a professional development strategy to ensure that staff know how to use these new technologies to improve education or library services; (3) an assessment of the telecommunication services, hardware, software, and other services that will be needed to improve education or library services; (4) a sufficient budget to acquire and support the non-discounted elements of the plan: the hardware, software, professional development, and other services that will be needed to implement the strategy; and (5) an evaluation process that enables the school or library to monitor progress toward the specified goals. See *id.*

forth its technological needs and the services for which it seeks discounts.<sup>7</sup> Once the school or library has complied with the Commission's competitive bidding requirements and entered into agreements for eligible services, it must file an FCC Form 471 application to notify the Administrator of the services that have been ordered, the service providers with whom the applicant has entered into an agreement, and an estimate of funds needed to cover the discounts to be given for eligible services.<sup>8</sup>

5. The Administrator reviews the FCC Forms 471 that it receives and issues funding commitment decisions indicating discounts that the applicant may receive in accordance with the Commission's rules. Subsequently, the applicant either: (1) pays the bill in full, and seeks reimbursement for discounts from the Administrator via the service or equipment provider, or (2) pays the non-discount portion of the service cost to the service provider, who, in turn, seeks reimbursement from the Administrator for the discounted amount.<sup>9</sup>

6. Under the Commission's rules, eligible schools and libraries may receive discounts ranging from 20 percent to 90 percent of the pre-discount price of eligible services, based on indicators of need.<sup>10</sup> Schools and libraries in areas with higher percentages of students eligible for free or reduced-price lunch through the National School Lunch Program (or a federally approved alternative mechanism) qualify for higher discounts for eligible services than applicants with low levels of eligibility for such programs. Schools and libraries located in rural areas also generally receive greater discounts.<sup>11</sup>

7. The Commission's priority rules provide that requests for telecommunications services and Internet access for all discount categories shall receive first priority for the available funding (Priority One services). The remaining funds are allocated to requests for support for internal connections (Priority Two services), beginning with the most economically disadvantaged schools and libraries, as determined by the schools and libraries discount matrix. Currently, the most disadvantaged schools and libraries are eligible for a 90 percent discount on eligible services, and thus must pay only 10 percent of the cost of the service. To the extent funds remain after discounts are awarded to entities eligible for a 90 percent discount, the rules provide that the Administrator shall continue to allocate funds for discounts to applicants at each descending single discount percentage. The Commission's rules also provide that if sufficient funds do not exist to grant all requests within a single discount percentage, the Administrator shall allocate the

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<sup>7</sup> 47 C.F.R. § 54.504(b)(1), (b)(3).

<sup>8</sup> 47 C.F.R. § 54.504(c).

<sup>9</sup> Schools and Libraries Universal Service, Billed Entity Applicant Reimbursement Form, OMB 3060-0856 (October 1998) (FCC Form 472 or BEAR Form); Schools and Libraries Universal Service, Service Provider Invoice Form, OMB 3060-0856 (October 2001) (FCC Form 474 or SPI Form).

<sup>10</sup> See 47 C.F.R. § 54.505.

<sup>11</sup> *Id.* See also Appendix B (discount matrix).

remaining support on a pro rata basis over that single discount percentage level.<sup>12</sup>

8. As the program approached its fifth year of operation, the Commission issued the *Schools and Libraries NPRM* to seek comment on ideas raised by both the applicant and service provider communities for improving the program.<sup>13</sup> In particular, the Commission sought comment on ways to ensure that the program funds are utilized in an efficient, effective, and fair manner, while preventing waste, fraud, and abuse. On June 13, 2002, the Commission released the *Schools and Libraries Order*, which adopted a framework for the carryover of unused funds from the schools and libraries universal service support mechanism.<sup>14</sup> On April 30, 2003, the Commission released the *Schools and Libraries Second Order and Further Notice*, which adopted a debarment rule and other measures to ensure that program funds are utilized in an efficient, effective and fair manner, and sought comment on additional matters, including the implementation of the carryover of unused funds to subsequent years.<sup>15</sup>

### III. THIRD REPORT AND ORDER

#### A. Limits on Use of Internal Connections

##### 1. Background

9. Because demand for discounts from the schools and libraries universal service support mechanism has exceeded the annual \$2.25 billion cap, in recent funding years only applicants eligible for the highest discount percentages have received discounts for internal connections.<sup>16</sup> Thus, applicants in the highest discount percentages have been able to repeatedly apply for and receive discounts for Priority Two services, while applicants in the lower discount bands have not received any Priority Two discounts because the annual funding has been exhausted. Moreover, nothing in our current rules expressly preclude entities with 90 percent discounts from replacing, on a yearly or almost-yearly basis, equipment obtained with universal service discounts, and

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<sup>12</sup> 47 C.F.R. § 54.507(g)(1)(i-iv); see also *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Fifth Order on Reconsideration and Fourth Report and Order, 13 FCC Rcd 14915, 14938 para. 36 (1998) (*Fifth Order on Reconsideration*).

<sup>13</sup> *Schools and Libraries Universal Service Support Mechanism*, CC Docket 02-6, Notice of Proposed Rulemaking, 17 FCC Rcd 1914 (2002) (*Schools and Libraries NPRM*).

<sup>14</sup> See *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Report and Order, 17 FCC Rcd 11521 (2002) (*Schools and Libraries Order*).

<sup>15</sup> See *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Second Report and Order and Further Notice of Proposed Rulemaking, 18 FCC Rcd 9202 (2003) (*Schools and Libraries Second Order or Schools and Libraries Further Notice*).

<sup>16</sup> For example, USAC estimates that the demand for discounts for Funding Year 2003 of the schools and libraries program is \$4.718 billion. See Letter from George McDonald, Vice-President, Universal Service Administrative Company, Schools and Libraries Division, to William Maher, Chief of the Wireline Competition Bureau, Federal Communications Commission, April 3, 2003. Funding years are described by the year in which the funding period starts. For example, the funding period which begins on July 1, 2003 and ends on June 30, 2004, is called Funding Year 2003. The funding period which begins on July 1, 2004, and ends on June 30, 2005, is called Funding Year 2004.

transferring that equipment to other entities with lower discount percentages that otherwise would not receive funding for such equipment due to the exhaustion of the capped amount.<sup>17</sup> The Act and our existing rules provide only that equipment purchased with universal service discounts “shall not be sold, resold, or transferred in consideration for money or any other thing of value.”<sup>18</sup>

10. With the goals of promoting equitable distribution of program funds and preventing waste, fraud, and abuse, the Commission sought comment in the *Schools and Libraries NPRM* on whether to revise these rules.<sup>19</sup> Specifically, it sought comment on whether the program’s goals would be better achieved by requiring that schools and libraries make significant use of the discounted equipment that they receive, before seeking to substitute new discounted equipment. The Commission proposed two options. The first option would limit transfers of equipment for three years from the date of delivery and installation of equipment for internal connections other than cabling, and ten years in the case of cabling.<sup>20</sup> The second option would deny internal connections discounts to any entity that has already received discounts on internal connections within a specified period of years, regardless of the intended use of the new internal connections.<sup>21</sup> Virtually all commenters that responded to these issues raised in the *Schools and Libraries NPRM* agreed that some form of restriction on the use of internal connections was appropriate, although parties had differing views on which measures would best carry out the Commission’s goals.<sup>22</sup>

## 2. Discussion

11. In this Order, we adopt a rule limiting each eligible entity’s receipt of discounts on internal connections to twice every five funding years. We exempt basic maintenance services from this restriction. We also clarify the types of maintenance services that are eligible for discounts. In addition, we adopt a rule that limits an entity’s ability to transfer equipment

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<sup>17</sup> See 47 C.F.R. § 54.617.

<sup>18</sup> 47 U.S.C. § 254(h)(3); 47 C.F.R. § 54.513.

<sup>19</sup> *Schools and Libraries NPRM*, 17 FCC Rcd 1914. A list of the parties that filed comments and/or replies in response to the *Schools and Libraries NPRM* and the *Schools and Libraries Further Notice* is provided in Appendix D.

<sup>20</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1930-31 para. 39.

<sup>21</sup> *Id.* at 1931 para. 40.

<sup>22</sup> Some commenters supported limiting equipment transfers. See, e.g., State of Alaska NPRM Comments at 8; American Library Association, BellSouth Corporation and SBC Communications NPRM Comments at 18; Colorado Department of Education NPRM Comments at 7; Council of the Great City Schools NPRM Comments at 4; Iowa Communications Network NPRM Comments at 2; Maine Public Utilities Commission NPRM Comments at 4; New York Board of Education NPRM Comments at 6; Seattle Public Library NPRM Comments at 2; TAMSCO Telecommunications Division NPRM Comments at 3. Other commenters supported restrictions on the receipt of internal connections discounts. See, e.g., Bakersfield Schools District NPRM Comments at 3; Central Susquehanna Intermediate Unit NPRM Comments at 3; City of Boston NPRM Comments at 8; Illinois State Board of Education NPRM Comments at 22; Quaker Valley School District NPRM Comments at 1; Siemens Enterprise Network NPRM Reply at 2; Spectrum Communications Cabling Services NPRM Comments at 3; York County Library System NPRM Comments at 10.

purchased with universal service funds.

12. *Frequency of Discounts.* We conclude that each eligible entity may receive commitments for discounts on Priority Two services, except as discussed below, no more than twice every five funding years.<sup>23</sup> The practical effect of this rule will be to permit applicants to receive funding once every three years for internal connections, as supported by the record,<sup>24</sup> but will allow applicants to obtain internal connections in two consecutive years as part of a staged implementation of internal connections.<sup>25</sup> In order to give applicants sufficient planning time, we conclude that this rule will become effective beginning with support received in Funding Year 2005. Commitments for Priority Two services received in years prior to Funding Year 2005 will not be considered in determining an applicant's eligibility to receive support for Priority Two services.

13. For the purpose of determining whether an applicant is eligible to receive a funding commitment for Priority Two services under this rule, the five-year period begins in any year, starting with Funding Year 2005, in which the entity receives discounted Priority Two services. The rule is applicable to discounts for services that are site-specific to the entity and for services that are shared by the entity with other entities. Thus, if an entity receives support only for shared services in a particular funding year, that funding will be counted as one of the two years out of five that it may receive support.<sup>26</sup> The restriction does not apply to consortium members who do not actually receive Priority Two funding when other members of the consortium receive discounts in specific funding periods.

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<sup>23</sup> For the purpose of implementing this rule, an entity is an individual eligible school or library as defined in our rules. See 47 C.F.R § 54.501(b), (c). We note that each individual school or library is currently given an "entity number" to facilitate processing of the FCC Form 471.

<sup>24</sup> Several commenters suggest limiting discounts on internal connections to every two or three years. See, e.g. Central Susquehanna Intermediate Unit NPRM Comments at 3; Integrity Networking Systems, Inc. NPRM Comments at 3; Marian High School NPRM Comments at 1; Michigan Department of Information Technology NPRM Comments at 15; North Carolina Department of Cultural Resources NPRM Comments at 1; Pennsylvania Department of Education NPRM Comments at 7; Siemens Enterprise Networks NPRM Reply at 2. See also *E-rate Public Forum*, American Library Association Statement at 3 and Central Susquehanna Intermediate Statement at 4.

<sup>25</sup> For example, under this new rule, a school or library could receive support for internal connections in Funding Year 2005, Funding Year 2008, and Funding Year 2011. Alternately, a school that receives support for Priority Two services in Funding Years 2005 and 2006 will not be eligible to receive support for Priority Two services until Funding Year 2010. In another example, if a school receives discounts in Funding Year 2006 and then in Funding Year 2010, it would be eligible to receive Priority Two discounts again in Funding Year 2011. Appendix C provides, for illustrative purposes, examples of what would be permitted under this rule.

<sup>26</sup> Applying the twice-every-five-years restriction to all entities receiving shared services in this manner is necessary to prevent avoidance of this rule by applicants that might seek discounts more frequently than permitted by nominally identifying services as shared when they are intended primarily to serve a single entity. We recognize that attributing shared services in this way will result in the need for additional planning by entities that receive support for shared services. However, we find that such planning is consistent with the Commission's existing policies regarding plans for using technology. Moreover, such applicants are free to seek support for non-shared services in that same year, or the other year in the five-year cycle in which they will be permitted to receive support for Priority Two services.

14. We find that, by limiting the frequency in which applicants may receive Priority Two discounts, funds will be made available to more eligible schools and libraries on a regular basis. Specifically, we find that the twice-every-five-years rule we adopt balances this goal with the need to ensure that the most disadvantaged schools and libraries are able to maintain functioning internal connections networks. Permitting applicants to receive support more often than twice every five years would not make funds available to significantly more eligible schools and libraries, while limiting applicants to support less frequently than twice every five years could prevent applicants from updating their internal connections as necessary.

15. We are not persuaded by those commenters that assert that the most disadvantaged applicants will suffer from a policy restricting receipt of internal connections discounts.<sup>27</sup> The Commission remains committed to ensuring that discounts continue to flow to schools and libraries that are economically disadvantaged. Indeed, program rules continue to provide greater discounts for the most economically disadvantaged schools and libraries. We recognize, however, that many applicants below the very highest discount levels are also economically disadvantaged and also unable to acquire internal connections without universal service support. We also recognize that demand for universal service discounts will likely continue to exceed the annual funding cap. Thus, we agree with commenters that without revising our existing policies, some economically disadvantaged applicants will continue to be denied Priority Two funding.<sup>28</sup> We find that the twice-every-five-years restriction is appropriate and necessary to make advanced technologies more accessible to all schools and libraries. We further find that the twice-every-five-years policy will increase the mechanism's funding reach to a greater number of economically disadvantaged schools and libraries.

16. It is important to note that even with this revised policy on the funding of internal connections, funding commitments will continue to be made in accordance with the annual funding cap. Thus, it is conceivable that an applicant may be eligible to apply for discounts on Priority Two services and still be denied funding because demand for discounts exceeds available funding. In this instance, we encourage applicants to reapply for discounts during the following funding year. We further note that it is the receipt of support for Priority Two services, rather than the application for support, that counts toward the limitation that an entity may receive in only two out of five years.

17. Furthermore, we conclude that, by precluding a particular entity from receiving support for Priority Two discounts every year, our modified rule strengthens incentives for applicants to fully use equipment purchased with universal service funds. Our current rules permit applicants in the highest discount bands to upgrade their equipment on a yearly basis, even

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<sup>27</sup> See, e.g., Council of the Great City Schools NPRM Comments at 4; Memphis City Schools NPRM Comments at 2, Montana Independent Telecommunications Systems NPRM Comments at 7 (“denying internal connections within a specified period of years regardless of the intended use...creates a barrier for the most disadvantaged schools...”), New York Public Library NPRM Comments at 2.

<sup>28</sup> See, e.g., Bakersfield School District NPRM Comments at 3, Colorado Department of Education NPRM Comments at 8, Marian High School NPRM Comments at 1.



when existing equipment continues to have a useful life.<sup>29</sup> By limiting each eligible entity's ability to receive support for internal connections, recipients will have greater incentive not to waste program resources by replacing or upgrading equipment on an annual basis.

18. A few commenters maintain that limiting funding of internal connections will disrupt applicants' planning and budgets.<sup>30</sup> We recognize that our modified rule will limit applicant flexibility to some extent, particularly for those applicants that wish to make modest infrastructure investments on a yearly basis. But, we conclude that the benefits of the rule--namely, making support available to more applicants on a regular basis and preventing wasteful and abusive practices--outweigh the potential impact on such applicants. We find that the twice-every-five-years restriction provides sufficient flexibility for applicants to make efficient use of Priority Two funding, and thus is reasonable. In particular, we recognize that for a variety of different reasons, an applicant may not be able to make efficient use of program discounts in a single year. For example, an applicant's annual resources may require the applicant to extend its costs over a period of years. Our modified rule allows an applicant to seek internal connections discounts in two consecutive years, thus, enabling an entity to spread its costs over two funding years.<sup>31</sup> We conclude that providing applicants the flexibility to implement internal connections over two consecutive years is sufficient to accommodate the differing planning and budgetary needs of most applicants. We expect applicants to assume the responsibility of adequately planning and budgeting to make the most effective use of discounts available to them.

19. USAC also suggests that in an effort to counter funding limitations, some applicants may request more funding than they will be able to use in a given funding year.<sup>32</sup> We emphasize that existing program rules require applicants to examine their technology needs and budgetary resources before making funding requests to ensure that applicants make effective use of any discounted services that they receive.<sup>33</sup> Failure to have an approved technology plan is a

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<sup>29</sup> A school or library is expected to use equipment purchased with universal service discounts for the specified purpose for a reasonable period of time. Although we decline to adopt useful life criteria for such equipment, *see infra* para. 30, we address this issue by adopting a general prohibition on the transfer of equipment for a period of three years after purchase. *See infra* paras. 25-29.

<sup>30</sup> *See, e.g.*, Excalibur Internet Corporation NPRM Comments at 5; Funds for Learning NPRM Comments at 13; Information Technology Industry Council NPRM Reply at 3; Los Angeles Unified School District NPRM Comments at 7; National Education Association, International Society for Technology in Education and the Consortia for School Networking NPRM Comments at 19; TAMSCO Telecommunications Division NPRM Comments at 3.

<sup>31</sup> We therefore reject commenters' suggestion that the Commission grant internal connection requests only once every other year. *See, e.g.*, American Library Association NPRM Comments at 42 (ban equipment purchases for the same location two years in a row); Council of Chief State School Officers NPRM Comments at 45 (limit to once every other year); Council of the Great City Schools NPRM Comments at 4; Illinois State Board of Education NPRM Comments at 22; Marion High School NPRM Comments at 2; Spectrum Communications Cabling Services NPRM Reply at 2.

<sup>32</sup> *See* USAC NPRM Comments at 24.

<sup>33</sup> On the FCC Form 471, among other things, applicants must certify that they have secured access to "all of the resources, including computers, training, software, maintenance, and electrical connections necessary to make effective use of the services purchased as well as to pay the discounted charges for eligible services." *See* FCC (continued....)

violation of our current rules.<sup>34</sup> We expect funding requests to be based on an applicant's technology plan, not based on a scheme to maximize funding. A funding request that is not reasonably based on a technology plan does not constitute a *bona fide* request for services.<sup>35</sup> Further, the Administrator's review and enforcement of the necessary resources certification must and will continue to serve as a safeguard against unreasonable funding requests.<sup>36</sup>

20. *Maintenance Costs.* We agree with commenters that maintenance costs should be exempt from the twice-every-five-years restriction.<sup>37</sup> The *Universal Service Order* provides that support for internal connections includes "basic maintenance."<sup>38</sup> Maintenance costs associated with internal connections services are currently eligible for discounts as a Priority Two service.<sup>39</sup> Proper maintenance of internal connections products ensures that equipment functions properly, thereby limiting uneconomical replacement of equipment. We therefore continue to allow applicants to apply for discounts for maintenance of equipment each funding year.

21. We instruct USAC to revise Block 5 of the FCC Form 471 to include a separate category of service for maintenance requests, with this form change to take effect for Funding Year 2005.<sup>40</sup> Maintenance requests will continue to be funded as Priority Two funding.<sup>41</sup> However, maintenance requests will be considered for funding separately from other requests for Priority Two funding and, therefore, will not be subject to the twice-every-five years funding rule

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Form 471, OMB No. 3060-0806 (December 2002). These certifications are consistent with the requirements set forth in the *Universal Service Order*. See *Universal Service Order*, 12 FCC Rcd 8776, 9079 para. 577 (applicants for schools and libraries discounts would be required to certify in their requests for services that "all of the necessary funding in the current funding year has been budgeted and will have been approved to pay for the 'non-discount' portion of requested connections and services as well as any necessary hardware, software, and to undertake the necessary staff training required in time to use the services effectively . . . .")

<sup>34</sup> 47 C.F.R. § 54.504(b)(2)(vii).

<sup>35</sup> 47 U.S.C. § 254(h)(1)(B).

<sup>36</sup> Particularly, where an applicant provides an inaccurate or inadequate necessary resources certification in connection with its funding request, the Administrator will deny such funding requests.

<sup>37</sup> See, e.g., Council of Chief State School Officers NPRM Comments at 4, Illinois State Board of Education NPRM Comments at 22, Siemens Enterprise Networks NPRM Reply at 2.

<sup>38</sup> *Universal Service Order*, 12 FCC Rcd at 9021 para. 460.

<sup>39</sup> See SLD's Eligible Service Lists on USAC's website, <http://www.sl.universalservice.org/data/pdf/Eligible%20Services%20List%2010-18-02.pdf>.

<sup>40</sup> USAC develops the forms used in the schools and libraries mechanism under Commission oversight. The Commission obtains OMB approval for those forms.

<sup>41</sup> We therefore reject commenters' suggestion that the Commission revise the priority for maintenance. See, e.g., Integrity Networking Systems, Inc. NPRM Comments at 3; Tel/Logic, Inc. NPRM Comments at 18 (internal connections maintenance would remain a Priority Two service, but create a priority three category for new internal connections equipment); but see Spectrum Communications Cabling Services NPRM Reply at 6 (establishing a preference for maintenance is unnecessary).

we adopt in this Order.<sup>42</sup> The revision of the FCC Form 471 will allow efficient review of the Priority Two funding requests.

22. In response to allegations of waste, fraud, and abuse, we prospectively clarify the services eligible for Priority Two support as basic maintenance costs for internal connections. Although the *Universal Service Order* allows support for those internal connections services that are "necessary to transport information all the way to individual classrooms" and public areas of a library, and specifically authorizes support for "basic maintenance services" that are "necessary to the operation of the internal connections network,"<sup>43</sup> our rules do not expressly specify the types of maintenance costs that are eligible for support. In light of our concerns about allegations of waste, fraud, and abuse in this area and our changes above, we conclude that we should provide further clarity on what maintenance services are "necessary" under the terms of the *Universal Service Order*, and thus eligible for support and exempt from the twice-every-five-years rule.

23. Basic maintenance services are "necessary" if, but for the maintenance at issue, the connection would not function and serve its intended purpose with the degree of reliability ordinarily provided in the marketplace to entities receiving such services without e-rate discounts. Basic maintenance services do not include services that maintain equipment that is not supported or that enhance the utility of equipment beyond the transport of information, or diagnostic services in excess of those necessary to maintain the equipment's ability to transport information. For example, basic maintenance will include repair and upkeep of previously purchased eligible hardware, wire and cable maintenance, and basic technical support, including configuration changes. On-site technical support is not necessary to the operation of the internal connection network when off-site technical support can provide basic maintenance on an as-needed basis. Services such as 24-hour network monitoring and management also do not constitute basic maintenance. Such services are therefore ineligible for discounts under the schools and libraries universal service mechanism.

24. We also provide greater clarity as to how USAC should address requests for discounts on technical support for internal connections. When confronted with products or services that contain both eligible and ineligible functions, USAC, in the past, has utilized cost allocation to determine what portion of the product price may receive discounts.<sup>44</sup> We generally endorse this practice as a reasonable means of addressing mixed use products and services. At the same time, however, we are concerned that it is administratively difficult and burdensome to derive reasonable cost allocations for the eligible portions of services provided under a technical support contract. In a rapidly-changing marketplace, with vendors supplying complex packages of services, it simply is not administratively feasible to determine what portion of a technical support contract is directed to basic maintenance. Therefore, we hereby clarify prospectively that technical support, including on-site Help Desks, is not eligible under our rules if it provides any

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<sup>42</sup> Based on the data entered in Block 5, USAC will create a database/record of an entity's receipt of Priority Two funding, and where appropriate, deny an entity's request for discounts.

<sup>43</sup> *Universal Service Order*, 12 FCC Red at 9021-22 para. 460.

<sup>44</sup> See [www.sl.universalservice.org/reference/costallocationguide.asp](http://www.sl.universalservice.org/reference/costallocationguide.asp).

ineligible features or functions. A Help Desk system typically goes beyond the level of support authorized by the Commission in the *Universal Service Order*, which stated that “[s]upport should be available to fund discounts on such items as routers, hubs, network file services, and wireless LANs and their installation and *basic* maintenance....”<sup>45</sup> There is no language in the *Universal Service Order* that contemplates the provision of discounts for the comprehensive level of support typically provided by a Help Desk. On the contrary, the *Universal Service Order* indicates that support will be provided for a product or service “only if it is necessary to transport information all the way to individual classrooms. That is, if the service is an essential element in the transmission of information within the school or library . . . .”<sup>46</sup> We conclude that if a technical support contract provides more than basic maintenance, it shall be ineligible for discounts under our modified rules. We instruct USAC to review and fund requests for discounts on maintenance services in accordance with this clarification, as of the effective date of this Order.<sup>47</sup>

25. *Equipment Transfers*. We also find it appropriate to amend our rules expressly to prohibit, except as provided below, the transfer of equipment purchased with discounts from the schools and libraries universal service support mechanism. The Act prohibits the sale or transfer of equipment purchased with discounts from the universal service program in consideration of money or anything else of value.<sup>48</sup> Here, in order to promote the goal of preventing waste, fraud, and abuse, we extend that prohibition to all transfers, without regard to whether money or anything of value has been received in return for a period of three years after purchase.<sup>49</sup>

26. Recipients of support are expected to use all equipment purchased with universal service discounts at the particular location, for the specified purpose for a reasonable period of time. Purchasing equipment with universal service discounts and then replacing or upgrading that equipment annually or almost annually is unnecessary and not economically rational.<sup>50</sup>

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<sup>45</sup> *Universal Service Order*, 12 FCC Red at 9021 para. 460 (emphasis added).

<sup>46</sup> *Id.* at 9021 para. 459.

<sup>47</sup> To the extent this clarification impacts existing contracts, we shall permit parties 90 days from the effective date of this Order to renegotiate those contracts, or to provide the Administrator with an itemized breakout of the components of the contract, clearly identifying the portion of the contract price to be allocated to basic maintenance. We will permit parties to utilize cost allocation for signed contracts in existence as of the effective date of this Order. The burden is on the applicant to justify what portion of a contract price should be allocated to basic maintenance services.

<sup>48</sup> 47 U.S.C. § 254(h)(3).

<sup>49</sup> This action is not intended to prevent schools or libraries from trading-in equipment to a service provider for other equipment with similar functionalities. We note, however, that under the twice-every-five-years rule we adopt today, an applicant may face limitations on its ability to finance trade-ins using e-rate funding. The school or library may not use the credit for the trade-in to pay for its non-discounted portion of the services it receives in return.

<sup>50</sup> Colorado Department of Education NPRM Comments at 8 (applicants that receive funding for internal connections year after year pose a risk of abuse of the program); Delaware Center for Educational Technology NPRM Comments at 3 (the idea that a school district could upgrade the poorest schools in the district yearly and (continued....))

Unnecessary replacement of equipment suggests that entities are not fully utilizing the equipment purchased with universal service discounts. We agree with commenters that such practices deprive other eligible entities of the full benefits of the schools and libraries universal services program.<sup>51</sup> Moreover, the practice of purchasing equipment with universal service funds, then transferring that equipment to other schools and libraries with lower discount rates would undermine the intent of the Commission's priority rules, and is therefore prohibited. We find, however, that it would be wasteful to prevent recipients from transferring equipment that, after a reasonable period of time, has been replaced or upgraded. We therefore permit recipients freely to transfer equipment to other eligible entities three years or more after the purchase of such equipment.<sup>52</sup> Consistent with the Act, however, such transfers must not be in consideration of money or anything else of value.

27. We agree also with commenters that argue that applicants may have legitimate reasons to transfer internal connections equipment due to the closing of a school or other eligible facilities.<sup>53</sup> For example, due to a natural disaster, a school district may conclude that its needs are best served by temporarily or permanently closing a particular school and transferring its students, as well as any valuable equipment purchased with supported discounts, to other locations. Similarly, a school district may choose to close, remodel, or consolidate a particular school to meet changing demographic needs or fiscal realities, and thereby transfer the students and useable school property to a nearby school. Likewise, a county or municipality may choose to close a library branch for financial reasons. Under these circumstances, we find that it would be economically rational and consistent with the goals of the schools and libraries program for the support recipient to transfer any equipment it has purchased with universal service discounts to another eligible location where the equipment may be used effectively.<sup>54</sup> We therefore conclude

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transfer the 'old' equipment to other schools is definitely abuse of the system); E-Rate Elite NPRM Comments at 15 (applicants transferring equipment in violation of program rules are circumventing the funding process, abusing the program, and preventing students with a greater need from receiving much needed assistance); Excaliber Internet Corporation NPRM Comments at 5 (continual transfers of equipment are wasteful of program funds); Florida Public Service Commission at 5 (it is necessary for the FCC to establish rules governing when equipment can be transferred; inadequate incentives exist to prevent such wasteful or fraudulent behavior); Iowa Communications Network NPRM Comments at 1 (transfer of equipment yearly to ineligible users seems to counter the goals of the program); Montana Independent Telecommunication System NPRM Comments at 6 (applicants that transfer equipment obtained with universal service discounts to other schools and libraries that may not be eligible for such equipment adversely affect funding availability for all applicants).

<sup>51</sup> See, e.g., E-rate Elite NPRM Comments at 15, Excaliber Internet Corporation NPRM Comments at 5, Iowa Communications Network NPRM Comments at 1, Montana Independent Telecommunication System NPRM Comments at 6-7, Software & Information Industry Association at 4; see also *Task Force Recommendation* at 6 (recommending prohibition on transfers within service life of equipment).

<sup>52</sup> The conclusion that three years is a reasonable period for a recipient to retain equipment purchased with internal connections discounts is consistent with our conclusion, above, that an applicant should be limited to internal connections discounts in only two out of every five years. In effect, the twice-in-five-years rule will permit an applicant to seek discounts for internal connections every three years. See *supra* para. 12.

<sup>53</sup> See, e.g., Florida Public Service Commission NPRM Comments at 4-5.

<sup>54</sup> Consistent with the Act, such transfers may not be in consideration of money or anything of value. 47 U.S.C. § 254(h)(3).

that a recipient may transfer equipment purchased with universal service discounts to other eligible entities if the particular location where the equipment was originally installed is permanently or temporarily closed. In these limited circumstances, we note that it is not necessary for the transferring and receiving entities to have comparable discount levels, as long as each is eligible under the schools and libraries program.

28. In the event that a recipient is permanently or temporarily closed and equipment is transferred, the transferring entity must notify the Administrator of the transfer, and both the transferring and receiving entities must maintain detailed records documenting the transfer and the reason for the transfer for a period of five years. We instruct the Administrator to verify compliance with this requirement as part of its beneficiary audit reviews. In order to enable the Administrator to verify compliance with this transfer prohibition, we require all recipients of internal connections support to maintain asset and inventory records for a period of five years sufficient to verify the actual location of such equipment.<sup>55</sup>

29. This rule change shall be implemented upon the effective date of this Order. To facilitate enforcement of this rule, we will amend the FCC Form 471 for Funding Year 2005 to include a reasonable use certification.<sup>56</sup> In order to receive discounts, applicants must certify that they will use all equipment purchased with universal service discounts at the particular location for the specified purpose. Applicants will thereafter be held accountable for their compliance with the reasonable use certification.

30. We decline to institute useful life criteria for equipment purchased with universal service funds.<sup>57</sup> Useful life criteria could provide a more equitable distribution of Priority Two funding and ensure that more applicants receive the full benefit of the program by ensuring that applicants did not replace equipment components of internal connections services more frequently than necessary. We believe, however, that measures adopted above, including the restriction of transfers and our revised policy governing the funding of Priority Two equipment, will provide similar results in achieving these goals.<sup>58</sup> We also conclude that developing and enforcing useful life criteria would add a significant degree of complexity to the program, which would result in increased administrative costs and burden for both recipients and USAC.

## **B. Eligible Services**

### **1. Background**

31. Since the initial implementation of the schools and libraries support mechanism, USAC has developed various procedures and guidelines, consistent with the Commission's rules

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<sup>55</sup> This recordkeeping requirement will become effective upon receiving any approval required from the Office of Management and Budget (OMB) under the Paperwork Reduction Act.

<sup>56</sup> FCC Form 471 already is in use for Funding Year 2004, so it is not feasible to amend the form to include this certification for Funding Year 2004.

<sup>57</sup> See, e.g., *Task Force Recommendation* at 6; see also Tel/Logic Inc. NPRM Comments at 14.

<sup>58</sup> See *supra* paras. 12-19, 25-28.

and requirements, for applicants to ensure that funding is provided only for eligible services. These policies include guidelines for allocating costs between eligible and ineligible services, a prohibition on the provision of free services, the eligible services list maintained on USAC's website, and procedures for service substitutions.

32. In the *Universal Service Order*, the Commission concluded that, when a school or library signs a contract for both eligible services and ineligible services, the contract must break out the price of eligible services separately.<sup>59</sup> This rule cannot be easily applied, however, in those circumstances when a single product or service contains both eligible and ineligible elements. For example, a particular service may be eligible or ineligible depending on how it is used, or internal connections may provide functionality that is ineligible for support. For that reason, the Administrator developed guidelines to aid service providers and applicants in determining how costs of a single service or product should be allocated between eligible and ineligible functions.<sup>60</sup> These guidelines distinguish between products and services that have a significant element that is ineligible for support, and products and services with ineligible components that are merely ancillary to the eligible components. Cost allocation may be used for products and services with mixed eligibility, including significant ineligible components, only when a clear delineation can be made between the eligible and ineligible component parts. There must be some tangible basis for this delineation, even if the basis is not strictly based on cost.<sup>61</sup> The price for the eligible portion must represent the most cost-effective means of receiving the eligible services. For products or services that contain an ineligible functionality on an ancillary basis, the Administrator does not require the allocation of any portion of the cost to the ineligible use. However, the price for the service or product must be the most cost-effective means of receiving the eligible component of the service, without regard to the value of the ineligible component.

33. USAC advises the public, consistent with Commission rules and requirements, that applicants and service providers are prohibited from using the schools and libraries support mechanism to subsidize the procurement of ineligible or unrequested products and services.<sup>62</sup> Applicants and services providers are further cautioned that any such promotions or discounts must be accounted for in the e-rate funding request to reveal the true cost the applicant would incur vis-à-vis the service provider proposed contract.<sup>63</sup> Price reduction, free goods or services, and trade-in values are among the promotions that require accounting and proper allocation to

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<sup>59</sup> *Universal Service Order*, 12 FCC Rcd at 9022 para. 462.

<sup>60</sup> See <http://www.sl.universalservice.org/reference/costallocationguide.asp>.

<sup>61</sup> For example, the cost allocation may be based on the added cost or added market value of the ineligible functions. In circumstances where there is purely economic basis for separating the costs, the cost allocation may be based on data demonstrating how the product's use will be divided between eligible and ineligible services.

<sup>62</sup> See <http://www.sl.universalservice.org/reference/freeservices.asp>.

<sup>63</sup> *Id.*

capture the true cost of service.<sup>64</sup>

34. Currently, USAC updates on a yearly basis, and posts to its website, a list of services eligible for funding under the categories of telecommunications service, Internet access, and internal connections.<sup>65</sup> USAC updates the list, in consultation with the Wireline Competition Bureau, to reflect any changes in rules that have occurred over the last year and to address issues that arise in the application review process. In the *Schools and Libraries NPRM*, the Commission invited parties to submit proposals for rule changes that would improve the operation of the eligibility determination process in terms of efficiency, predictability, flexibility, and administrative cost.<sup>66</sup> Since the issuance of the *Schools and Libraries NPRM*, a number of parties have urged the Commission to create a more transparent process for updating the eligible services list.<sup>67</sup>

## 2. Discussion

35. Although the current cost allocation approach used by the Administrator reasonably implements the Commission's rules and requirement regarding eligible and ineligible services, we conclude that administration of the schools and libraries support mechanism would benefit from an explicit rule regarding the cost allocation for services with mixed eligibility. We also conclude that the eligibility process would be improved by adopting a rule for the yearly updating of the eligible services list. Additionally, we codify rules prohibiting the provision of "free" services to recipient schools and libraries by service providers that also provide supported services to those schools and libraries and codify procedures for applicants to modify funding requests that have been granted but not yet funded. Finally, we provide additional guidance on the provision of discounts on services that include the lease of on-premises equipment.

36. *Cost Allocation.* We specifically amend our rules to make clear how applicants and service providers should allocate costs of a service or product that, although generally eligible for universal service support, contains both eligible and ineligible components. In the *Universal Service Order*, the Commission concluded that, when a school or library signs a contract for both eligible and ineligible services, the contract must break out the price of eligible services separately from ineligible services.<sup>68</sup> Since that time, the marketplace has seen an evolution of products and services that contain both eligible and ineligible features but which are not commercially available on an unbundled basis. Thus, the issue has evolved from merely separately listing eligible services and products from ineligible services and products to one of determining what components or features of an otherwise eligible service or product may be

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<sup>64</sup> *Id.*

<sup>65</sup> See <http://www.sl.universalservice.org/reference/eligible.asp>.

<sup>66</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1921 para. 14.

<sup>67</sup> See Alaska NPRM Comments at 2; Central Susquehanna NPRM Comments at 2; Iowa DOE Comments at 3, 7; Greg Weisiger NPRM Comments at 9; ITI NPRM Reply at 2; NASTD NPRM Reply at 1; *E-rate Public Forum*, Funds for Learning Statement at 5.

<sup>68</sup> *Universal Service Order*, 12 FCC Rcd at 9022 para. 462.



ineligible when the service or product is not commercially available on an unbundled basis. Consistent with the Commission's directive to separate these costs, the Administrator has generally required schools, libraries, or the service provider to separate the costs of an ineligible component from what generally would be an eligible service or product.<sup>69</sup> As explained above, the Administrator has provided reasonable guidance, consistent with Commission rules and requirements, to schools, libraries, and service providers in determining the allocation approach.<sup>70</sup>

37. As part of our efforts to improve the operation of the eligibility determination process,<sup>71</sup> we explicitly amend our rules to include cost allocation rules for services and products that contain mixed eligible and ineligible components, features, or functions to provide greater clarity in this area. Under these rules, if a product or service contains ineligible components, costs should be allocated to the extent that a clear delineation can be made between the eligible and ineligible components. The clear delineation must have a tangible basis and the price for the eligible portion must be the most cost-effective means of receiving the eligible service. If the ineligible functionality is ancillary, the costs need not be allocated to the ineligible functionality. An ineligible functionality may be considered "ancillary" if (1) a price for the ineligible component that is separate and independent from the price of the eligible components cannot be determined, and (2) the specific package remains the most cost-effective means of receiving the eligible services, without regard to the value of the ineligible functionality.

38. These cost allocation rules address the widespread availability of products and services with mixed eligibility and are fully consistent with the overriding requirement that support be provided for eligible services, while preventing support for ineligible services. By providing service providers and applicants a means of allocating costs between eligible and ineligible components, features or functions of what would otherwise be an eligible service, the cost allocation method increases the variety of service options available to schools and libraries, improving each school or library's ability to purchase the most useful and cost-effective service possible. Without this cost allocation approach, applicants may fail to pursue the purchase of certain advanced telecommunications and information services, contrary to the intent of section 254. Our E-rate rules should not drive the development of communications services and technologies, but rather should permit the marketplace to flourish and innovate in ways that meet consumer needs and facilitate access to these innovations. Schools and libraries should continue to allocate eligible and ineligible costs in their contracts with service providers. In the interests of ensuring that support be provided only for eligible services, the Administrator also should continue to employ the use of the cost allocation method when necessary.<sup>72</sup>

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<sup>69</sup> See <http://www.sl.universalservice.org/reference/eligible.asp>. In addition, in those instances where a school requests support for a service or product with mixed use components, the Administrator has only provided support for the eligible component. *Id.*

<sup>70</sup> See *supra* para. 32.

<sup>71</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1921 para. 14.

<sup>72</sup> Although there is language in the *Universal Service Order* that suggests that schools and libraries should not receive universal service support for contracts that provide only one price for a bundle of mixed eligibility services, the Commission's intent was to ensure adequate cost allocation between eligible and ineligible services (continued....)

39. The Commission recently addressed those circumstances where an applicant erroneously identifies certain costs as eligible for support by adopting the 30 percent rule. Specifically, we concluded in the *Second Report and Order* that where less than 30 percent of a request for support is ineligible, the Administrator is permitted to grant support, reduced by the amount of ineligible services.<sup>73</sup> We clarify that the Administrator may rely on the cost allocation methods we adopt today in applying the 30 percent rule and performing any resulting adjustments.

40. *Eligible Services List.* We now adopt a more formalized process for updating the eligible services list, beginning with Funding Year 2005. Under the new rule, USAC will be required to submit by June 30 of each year a draft of its updated eligible services list for the following funding year.<sup>74</sup> The Commission will issue a Public Notice seeking comment on USAC's proposed eligible services list. At least sixty days prior to the opening of the window for the following funding year, the Commission will then issue a public notice attaching the final eligible services list for the upcoming funding year. The Commission anticipates that this public notice will be released on or before September 15 of each year. This process will provide greater transparency to the development of the eligible services list. The yearly updated list will interpret what may be funded under current rules, and will represent a safe harbor that all applicants can rely on in preparing their applications for the coming funding year. It will provide interested parties, both recipients and service providers, an opportunity to bring to the Commission's attention areas of ambiguity in the application of current rules in a rapidly changing marketplace. Currently, the only way an applicant can determine whether a particular service or product is eligible under our current rules is to seek funding for that service or product, and then seek review of the Administrator's decision to deny discounts. The rule we adopt today will simplify program administration and facilitate the ability of both vendors and applicants to determine what services are eligible for discounts.

41. *Prohibition of "Free" Services.* We also take this opportunity to clarify and amend our rules to codify a prohibition on the provision of free services to an eligible entity by a service provider that is also providing discounted services to the entity.<sup>75</sup> The Commission requires that an entity must pay the entire undiscounted portion of the cost of any services it receives through

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and to avoid imposing an excessive burden on the Administrator. See *Universal Service Order*, 12 FCC Rcd at 9022-23 para. 462. As a practical matter, the application process evolved in such a manner that this concern could be adequately addressed by the Administrator. Thus, in those instances where the Administrator has been presented with mixed eligibility services during the application process, the Administrator has been able to resolve the cost allocation with the school or library and service provider in a reasonable way, and avoid committing universal service support to ineligible services.

<sup>73</sup> *Schools and Libraries Second Order*, 18 FCC Rcd at 9215-16 paras. 40-41. We found that this rule improves operation of the schools and libraries program by permitting the Administrator to process efficiently requests for support for services that inadvertently include some ineligible components.

<sup>74</sup> For instance, on June 30, 2004, USAC would submit its draft eligible services list for Funding Year 2005.

<sup>75</sup> <http://www.sl.universalservice.org/reference/freeservices.asp> (Free Service Advisory notes that requests that do not account for free services will result in a denial and may result in criminal penalties).

the schools and libraries program.<sup>76</sup> For the purpose of this program, the provision of unrelated free services by the service provider to the entity constitutes a rebate of the undiscounted portion of the costs, a violation of the Commission's rules. Codifying this existing restriction will clarify the obligations of schools and libraries that receive discounted services under the schools and libraries program and improve the ability of the Commission to take appropriate enforcement action.

42. *Service Substitution.* Again, as part of our efforts to improve the operation of the schools and libraries support mechanism, we also formally adopt and codify the Administrator's current procedures relating to requests for service or equipment changes.<sup>77</sup> These procedures provide flexibility to applicants where it has become necessary to make a minor modification to their original funding request.<sup>78</sup> We find that the Administrator's service substitution procedures are consistent with the Commission's goal of affording schools and libraries maximum flexibility to choose the offering that meets their needs most effectively and efficiently.<sup>79</sup> We conclude that codifying these existing procedures in our rules will facilitate USAC's administration of the schools and libraries support mechanism. In codifying USAC's procedures in our rules, we make one modification, however. USAC's current procedures permit a service substitution only if the substitution does not result in an increase in the pre-discount price of the eligible service. We will permit applicants to substitute an eligible service with a higher pre-discount price, but will provide support based on the lower, original price, rather than the higher price for the substituted service.<sup>80</sup> We agree with commenters that this will further maximize flexibility for schools and libraries to meet their needs effectively and efficiently, without additional cost to the E-rate program.<sup>81</sup>

43. Accordingly, we amend our rules to specify that service change requests will be granted for a substitute service or product where (1) that service or product has the same

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<sup>76</sup> *Universal Service Order*, 12 FCC Rcd at 9035-36 para. 493 (citing *Federal-State Joint Board on Universal Service*, CC Docket 96-45, Recommended Decision, 12 FCC Rcd 87, 367 para. 549 (1996)); see also <http://www.sl.universalservice.org/reference/obligation.asp>.

<sup>77</sup> See <http://www.sl.universalservice.org/reference/ServiceSub.asp>.

<sup>78</sup> A "minor contract modification" is defined as "a change to a universal service contract that is within the scope of the original contract and has no effect or merely a negligible effect on price, quantity, quality, or delivery under the original contract." See 47 C.F.R. §54.500(g).

<sup>79</sup> *In the Matter of Request for Review of the Decision of the Universal Service Administrator by Copan Public Schools, Copan Oklahoma, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, CC Docket Nos. 96-45 and 97-21, 15 FCC Rcd 5498, 5502 para. 7 (2000) (*Copan Order*).

<sup>80</sup> In other words, if an applicant requests support for an eligible service with a pre-discount price of \$100, the applicant may substitute a comparable eligible service with a pre-discount price of \$120, but will receive support based on the \$100 pre-discount price requested, rather than the \$120 pre-discount price ultimately received.

<sup>81</sup> See, e.g., Funds for Learning NPRM Comments at 27; NYPL NPRM Comments at 7; Tel/Logic NPRM Comments at 15; see also *Task Force Recommendation* at 11.

functionality;<sup>82</sup> (2) the substitution does not violate any contract provisions or state or local procurement laws; (3) the substitution does not result in an increase in the percentage of ineligible services or functions, but (4) support shall be provided based on the lesser of the pre-discount price of the original service or the substitute service. In order to ensure the integrity of the competitive bidding process, we require the applicant's request for a service change to include a certification that the requested change in service is within the scope of the controlling Form 470, including any associated Requests for Proposal (RFP), for the original services. We also require that support not be provided in excess of the amount the applicant originally would have been eligible for. By adopting these procedures as rules, we recognize that events may occur between the time of the original funding request and the time when commitments are made that make the original funding request impractical or even impossible to fulfill.

44. *Eligibility of On-Premises Equipment as Part of Priority One Service.* In the *Schools and Libraries NPRM*, the Commission sought comment on whether to modify its policies regarding the funding of Priority One services (telecommunications service and Internet access) that include service provider charges for capital investments for wide area networks. Those policies were established in the *1999 Tennessee Order* and the *Brooklyn Order*.<sup>83</sup>

45. We decline at this time to modify our existing policies in this area, and in the attached Further Notice of Proposed Rulemaking seek more focused comment on specific rule changes that would limit the availability of discounts for service provider charges that recoup the cost of significant infrastructure investment. We do, however, clarify the scope of the existing requirements in this area to facilitate USAC's processing of applications.

46. In the *1999 Tennessee Order*, the Commission addressed the issue of whether certain facilities located on the applicant's premises (namely, routers and hubs) are part of an end-to-end Internet access service or part of internal connections.<sup>84</sup> The Commission determined that facilities located on an applicant's premises should be presumed to be internal connections, but that an applicant may rebut that presumption.<sup>85</sup> In analyzing the facts presented in the *1999*

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<sup>82</sup> We clarify that a service or equipment change request would not meet this test if it changes the type of service requested pursuant to the original funding request from one category to another (e.g., a change from telecommunications service to internal connections, or a change from Internet access to telecommunications service). We further clarify that a substitution that constitutes a minor contract modification under our rules will not automatically meet the requirements of our service substitution rule.

<sup>83</sup> *Request for Review by Brooklyn Public Library, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, File No. SLD-149423, CC Dockets No. 96-45 and 97-21, Order, 15 FCC Rcd 18598 (2000) (*Brooklyn Order*); *Request for Review by the Department of Education of the State of Tennessee of the Decision of the Universal Service Administrator, Request for Review by Integrated Systems and Internet Solutions, Inc., of the Decision of the Universal Service Administrator, Request for Review by Education Networks of America of the Decision of the Universal Service Administrator, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, CC Docket Nos. 96-45 and 97-21, Order, 14 FCC Rcd 13734 (1999) (*1999 Tennessee Order*).

<sup>84</sup> *1999 Tennessee Order*, 14 FCC Rcd 13734.

<sup>85</sup> *Id.* at 13753-54 paras. 37-38.

*Tennessee Order*, the Commission concluded that this presumption had been rebutted. In support of the rebuttal, the Commission noted that the hub sites at issue constituted the Internet access provider's points of presence and that the applicant's internal connections networks would continue to function without the hub sites, indicating that the hub sites were not necessary to transport information within the schools' instructional buildings on a single campus.<sup>86</sup> Further, the Commission found that other indicia--the ownership of the facility, the lack of a lease-purchase arrangement, the lack of an exclusivity arrangement, and the fact that the service provider was responsible for its maintenance--supported its conclusion that, on balance, the facilities should be deemed part of an end-to-end service.<sup>87</sup> The Commission found that these factors weighed against a finding of internal connections, even though the cost of leasing those facilities represented nearly 67 percent of the total funding request. The decision was based on the facts presented; the Commission did not establish a per se requirement that an applicant must meet all factors in order to receive discounts on service provider charges for the cost of leasing on-premises equipment.

47. We conclude it is administratively efficient for USAC to use the factors relied upon in the *1999 Tennessee Order* as a processing standard. USAC has posted an advisory on its website providing guidance to help applicants and service providers understand how it has implemented the *1999 Tennessee Order*.<sup>88</sup> Specifically, USAC has provided guidance that a private branch exchange (PBX) that routes calls within a school or library is not eligible for support as Priority One on-premises equipment. This guidance is consistent with our *1999 Tennessee Order* because a PBX, like most on-premises equipment, is presumed to be Priority Two internal connections. Moreover, it is unlikely that an applicant would be able to establish a rebuttal to that presumption, because the PBX functions to transmit information from and between multiple locations within a local network. If the PBX were removed from a school, the school would lose its ability to route phone calls within the building or campus, but could maintain its access to the public switched telephone network. In other words, the PBX is necessary to maintain the internal communications network, but not its end-to-end access to telecommunications services.<sup>89</sup>

48. We now clarify that the *1999 Tennessee Order* does not preclude the provision of support for on-premises equipment that constitutes basic termination equipment. Accordingly, an applicant may receive a discount for the lease of a cable modem as part of Priority One Internet access. A cable modem is a type of basic terminating component. It is analogous to a channel service unit/data service unit (CSU/DSU) or a network interface device (NID) in that it functions as the termination point for a Priority One service.<sup>90</sup> The language in the *1999 Tennessee Order*

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<sup>86</sup> *Id.* at 13753-54 para. 38.

<sup>87</sup> *Id.* at 13754-55 paras. 39-40.

<sup>88</sup> See <http://www.sl.universalservice.org/reference/OnPremP1.asp>.

<sup>89</sup> We note that an applicant will still be able to receive discounts for Centrex service, which telecommunications carriers provide without the use of on-premises equipment, as a Priority One service.

<sup>90</sup> USAC provides discounts on the cost of leasing a single CSU/DSU, as well as the cost of installing a NID, as part of a Priority One service.

stating that facilities located on the school premises are presumed to be internal connections was enunciated in the context of considering the status of network hubs and routers, and should not be read to encompass basic terminating equipment. A basic terminating component, though normally located on a customer's premises, is necessary to receive the end-to-end Internet access service because it provides translation of the digital transmission using the appropriate protocols. In the case of a cable modem, it would not be possible to receive the Internet access service in question without the cable modem on the customer's premises. Conversely, the internal connections on the site would continue to function without the cable modem. Moreover, while customers may obtain cable modems from other sources, providers of cable modem service typically offer customers the opportunity to lease a cable modem in conjunction with the provision of cable modem service. We also note that the cost of leasing a cable modem is a relatively low proportion of the yearly cost of the service. The fact that technical limitations would, as a practical matter, preclude the service provider from using the cable modem to deliver service to other customers, creating a de facto exclusivity arrangement, in our view does not support a finding that such equipment must be viewed as internal connections. Rather, we conclude that it is appropriate to provide discounts on the lease of a single basic terminating component used at a site as a Priority One service.<sup>91</sup>

49. We also clarify that it is appropriate to provide Priority One discounts on service provider charges to recoup the cost of leasing optical equipment to light fiber, when that optical equipment is the single basic terminating component of an end-to-end network and it is necessary to provide an end-to-end telecommunications or Internet access service. We reach that conclusion even though the optical equipment on the customers' end, as a technical matter, is dedicated to the customer's sole use.

## C. Carryover of Funds

### 1. Background

50. In the *Schools and Libraries NPRM*, the Commission sought comment on whether to carry forward unused funding to subsequent funding years.<sup>92</sup> Subsequently in the *Schools and Libraries Order*, the Commission concluded that, beginning with the second quarter of 2003, any unused funds from the schools and libraries support mechanism would, consistent with the public interest, be carried forward for disbursement in subsequent funding years of the schools and libraries support mechanism.<sup>93</sup>

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<sup>91</sup> To the extent an applicant seeks to lease multiple terminating components, one would be deemed eligible for funding as a Priority One service and the remainder would be eligible for funding as Priority Two internal connections. Further, if an applicant seeks to purchase a single basic terminating component, it will be eligible for a discount only as Priority Two internal connections.

<sup>92</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1940-41 para. 70.

<sup>93</sup> See *Schools and Libraries Order*, 17 FCC Rcd at 11523-24 para. 3. In the *Schools and Libraries Order*, the Commission decided that it was in the public interest to take immediate action to stabilize the contribution factor while the Commission considered whether and how to reform the way in which contributions to the universal (continued....)

51. In the *Schools and Libraries Further Notice*, the Commission proposed specific rules and procedures for implementing the carrying over of unused funds to subsequent funding years of the schools and libraries mechanism.<sup>94</sup> In particular, the Commission proposed to amend the rules to require USAC to provide quarterly estimates to the Commission regarding the amount of unused funds that will be available to carry forward.<sup>95</sup> The Commission also proposed to amend the rules so that the Commission would carry forward available unused funds from prior years on an annual basis for use in the following full year of the schools and libraries program.<sup>96</sup> Most comments on this issue supported the proposed rules and procedures. In its last quarterly filing, USAC reported \$420 million in unused funds.<sup>97</sup>

## 2. Discussion

52. We adopt the procedures for carrying forward unused funds for the schools and libraries program proposed in the *Schools and Libraries Further Notice*. Specifically, we amend our rules to require the Administrator to provide quarterly estimates to the Commission regarding the amount of unused funds that will be available for carryover in the subsequent full funding year. We further amend our rules so that the Commission will carry forward available unused funds from prior years on an annual basis. We find that, in light of the high demand for discounts, such action is consistent with section 254 and the public interest, as well as the framework established in the *Schools and Libraries Order*. Accordingly, we amend section 54.507(a) of our rules, as provided in Appendix A.<sup>98</sup>

53. The Administrator shall continue to estimate unused funds as the difference between the amount of funds collected, or made available for that particular funding year, and the amount of funds disbursed or to be disbursed.<sup>99</sup> We note that the Administrator already considers the remaining appeals for a funding year when identifying unused funds.<sup>100</sup> Therefore, we do not believe that the carryover of unused funds will detract from the funding of outstanding appeals.<sup>101</sup>

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service mechanism were assessed. The Commission determined that unused funds would be applied to reduce the contribution factors for the third and fourth quarters of 2002 and the first quarter of 2003. Starting with the second quarter of 2003, any unused funds from the schools and libraries fund would be carried forward for disbursement in the schools and libraries support mechanism.

<sup>94</sup> *Schools and Libraries Further Notice*, 18 FCC Rcd at 9233-34 paras. 93-98.

<sup>95</sup> *Id.* at 9233 para. 94.

<sup>96</sup> *Id.*

<sup>97</sup> See Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2004, available at <http://www.universalservice.org/overview/filings> (filed October 31, 2003) (*USAC Filing for First Quarter 2004 Projections*).

<sup>98</sup> See Appendix A.

<sup>99</sup> See *Schools and Libraries Further Notice*, 18 FCC Rcd at 9234 para. 96.

<sup>100</sup> See, e.g., *USAC Filing for First Quarter 2004 Projections* at 30-32.

<sup>101</sup> See CoSN and ISTE FNPRM Comments at 3; EdLiNC FNPRM Comments at 1.

54. Consistent with the proposed rules in the *Schools and Libraries Further Notice*, we also amend the rules to require the Administrator to file with the Commission quarterly estimates of unused funds from prior years of the schools and libraries support mechanism when it submits its projection of schools and libraries program demand for the upcoming quarter.<sup>102</sup> This amendment codifies the Administrator's existing reporting practice and reporting cycle.<sup>103</sup> The quarterly estimate serves to prepare the Administrator for the annual release of carryover funds and provides schools and libraries with general notice regarding the amount of unused funds that may be made available in the subsequent year.<sup>104</sup> We disagree with NAIS that the quarterly reporting procedure would become too cumbersome and hinder the "overall integrity of the program."<sup>105</sup> We do not believe that the Administrator will be overburdened by this requirement because it has been reporting quarterly estimates of unused funds for six quarters without a problem.

55. We further amend the rules to make unused funds available annually in the second quarter of each calendar year for use in the next full funding year of the schools and libraries mechanism. Based on the estimates provided by the Administrator, the Commission will announce a specific amount of unused funds from prior funding years to be carried forward in accordance with the public interest to increase funds for the next full funding year in excess of the annual funding cap. For example, the Commission will carry forward the unused funds as of second quarter 2004 for use in the Schools and Libraries Funding Year 2004, thereby increasing the available funds in Funding Year 2004 above the annual funding cap of \$2.25 billion.<sup>106</sup> The Wireline Competition Bureau will announce the availability of carryover funds during the second quarter of the calendar year, when it announces the universal service contribution factor for the third quarter of each year.<sup>107</sup> The amount of unused funds to be carried forward will be deemed approved by the Commission if it takes no action within 14 days of release of the public notice announcing the contribution factor and the amount of unused funds.

56. We determine that it is in the public interest to carry forward unused funds for disbursement on an annual basis in the second quarter of the calendar year. Distribution of unused funds on an annual basis allows the Administrator to refine its calculation of available funds over four reporting quarters as the funding year progresses starting with the third quarter of the calendar year. The annual carryover of funds during the second quarter of the calendar year also coincides with the time of year the Administrator begins making funding commitment

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<sup>102</sup> See 47 C.F.R. §54.709.

<sup>103</sup> See *Wireline Competition Bureau Announces No Change in Third Quarter 2002 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, 17 FCC Rcd 11128, 11129 (2002).

<sup>104</sup> See *Schools and Libraries Further Notice*, 18 FCC Rcd at 9233 para 94.

<sup>105</sup> See NAIS FNPRM Comments at 1.

<sup>106</sup> Consistent with the *Schools and Libraries Order*, all unused funds as of second quarter of 2003, *i.e.*, any remaining unused funds from all funding years, will be carried forward into Funding Year 2004 in accordance with the public interest. *Schools and Libraries Order*, 17 FCC Rcd at 11530-31 para. 19.

<sup>107</sup> 47 C.F.R. §54.709(a)(3).



decisions for the upcoming funding year.<sup>108</sup> We believe that the timing of this process provides certainty regarding when unused funds will be carried forward for use in the schools and libraries program with minimal disruption to the administration of the program.<sup>109</sup>

57. In order to implement the Commission's prior decision to carry over funds beginning April 1, 2003, we modify the schedule for this year only in order to implement the process for Funding Year 2003. We direct the Administrator to carry forward unused funds as projected for the first quarter of 2004 for use during the remainder of Funding Year 2003.<sup>110</sup> While there will be an increase in the amount of funds available in Funding Year 2003, we note that no decisions previously made by USAC concerning the distribution of funds for Funding Year 2003 will be reversed or revisited. Only funding requests that are currently pending will be considered for the Funding Year 2003 carryover funding. Henceforth, starting with the second quarter of 2004, funds will be carried over on an annual basis as described in the previous paragraph.

58. Finally, we take this opportunity to revise section 54.509(b) of the Commission's rules to conform to the *Fifth Order on Reconsideration*.<sup>111</sup> Section 54.509(b) provides that, if the estimates of future funding needs of schools and libraries lead to a prediction by the Administrator that total funding requests will exceed available funding for a funding year, the Administrator shall adjust the discount matrix by calculating a percentage reduction of support to all schools and libraries, except those in the two most disadvantaged categories, in order to permit all requests in the next funding year to be fully funded. The technical correction we make to section 54.509(b) clarifies that the reduction in percentage discounts explained in section 54.509(b) does not apply within a filing window or period, as described in section 54.507(c). Priority within a filing window is determined in accordance with section 54.507(g)(1) of the rules. Thus, section 54.509(b) applies only during a funding year in which the Administrator is acting in accordance with section 54.507(g)(2). We find that the rule change is exempt from the notice and comment requirements of the Administrative Procedure Act because it concerns a non-substantive technical change to the existing rules.<sup>112</sup>

#### IV. SECOND FURTHER NOTICE OF PROPOSED RULEMAKING

##### A. Discount Matrix

59. Under the Commission's rules, eligible schools and libraries may receive discounts ranging from 20 percent to 90 percent of the pre-discount price of eligible services, based on

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<sup>108</sup> Applicants learn about their funding commitments via a Funding Commitment Decision Letter (FCDL). The Administrator releases FCDLs in waves every other week. For Funding Year 2003, the first wave of letters was released April 28, 2003.

<sup>109</sup> *Schools and Libraries Further Notice*, 18 FCC Rcd at 9234 para. 97.

<sup>110</sup> See *USAC Filing for First Quarter 2004 Projections* at 30-32.

<sup>111</sup> *Fifth Order on Reconsideration*, 13 FCC Rcd at 14936-40 para. 34-38.

<sup>112</sup> 5 U.S.C. § 553(b)(3)(A).

indicators of need.<sup>113</sup> We seek comment on the effectiveness and efficiency of the discount matrix used to determine support payments for eligible applicants. In particular, we seek comment on changing the matrix to adjust the levels of discounts received by schools and libraries for supported services. We also particularly seek comment from the State members of the Federal-State Joint Board on Universal Service, and commit to ongoing informal consultations on these issues.

60. Interested parties have indicated that an altered discount matrix may better serve the schools and libraries program. In response to the *Schools and Libraries NPRM*, several commenters asserted that reducing the discount rate would make applicants more accountable for their funding requests<sup>114</sup> and dissuade vendors from improperly offering to forgive or refund the 10 percent contribution required of applicants in the highest discount band.<sup>115</sup> In addition, commenters stated that altering the discount rate would be an effective way to increase the availability of funds for eligible applicants outside the highest discount band.<sup>116</sup> While the *Universal Service Order* prioritized support for entities with the greatest level of economic disadvantage,<sup>117</sup> some interested parties have suggested that greater emphasis should be given to the equitable distribution of E-rate funds to eligible applicants from all discount bands, to ensure that they have comparable access to advanced telecommunications and information services.<sup>118</sup> Participants in the Commission's Public Forum on the E-rate program in May 2003 also suggested that the Commission amend its discount matrix, and USAC's Task Force on Waste,

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<sup>113</sup> See 47 C.F.R. § 54.505. Schools and libraries in areas with higher percentages of students eligible for free or reduced-price lunch through the National School Lunch Program or a federally approved alternative mechanism qualify for higher discounts for eligible services than applicants with low levels of eligibility for such programs. Schools and libraries located in rural areas also generally receive greater discounts. *Id.*

<sup>114</sup> See, e.g., Iowa DOE NPRM Comments at 3-4; Pennsylvania Board of Education NPRM Comments at 7. Some interested parties have claimed that the minimal financial contribution required of applicants in the highest discount band allows applicants to request funds without regard to need or cost-effectiveness and allows vendors to exploit the system. See, e.g., Iowa DOE NPRM Comments at 3-4; Pennsylvania Board of Education NPRM Comments at 7. Some parties assert that 90 percent applicants periodically request funding for services and equipment that they cannot practically utilize. Letter from Greg Weisiger, Virginia Department of Education, on behalf of CCSSO (filed Mar. 18, 2003).

<sup>115</sup> See, e.g., Funds for Learning, LLC NPRM Comments at 15; Tel/Logic NPRM Comments at 18 & n.5. Specifically, some commenters suggested that vendors offer "grants" or extra services, in the amount equivalent to the applicants' contribution to those applicants that must pay 10 percent of the costs as consideration for accepting a vendor's bid. See, e.g., Iowa DOE NPRM Comments at 3-4; Pennsylvania Board of Education NPRM Comments at 7; see also Letter from Greg Weisiger, Virginia Department of Education, on behalf of CCSSO (filed Mar. 18, 2003) and Semiannual Reports of the Office of the Inspector General.

<sup>116</sup> See e.g., Illinois State Board of Education NPRM Comments at 10; Pennsylvania Department of Education NPRM Comments at 7; Council of Chief State School Officers NPRM Comments at 47-48. Several parties reiterated these suggestions at a May 8, 2003, public forum held by the Commission. See *E-rate Public Forum*, BellSouth Statement at 10; Funds for Learning, LLC Statement at 12, and American Library Association Statement at 4-5.

<sup>117</sup> See *Universal Service Order*, 12 FCC Rcd. at 9038 paras. 497-499.

<sup>118</sup> See, e.g., Illinois State Board of Education NPRM Comments at 10; Pennsylvania Department of Education NPRM Comments at 7; CCSSO NPRM Comments at 47-48; *E-Rate Public Forum*, BellSouth Statement at 10-11.

Fraud, and Abuse has recommended that the discount level for internal connections be lowered from 90 percent to 80 percent.<sup>119</sup>

61. For these reasons, we seek comment on whether the Commission should amend the discount matrix to reduce the discounts available in some or all of the discount bands, including the current 90 percent discount band. We propose that such a change, if adopted, become effective in Funding Year 2005. We seek comment on whether the current discount matrix provides sufficient incentives for schools and libraries to limit funding requests to services that can be efficiently used and for vendors to competitively price their services. We also seek comment on whether it would be appropriate to adjust the discount matrix in order to expand the reach of funding to lower discount bands. We note that the rules we adopt in the foregoing Order, limiting the availability of support for internal connections to twice every five years, is intended to make support available to more applicants on a regular basis. How does this action affect the need to adjust the discount matrix? We further seek comment on which discount rates in the matrix, if any, other than the highest discount rate band, should be reduced. Additionally, we seek comment on whether developing a separate discount matrix for Priority Two funding would effectively address issues of waste, fraud, and abuse and expand the reach of funds to a larger number of schools and libraries.<sup>120</sup> Many parties have suggested that, at a minimum, the maximum discount level for internal connections be lowered to 70 percent.<sup>121</sup> What would be the effect of such a change? While we seek comment generally on revisions to the discount matrix, we note that we are not seeking comment on whether to combine the existing Priority One and Priority Two funding categories.

62. We ask that commenters address implementation issues surrounding a change in the discount matrix. Currently, in the event that there are not sufficient funds remaining under the annual cap to support all requests for discounts at a particular discount level, funds are allocated on a pro rata basis among applicants at that discount level.<sup>122</sup> Should funds continue to be allocated among all applicants at the discount level on a pro rata basis, or is there some other means of allocating the remaining funds? We seek comment on how changes to the discount matrix should be implemented across all levels of need. Should certain existing discount levels be combined? For example, should the 90 and 80 percent discount levels be combined? In the

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<sup>119</sup> See, e.g., *E-Rate Public Forum*, Funds for Learning Statement at 13 (matrix should be revised so that all schools with 50 percent or more students eligible for free lunch receive equal discounts) and StateNets Statement at 3; *Task Force Recommendation* at 3-4.

<sup>120</sup> Since inception of E-rate program, all eligible requests for Priority One services have been funded, but there have been funds available for only a portion of eligible requests for Priority Two services. Further, concerns have been expressed that a comparatively higher occurrence of waste, fraud and abuse problems exists among Priority Two services. Update on USAC Task Force on the Prevention of Waste, Fraud and Abuse: Meeting #3, at <http://www.sl.universalservice.org/taskforce/update3.asp>; see also CCSSO NPRM Comments at 47-48; Pennsylvania Board of Education NPRM Comments at 7; State of Alaska Department of Education and Early Development NPRM Reply at 6; Iowa DOE NPRM Comments at 9.

<sup>121</sup> See, e.g., Greg Weisiger NPRM Comments at 6; ISBE NPRM Comments at 26; SECA NPRM Comments at 16-18; Tel/Logic NPRM Comments at 9-10; Wisconsin NPRM Comments at 2-3.

<sup>122</sup> 47 C.F.R. § 54.507(g)(1)(iv).

alternative, should each discount level be reduced by a fixed amount? For example, should each discount level be reduced by 10 percent? Is there some other method of re-setting other discount levels below the highest discount level? Finally, we seek comment on how the transition to a new discount matrix, if adopted, should be implemented in order to minimize burdens on applicants and disruptions to the program.

## B. Competitive Bidding Process

63. We seek comment on the current process of applying for discounted services. Pursuant to competitive bidding requirements, eligible schools and libraries that wish to receive support for discounted services must submit FCC Form 470 to the Administrator.<sup>123</sup> The FCC Form 470 describes the applicant's telecommunication needs and notifies service providers of the applicant's intent to contract for eligible services. After the FCC Form 470 has been posted to the Administrator's website for 28 days, the applicant may contract for the provision of services and file an FCC Form 471, requesting discounts for the services.<sup>124</sup> We seek comment on whether this process typically results in competitive bids, and ask commenters to elaborate on the characteristics of recipients that do not ordinarily receive multiple bids.<sup>125</sup> We seek comment on whether this process continues to suit the needs of the schools and libraries program, or if a different application process would better suit the program's needs.<sup>126</sup> We specifically request that commenters discuss how the current process and any proposed processes address the Commission's goal of minimizing waste, fraud, and abuse in the program, while encouraging the benefits of competition as set out in the *Universal Service Order*.<sup>127</sup>

64. A number of parties have suggested that the current Form 470 posting process should be modified for certain types of services. For instance, one participant in the Commission's public forum on the ways to improve the administration of the schools and libraries mechanism suggested that the Form 470 process be eliminated for requests for funding local telephone service.<sup>128</sup> Others suggest that the FCC simplify the application process for applications that only seek funding for local and long distance service (including cell phone service), or that seek to continue an existing telecommunications service or Internet access service.<sup>129</sup> We seek comment on whether it would serve our goals to simplify or eliminate the current FCC Form 470 posting

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<sup>123</sup> 47 C.F.R. § 54.504 (b).

<sup>124</sup> 47 C.F.R. § 54.504 (b), (c).

<sup>125</sup> See, e.g., *E-Rate Public Forum*, EdLink Statement at 2 (applicants indicate that posting rarely yields multiple vendor bids) and Seattle Public Schools Statement at 2 (Form 470 posting process results in competitive bids in only a few instances).

<sup>126</sup> See, e.g., *Task Force Recommendation* at 5 (recommending that the complexity of the application process should better match the complexity of individual applicant situations).

<sup>127</sup> *Universal Service Order*, 12 FCC Rcd at 9029 para. 480 (noting that the competitive bidding process ensures that the eligible entity receives information about all telecommunication choices and receives varying, competitive bids, which preserves the fund for other eligible entities).

<sup>128</sup> *E-Rate Public Forum*, Central Susquehanna Intermediate Unit Statement at 3.

<sup>129</sup> *E-Rate Public Forum*, American Library Association Statement at 2-3.

process in such situations. What other mechanisms would ensure that our objective of ensuring that applicants are aware of potential service providers and select reasonably priced services is met? What would be the costs and benefits of such a change?

65. We also seek comment on how we can ensure that applicants select cost effective services in situations in which no entity, or only one entity, responds to a Form 470 posting. In some situations, there may be only one service provider capable of, or willing to, provide the requested service. How can we ensure that the prices for such services are reasonable, and do not waste scarce universal service funds? Should we adopt bright line rules that would impose limits on the amount of discounts that could be available in such situations?

66. We further seek comment on whether the Commission, as a condition of support, should require that each service provider certify that the prices in its bid have been independently developed. Such a certification could be modeled after the certificate of independent price determination required under federal acquisition regulations.<sup>130</sup> A fair and open competitive bidding process is critical to preventing waste, fraud, and abuse of program resources.<sup>131</sup> Adopting a certification requirement would ensure that service providers are fully aware that they may not communicate with other service providers in a way that subverts the competitive bidding process. Moreover, service providers that violate a non-collusion certification will, in many instances, also violate federal antitrust laws.<sup>132</sup> Requiring certifications of independent pricing would better enable the Commission or other government agencies to enforce the Commission's rules and to seek criminal sanctions where appropriate. We also seek comment on whether the Commission's rules should specifically require that records related to the competitive bidding process for services must be maintained by both the recipient and the service provider for a period of five years.

### C. Definition of Rural Area

67. We seek comment on modifications to the definition of "rural area" for the schools and libraries mechanism.<sup>133</sup> Currently, an area qualifies as rural under our rules for the schools and libraries support mechanism if it is located in a non-metropolitan county as defined by the Office of Management and Budget or is specifically identified in the Goldsmith Modification to 1990 Census data published by the Office of Rural Health Care Policy (ORHP).<sup>134</sup> We understand, however, that OHRP no longer utilizes the definition adopted by the Commission in

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<sup>130</sup> See 48 C.F.R. § 52.203-2.

<sup>131</sup> *Universal Service Order*, 12 FCC Rcd at 9029 para. 480; see also *id.* at 8950 n. 819 (asking, *inter alia*, whether safeguards were needed to prevent a bidder from driving out competitors).

<sup>132</sup> Sherman Act, 15 U.S.C. § 1.

<sup>133</sup> The Commission defines "rural" for the purposes of the schools and libraries program in section 54.505(b)(3)(ii). This definition is the same as the definition of "rural area" in section 54.5 of the Commission's rules, which is used by other universal service programs.

<sup>134</sup> See 47 C.F.R. §§ 54.5, 54.505(b)(3)(ii).

1997, and that there will be no Goldsmith Modification to the most recent 2000 Census data.<sup>135</sup>

68. We seek comment on whether we should adopt a new definition of rural area for the schools and libraries program, and, if so, what that new definition should be.<sup>136</sup> We seek comment on whether there are there any definitions for rural areas used by other government agencies that would be appropriate for the schools and libraries program. In addition to describing any proposed new definitions, we ask commenters to address the specific proposals that have already been raised in the rural health care proceeding. In particular, several commenters in the rural health care proceeding suggest that the Commission adopt the rural designation system currently utilized by ORHP, the Rural Urban Commuting Area (RUCA) system.<sup>137</sup> Others propose to define rural as non-urbanized areas, as specified by the Census Bureau.<sup>138</sup> We also recently sought comment on the definition of “rural area” in the context of increasing flexibility and the deployment of spectrum-based services in rural areas.<sup>139</sup> There we identified and sought comment on the following potential definitions of “rural area,” in addition to the ones already identified above: (1) counties with a population density of 100 persons or fewer per square mile; (2) Rural Service Areas; (3) non-nodal counties within an Economic Area; (4) the definition of “rural” used by the Rural Utility Service for its broadband program; (5) the definition of “rural” based on census tracts as outlined by the Economic Research Service of the USDA; and (6) any census tract that is not within ten miles of any incorporated or census-designated place containing more than 2,500 people, and is not within a county or county equivalent which has an overall population density of more than 500 persons per square mile of land.<sup>140</sup> Finally, some commenters in that proceeding assert that if the Commission adopts a new definition of rural, it should grandfather existing areas that currently qualify as rural area, if they

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<sup>135</sup> See Rural Health Care Support Mechanism, WC Docket No. 02-60, Notice of Proposed Rulemaking, 17 FCC Rcd 7806 (2002); see also Kansas Department of Health NPRM Comments at 3 (WC Docket 02-60).

<sup>136</sup> We note that the rural health care support mechanism uses the same definition of rural area. Recently, we sought comment on possible changes to the rural area definition in the context of the rural health care program in a separate notice of proposed rulemaking. Rural Health Care Support Mechanism, WC Docket No. 02-60, Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC 03-288, at paras. 63-64 (rel. Nov. 17, 2003) (*Rural Health Care Order*).

<sup>137</sup> See, e.g., Center for Rural Health Comments at 3 (WC Docket 02-60); New Mexico Health Comments at 3 (WC Docket 02-60); University of American Health Sciences Center Comments at 2 (WC Docket 02-60).

<sup>138</sup> See, e.g., American Telemedicine Comments at 5 (WC Docket 02-60); Blue Cross Comments at 4 (WC Docket 02-60); Northern Sierra Comments at 7-8 (WC Docket 02-60).

<sup>139</sup> *Facilitating the Provision of Spectrum-Based Services to Rural Areas and Promoting Opportunities for Rural Telephone Companies To Provide Spectrum-Based Services*, WT Docket No. 02-381, *2000 Biennial Regulatory Review Spectrum Aggregation Limits For Commercial Mobile Radio Services*, WT Docket No. 01-14, *Increasing Flexibility To Promote Access to and the Efficient and Intensive Use of Spectrum and the Widespread Deployment of Wireless Services, and To Facilitate Capital Formation*, WT Docket No. 03-202, Notice of Proposed Rulemaking, FCC 03-222, at paras. 10-12, (rel. October 6, 2003).

<sup>140</sup> *Id.* at para. 12.

would no longer qualify under the new definition.<sup>141</sup>

69. Commenters are encouraged to describe the effects of any new definition on the reach of the schools and libraries program, *e.g.*, how many existing rural areas would become non-rural and vice versa, and whether and how the Commission should consider any such changes in adopting a new definition for “rural area.” We also seek comment on whether it is necessary or desirable to use the same definition of “rural” for both the schools and libraries program and rural health care program.

#### **D. Definition of Internet Access**

70. In the *Schools and Libraries NPRM*, the Commission sought comment on whether modifying our rules governing the funding of Internet content would improve program operation consistent with our other goals of ensuring a fair and equitable distribution of benefits and preventing waste, fraud, and abuse. In particular, the Commission sought comment on whether to permit funding for an Internet access package that includes content if that package is the most cost effective form of Internet access.<sup>142</sup> Comments we received in response to the *Schools and Libraries NPRM* indicated that parties had widely varying views of what should be viewed as “content,”<sup>143</sup> although many parties expressed concern about providing funding for Internet access bundled with subject matter content.<sup>144</sup> The record developed on this issue, in conjunction with recent changes made in the rural health care program, leads us to seek more focused comment on whether we should alter the definition of Internet access used for the schools and libraries program. Support for Internet access under the schools and libraries program is provided only for “basic conduit access to the Internet.”<sup>145</sup> Support in the Internet access category has not been provided for virtual private networks,<sup>146</sup> nor has it been provided for Internet access services that enable communications through private networks. In our recent *Rural Health Care Order*, we concluded that the definition currently used in the schools and libraries context was too limited for the rural health care program, because it precludes support for features that provide the

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<sup>141</sup> See Midwest Comments at 4 (WC Docket 02-60). For the 2000 Census, urban territories include urbanized areas (UA) and urban clusters (UC), which consist of core census block groups or blocks that have a population density of at least 1,000 people per square mile and surrounding census blocks that have an overall density of at least 500 people per square mile. Rural territories include areas located outside of UAs and UCs. See [http://www.census.gov/geo/www/ua/ua\\_2k.html](http://www.census.gov/geo/www/ua/ua_2k.html) (visited Sept. 11, 2003).

<sup>142</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1925 para. 25.

<sup>143</sup> In response to this question, several commenters urged the Commission to permit funding for virus protection, firewalls, and filtering. See Coalition for E-Rate Reform NPRM Comments at 7; Funds for Learning NPRM Comments at 7-8; Illinois BoE NPRM Comments at 14-15; and TAMSCO NPRM Comments at 2.

<sup>144</sup> See *e.g.* Alaska DoE NPRM Reply at 6; Arkansas NPRM Reply at 4; ALA NPRM Comments at 28; CCSSO NPRM Comments at 26; EdLINC NPRM Comments at 6; Memphis NPRM Comments at 2; NEA NPRM Comments at 10; Weisiger NPRM Comments at 24.

<sup>145</sup> *Universal Service Order*, 12 FCC Rcd at 9008-09 para. 436.

<sup>146</sup> Support has been available for virtual private networks, however, to the extent offered as a telecommunications service.

capability to generate or alter the content of information.<sup>147</sup> We concluded that adopting such a limitation in the rural health care context would significantly undercut the utility of providing support for Internet access to rural health care providers, because the ability to alter and interact with information over the Internet is a functionality that could facilitate improved medical care in rural areas.<sup>148</sup>

71. We now seek comment on whether we should amend our definition of Internet access in the schools context to conform to the definition recently adopted for the rural health care mechanism. The Administrator has utilized cost allocation to ensure that support is not provided for features deemed ineligible under the Commission's definition of Internet access in the schools context, and also has provided discounts on services that provide ineligible features when that ineligible portion is provided on an ancillary basis.<sup>149</sup> While we conclude that this has been a reasonable way to implement our rules in an administratively workable fashion, we are concerned that the definition adopted in 1997 may unintentionally preclude support for features of Internet access that would provide substantial benefits to school children and library patrons in the United States. We are concerned that the rule adopted six years ago may not adequately address the full ranges of features and functionalities in Internet access services that are available in the marketplace today. Moreover, we seek comment on whether amending the current definition of Internet access would simplify and streamline program administration. We also seek comment on how broadening the definition of Internet access (a Priority One service) will impact the availability of funds for Priority Two services. To the extent commenters argue that the definition of Internet access should differ for the schools and libraries program, and the rural health care program, they should provide specific arguments outlining the legal, policy, or technical reasons for that position.

### **E. Wide Area Networks**

72. In the *Schools and Libraries NPRM*, the Commission sought comment on whether to modify its policies regarding the funding of Priority One services (telecommunications service and Internet access) that include service provider charges for capital investments for wide area networks.<sup>150</sup> The record we received demonstrated a wide range of views on what changes, if

<sup>147</sup> Section 54.5 of our rules states:

Internet Access" includes the following elements:

- ...
- (2) The transmission of information as part of a gateway to an information service, when that transmission does not involve the generation or alteration of the content of information, but may include data transmission, address translation, protocol conversion, billing management, introductory information content, and navigational systems that enable users to access information services, and that do not affect the presentation of such information to users . . .

47 C.F.R. § 54.5.

<sup>148</sup> *Rural Health Care Order and Further Notice*, FCC 03-288, at paras. 18-29.

<sup>149</sup> See [www.sl.universalservice.org/reference/costallocationguide.asp](http://www.sl.universalservice.org/reference/costallocationguide.asp).

<sup>150</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1922-23 paras. 16-20. The Commission noted that in the 1999 (continued...)



any, should be made in this area.<sup>151</sup>

73. In light of our decision above to impose limitations on funding of internal connections, we recognize that there may be even greater incentives than before for service providers to characterize charges for facilities that also could be viewed as internal connections as Priority One services. We believe it desirable, therefore, to seek more focused comment on specific proposals in this area to ensure that funds are distributed in a fair and equitable fashion. If we adopt rules in this area, we anticipate that those rules would be effective no earlier than Funding Year 2005. We seek comment on the advantages and disadvantages of the proposals set forth below.

74. We seek comment on whether to refine a standard for determining whether expenditures that subsidize infrastructure investment, either on-premises or off-premises, may properly be viewed as Priority One services. In particular, we seek comment on whether we should adopt a rule that would limit recipients from receiving discounts for service provider upfront capital investments to the extent those capital investments exceed 25 percent of the funding request for the service in question. Such a rule could serve to spread funding for Priority One services more evenly across all recipients, and could limit the extent to which the universal service fund is used to finance significant service provider infrastructure investment.

75. In the *Brooklyn Order*, the Commission determined that recipients may receive discounts on non-recurring charges associated with capital investment made by a service provider in an amount equal to the investment prorated equally over a term of at least three years.<sup>152</sup> We now seek focused comment on whether we should adopt a rule that discounts for any service provider charges for capital investment of \$500,000 or more must be prorated over a period of at least five years.<sup>153</sup> Like the other proposal, such a rule could serve to spread funding for Priority

(Continued from previous page)

*Tennessee Order*, it had established that universal service funds may be used to fund equipment and infrastructure build-out associated with the provision of eligible services, and that in the *Brooklyn Order*, it required that discounts on non-recurring charges associated with capital investment be prorated equally over a term of at least three years. USAC has implemented these decisions through guidelines posted on its website. See <http://www.sl.universalservice.org/reference/OnPremP1.asp>, <http://www.sl.universalservice.org/reference/wan.asp>.

<sup>151</sup> See, e.g., Alaska NPRM Comments at 4 (permitting the lease of WANs is the most efficient way to deliver service to rural schools); BellSouth/SBC NPRM Comments at 9-12 (should be viewed as provision of service, not a lease of a WAN); Boston at 3-4 (Priority One funding should be available only for leasing of CSU/DSUs and routers; leasing of servers, filters, switches, hubs, content caches and all other on-premise equipment should only be allowed under Internal Connections); NOBLE at 1 (basic connectivity equipment, such as routers, CSU/DSU should be treated as Priority One; hubs, switches and cabling should be treated as Priority Two internal connections); Sprint at 4-5 (consider what percentage of Priority One funds support the leasing of WANs before removing leased WANs from Priority One); Worldcom NPRM Comments at 8; Worldcom NPRM Reply at 7 (look at economic depreciation lives of any funded asset; should only fund the depreciable amount in a given year).

<sup>152</sup> *Brooklyn Order*, 15 FCC Rcd at 18606-07 para. 20.

<sup>153</sup> See New York Board of Education NPRM Comments at 3 (at a minimum, amortize costs of leasing equipment for WANs over five years to lessen drain on fund); Erate Elite NPRM Comments at 4 (extend cost recovery to five years); Great City NPRM Comments at 2 (extend cost recovery to five years); but see Arkansas NPRM Comments at 3-4 (lease expenses should be spread over three years); Cox NPRM Comments at 7-8 (three years); Excaliber NPRM Comments at 4 (three years).

One services more evenly across all recipients, and could limit the extent to which the universal service fund is used to finance significant service provider infrastructure investment.

76. We also take this opportunity to address other issues related to the provision of service over wide area networks. Under our current rules, schools and libraries may receive support to obtain telecommunications services using lit fiber. Schools and libraries may also receive discounts when they obtain Internet access that uses lit fiber.<sup>154</sup> In order to receive support for services using lit fiber as a Priority One service, the school or library must purchase a functioning service from either a telecommunications service provider or internet access provider, which in turn is responsible for ensuring that both the fiber and the equipment to light the fiber are provided.<sup>155</sup> If a school or library enters a contract to lease unlit fiber, and obtain telecommunications service or Internet access using lit fiber, it must segregate the cost of the unsupported unlit fiber from the cost of the supported lit fiber service in its application for support.

77. We seek comment on the provision of funding for unlit (dark) fiber under the schools and libraries support mechanism.<sup>156</sup> We note that the Commission has addressed dark fiber in several different contexts.<sup>157</sup> We seek comment on whether we should permit funding for dark

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<sup>154</sup> Consistent with our current definition of Internet access, the lit fiber may only be used by the school or library to access the Internet, and may not be used for communications between multiple locations, *i.e.*, inter-school communications such as video conferencing.

<sup>155</sup> In cases in which a school or library has previously purchased equipment to light fiber, such equipment may be traded-in to the service provider and leased back by the applicant. The applicant may not use the credit for the trade-in to pay its non-discounted portion of the services. Such a contract modification would be deemed a minor contract modification under section 54.500(g) of the Commission's rules if this was within the scope of the original contract and the change has no effect or negligible effect on price, quantity, quality, or delivery under the original contract. For instance, such a change could fit within the minor contract modification rule if the original contract was for the provision of high bandwidth transmission capability.

<sup>156</sup> USAC's 2003 Eligible Services list states, "The FCC has not resolved whether unlit dark fiber is a telecommunications service. Pending resolution of this issue, it is not eligible for funding." See <http://www.sl.universalservice.org/data/pdf/EligibleServicesList101003.pdf> (dated October 10, 2003). Prior to 2003, USAC provided funding for dark fiber as set forth on its Eligible Services List: "Service providers can lease fiber capacity that does not include modulating electronics to schools and libraries, if the applicant provides the electronics to modulate the fiber. The lease of such fiber cable for obtaining Telecommunications Services or Internet access is eligible, if the applicant's electronics are located solely at the eligible school or library sites, and if the conditions apply that are described under the heading 'Wide Area Network' in the relevant section (Telecommunications Services or Internet Access)." See 2002 Eligible Services List (issued October 17, 2001); 2001 Eligible Services List (issued December 19, 2000); 2000 Eligible Services List (issued November 23, 1999)

<sup>157</sup> See *Southwestern Bell Tel. Co. v. FCC*, 19 F.3d 1475 (D.C. Cir. 1994) (finding that the Commission had failed to provide a sufficient analysis for concluding that unlit (dark) fiber service was a common carrier service and suspending the Commission order pending proceedings on remand); Instructions to the Telecommunications Reporting Worksheet, FCC Form 499-A, February 2003, at 22 (instructing universal service contributors not to include revenues for dark fiber services as telecommunications revenues); *but see* Deployment of Wireline Services Offering Advanced Telecommunications Capability, *Fourth Report and Order*, 16 FCC Rcd 15435, 15473-74 paras. 74-75 and n. 189 (2001) (declaring that a dark fiber service with respect to cross-connects is a common carrier service under the second prong of *NARUC II*).

fiber, pursuant to section 254(h), to provide additional flexibility to applicants in meeting their communications needs. We also seek comment on whether any limitations should be adopted to preclude discounts on the full cost of dark fiber network buildout when the applicant will not be utilizing the full capacity of that network.

#### F. Recovery of Funds

78. In 1999, the Commission adopted the *Commitment Adjustment Order*, which directed the Administrator to recover funding erroneously committed to schools and libraries in violation of the Telecommunications Act of 1996.<sup>158</sup> The Commission adopted a companion order on the same day granting a limited waiver of four Commission rules to first year applicants who had received commitments and disbursements in violation of Commission rules.<sup>159</sup> Shortly thereafter, pursuant to the *Commitment Adjustment Order*, USAC submitted to the Commission its plan to collect universal service funds that were erroneously disbursed in the first year of the program in violation of the statute.<sup>160</sup> Subsequently, in 2000, the Commission adopted with minor modifications USAC's plan to implement the requirements of the *Commitment Adjustment Order*.<sup>161</sup> In that Order, the Commission also emphasized that the recovery plan "is not intended to cover the rare cases in which the Commission has determined that a school or library has engaged in waste, fraud or abuse."<sup>162</sup> The Commission stated that it would address such situations on a case-by-case basis.<sup>163</sup>

79. At the time the Commission adopted the *Commitment Adjustment Order*, USAC had been distributing funds through the schools and libraries universal service support mechanism for approximately one year. The Commission and USAC then faced a limited range of situations in

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<sup>158</sup> *Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, CC Docket Nos. 97-21 and 96-45, Order, FCC 99-291 (rel. October 8, 1999) (*Commitment Adjustment Order*), petitions for reconsideration pending, petition for review pending sub. nom. *United States Telecom Ass'n v. FCC*, Case Nos. 00-1500, 00-1501(D.C. Cir. Filed Nov. 27, 2000). Petitions for Reconsideration were filed by MCI WorldCom, Inc. (WorldCom), Sprint Corporation (Sprint), and the United States Telecom Association (USTA). Additional comments in support of the Petitions for Reconsideration were filed by Nextel Communications, Inc. (Nextel) and AT&T Corp. (AT&T).

<sup>159</sup> *Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, CC Docket Nos. 97-21 and 96-45, Order, 15 FCC Rcd 7197 (1999) (*Waiver Order*). The Order also directed USAC to waive one of its procedural requirements.

<sup>160</sup> See Letter from D. Scott Barash, Vice President and General Counsel, USAC, to Magalie Roman Salas, Secretary, Federal Communications Commission, dated October 22, 1999.

<sup>161</sup> *Changes to the Board of Directors of the National Exchange Carrier Association, Inc., Federal-State Joint Board on Universal Service*, CC Docket Nos. 97-21 and 96-45, Order, 15 FCC Rcd 22975 (2000) (*Commitment Adjustment Implementation Order*).

<sup>162</sup> See *Commitment Adjustment Implementation Order*, 15 FCC Rcd at 22980 para. 13.

<sup>163</sup> *Id.*

which errors had occurred requiring the recovery of funds.<sup>164</sup> Since then, through the audit process, the Commission and USAC have become aware of additional scenarios that may require recovery of funds due to errors made by applicants and/or service providers. While the *Commitment Adjustment Implementation Order* implemented procedures, consistent with the Commission's debt collection rules,<sup>165</sup> for recovery of funds that were disbursed in violation of *statutory* requirements, the Commission has not comprehensively addressed the question of what recovery procedures would be appropriate in situations where it is determined that funds have been disbursed in violation of particular programmatic rules that do not implicate statutory requirements.<sup>166</sup> Likewise, the Commission has not addressed the question of what procedures are needed to govern the recovery of funds that have been committed or disbursed in situations later determined to involve waste, fraud or abuse.

80. In administering the schools and libraries program, we have become aware of instances in which funds were disbursed erroneously, and, depending upon the circumstances surrounding the particular error as well as the procedure or rule implicated, we determined whether recovery was appropriate. In light of these experiences, we now consider whether we should implement procedures or adopt rules governing fund recovery across particular situations and, more generally, whether additional safeguards or procedures are needed to address the matter of erroneously disbursed funds.

81. In particular, we ask whether we should adopt specific recovery rules for funds that are disbursed in violation of statutory requirements. We also seek comment on whether the Commission should implement procedures or adopt rules for funds that are disbursed in violation of one or more programmatic rules or procedures under the schools and libraries program or in situations involving waste, fraud or abuse. If so, we ask whether we should adopt for all instances of improperly disbursed funds, procedures comparable to those adopted in the *Commitment Adjustment Implementation Order*, or whether we should modify any of those procedures. We note that, through petitions for reconsideration of the *Commitment Adjustment Order* and in comments filed in support of those petitions, particular service providers have argued that the Commission should recover erroneously disbursed funds from the party that received the benefit of the disbursement, specifically the school or library.<sup>167</sup> Although the Commission continues to believe that there are valid reasons for seeking recovery only from service providers, we ask whether there are any circumstances under which recovery would be more appropriately sought from a school or library applicant. At this time we do not resolve the specific issues raised in the

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<sup>164</sup> The *Commitment Adjustment Implementation Order* provides two examples of errors resulting in statutory violation requiring recovery: (1) funding committed for ineligible services; and (2) funding for telecommunications services provided by non-telecommunications carriers. *Commitment Adjustment Implementation Order*, 15 FCC Rcd at 22976-77 para. 3.

<sup>165</sup> See 47 U.S.C. §§ 1.901 *et seq.*

<sup>166</sup> USAC has utilized procedures consistent with the *Commitment Adjustment Implementation Order* for situations involving rule violations that do not implicate statutory requirements.

<sup>167</sup> See USTA Petition at 5-8; Sprint Petition at 2-3.

pending petitions for reconsideration. Instead, we seek to further develop the record in this area in light of particular issues that have come to our attention and as to which we seek comment in this notice.

82. We note that in some circumstances, there may be a series of rule violations that neither collectively nor individually implicate the full amount of the funding commitment. In the event that the full amount of the funding commitment has been disbursed under such circumstances, we seek comment on what circumstances would make recovery of the full amount of the funding commitment appropriate or inappropriate. We seek comment specifically on whether a pattern of systematic noncompliance with Commission rules warrants recovery of the full amount disbursed, irrespective of the dollars associated with specific audit findings. We note that, unlike errors resulting in statutory violations, the Commission may waive non-compliance with regulations in appropriate circumstances.<sup>168</sup> We recognize that some errors made by applicants and/or service providers may not violate the statute, may be minor in nature and may not affect the integrity of or otherwise undermine policies central to administration of the program. We invite comment on whether there are situations in which such errors would warrant a Commission decision not requiring the recovery of funds. For example, should we waive recovery if the dollars at issue are *de minimis*, either on absolute dollar or percentage of disbursement basis, and if so, what dollar level or percentage would be an appropriate threshold for deeming a violation to be *de minimis*? Parties advocating such a position should describe what mechanism the Commission should use to reach such a result, such as waiving the rules that are not statutory, are minor and do not affect program integrity, focusing particularly on how such a result could be achieved with administrative ease.

83. In addressing the issues above, we also invite commenters to explain whether any additional policies or rules directed at circumstances involving waste, fraud and abuse would be necessary, or whether procedures we may adopt in response to our questions above will be sufficient in correcting waste, fraud and abuse. In doing so, parties should consider whether certain violations are more critical in our attempts to control waste, fraud and abuse than others. Are the circumstances where waste, fraud and abuse are found the type that should result in recovery of funds from the entity that is responsible for the waste, fraud and abuse? How should we proceed if both the applicant and the service provider are culpable for such misconduct? We seek proposals that include detailed procedures for dealing with waste, fraud and abuse cases.

84. We also seek comment on whether we should implement other measures to ensure service provider and applicant accountability. In particular, we seek comment on whether we should implement procedures or adopt rules to defer action on any additional funding request involving a beneficiary for whom there is an outstanding commitment adjustment proceeding.<sup>169</sup>

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<sup>168</sup> See *Waiver Order*, 15 FCC Rcd at 7199 para. 6.

<sup>169</sup> In the *Schools and Libraries Second Order and Further Notice*, the Commission implemented rules for debarment of anyone convicted of a criminal violation or found civilly liable for actions relating to the schools and libraries program. The Commission also sought further comment on whether other circumstances not culminating in a criminal conviction or civil judgment warrant debarment. *Schools and Libraries Second Order and Further Notice*, 18 FCC Rcd at 9225-28 paras. 66-77, 9235-39 paras. 102-115.

Under such a policy, no discounts would flow to the beneficiary in subsequent years until there was full satisfaction of the outstanding commitment adjustment. We also seek comment on whether any applicant that has previously been subject to a commitment adjustment proceeding should be subjected to more rigorous scrutiny before receiving commitments in the future. If we were to implement such a policy, what additional showing should be required of the applicant in subsequent years, and how long should the entity be subjected to such enhanced scrutiny?

85. Commenters should provide discrete proposals with examples or data to support their suggestions.

### **G. Other Actions to Reduce Waste, Fraud, and Abuse**

86. We seek comment on a number of proposals intended to improve the abilities of the Commission and the Administrator to identify and enforce violations of the Commission's rules and, thereby, to reduce waste, fraud, and abuse in the schools and libraries universal service mechanism.

87. *Cost-Effective Funding Requests.* We seek comment on whether we should codify additional rules to ensure that applicants make informed and reasonable decisions in deciding for which services they will seek discounts. Currently, our rules specify that, in selecting a service provider, a recipient must carefully consider all bids submitted and must select the most cost-effective service offering.<sup>170</sup> Moreover, the *Universal Service Order* makes clear that applicants must request services based on an assessment of their reasonable needs.<sup>171</sup> Our rules do not expressly require, however, that the applicant consider whether a particular package of services are the most cost effective means of meeting its technology needs. Nor do our rules expressly establish a bright line test for what is a "cost effective" service. Would it be beneficial and administratively feasible to develop such a test, or, for example, a benchmark or formula for "cost-effective" funding requests, such as a specified dollar amount per student or per library patron for specified types of service?<sup>172</sup> Should we adopt a ceiling on the total amount of annual funding that an applicant can request?<sup>173</sup> If so, how would such a ceiling is calculated? Are there other rule changes that would ensure applicants are not requesting discounts for services beyond their reasonable needs?

88. *Recordkeeping Requirements.* We seek comment on whether to amend our rules governing the maintenance of records related to the receipt of universal service discounts.

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<sup>170</sup> 47 C.F.R. § 54.511(a); see also *Request for Review of the Decision of the Universal Service Administrator by Ysleta Independent School District et al.*, SLD No. 312479, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, CC Docket No. 97-21, Order, FCC 03-313, paras. 47-55 (rel. Dec. 8, 2003).

<sup>171</sup> *Universal Service Order*, 12 FCC Rcd at 9077-78 paras. 572-74.

<sup>172</sup> See *E-rate Public Forum*, Funds for Learning Statement at 15 and Sprint Statement at 1; see also Funds for Learning NPRM Comments at 14; State of Alaska NPRM Reply at 2; NEA, ISTE and CoSN Joint. NPRM Reply at 7-8; and Siemens Enterprise Networks NPRM Reply at 3.

<sup>173</sup> See *Task Force Recommendation* at 4 (supporting imposition of a funding ceiling).

Currently, the Commission rules require each entity receiving supported services to keep records related to the receipt of discounted services similar to those that the entity maintains for other purchases, but do not specify how long such records should be maintained.<sup>174</sup> Nor do our rules expressly require all entities to maintain records to demonstrate compliance with all rules. Recent beneficiary audits conducted by USAC's independent auditor identify a number of instances in which the independent auditor was unable to perform certain procedures due to lack of documentation. We seek comment on whether to amend our rules to require that all records related to the receipt of or delivery of discounted services, sufficient to demonstrate compliance with the Commission's rules governing the schools and libraries mechanism, be maintained by the beneficiary for a period of five years after the last day of the delivery of the discounted services. We also seek comment on what types of documents would be sufficient to demonstrate compliance.<sup>175</sup>

89. In addition, the Commission's rules require service providers to keep and retain records of rates charged to and discounts allowed for entities receiving supported services.<sup>176</sup> We seek comment on requiring that service providers retain all records related to the delivery of discounted services for a period of five years after the completion of the discounted services. Further, we seek comment on a requirement that service providers comply with random audits or reviews that the Commission or USAC may undertake periodically to assure program compliance, including identifying the portions of applicant's bills that represent the costs of services provided to eligible entities for eligible purposes.<sup>177</sup> In accordance with this proposed requirement, we also seek comment on requiring beneficiaries to authorize the release of such information.

90. Commenters are specifically requested to address the impact that these rule changes would have on the Commission's ability to enforce its substantive rules and reduce waste, fraud, and abuse in the schools and libraries universal service program. Commenters are also requested to identify with particularity any additional recordkeeping requirements that would improve the Commission's ability to enforce its rules in the schools and libraries program.

91. *Consultants and Outside Experts.* We seek comment on whether applicants should be required to identify any consultants or other outside experts, whether paid or unpaid, that aid in the preparation of the applicant's technology plan or in the applicant's procurement process.<sup>178</sup>

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<sup>174</sup> 47 C.F.R. § 54.516(a).

<sup>175</sup> We note that we recently adopted such a rule for the rural health care support mechanism. *See* 47 C.F.R. § 54.619.

<sup>176</sup> 47 C.F.R. § 54.501(d)(3).

<sup>177</sup> *Universal Service Order*, 12 FCC Rcd at 9081 para. 581 ("We agree with the Joint Board recommendation that schools and libraries, as well as carriers, be required to maintain appropriate records necessary to assist in future audits.").

<sup>178</sup> Above, we adopt rules that prohibit a school or library from receiving free services, including consulting services, from a service provider that also provides services for which the school or library receives a discount under the E-rate program. *See supra* para. 41.

Additionally, we seek comment on whether consultants and other outside experts offering their services to applicants should be required to register with USAC and to disclose any potential conflicts of interests derived from relationships with service providers.<sup>179</sup> Identifying these consultants and outside experts could facilitate the ability of the Commission, and law enforcement officials, to identify and prosecute individuals that may seek to manipulate the competitive bidding process or engage in other illegal acts. We also seek comment on whether we should adopt a rule that would prohibit an entity that seeks to become a service provider from providing any form of technology planning or procurement management assistance to applicants. Under such a rule, any entity that provides management support services, technical assistance, consulting services, assistance in technical evaluations, or systems engineering services to a particular recipient would be barred from competing for the contracts for eligible services with that recipient.

92. *Distribution of Support Payments.* We seek comment on whether the Commission should amend its rules to codify certain existing administrative procedures related to the payment of support for discounted services.<sup>180</sup> There are two methods by which support for discounts is distributed. One method is for the service provider to submit an invoice to the Administrator, seeking payment for the discounted portion of the supported service using FCC Form 474. The other method is for the recipient of the discounted services to pay the service provider and then seek reimbursement from the Administrator using FCC Form 473. Under either method, the Administrator requires that a completed Service Provider Annual Certification (or FCC Form 473) must be filed in order for payment to be made. We seek comment on whether this procedure should be codified in the Commission's rules. We also seek comment on whether the Commission should codify rules regarding the establishment of deadlines for service providers to file invoices with the Administrator.<sup>181</sup> The timely receipt and payment of invoices is extremely important to the administration of the program in accordance with the Commission's rules. Accordingly, we seek comment on whether to codify the Administrator's existing policy not to provide support for untimely filed invoices.

93. USAC provides an extension of the deadline to file invoices under certain conditions. Under current USAC procedures, these circumstances include: (1) authorized service provider changes; (2) authorized service substitutions; (3) no timely notice to USAC (e.g., the service providers' Form 486 Notification Letter is returned to USAC as undeliverable); (4) USAC errors that result in a late invoice; (5) USAC delays in data entering a form that ultimately result in a late

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<sup>179</sup> *Task Force Recommendation* at 9 (recommending consultant disclosure and registration practices); *see, e.g., E-rate Public Forum*, Sprint Statement at 2 (consultants should be competitively neutral, not affiliated with service providers).

<sup>180</sup> *See* [http://www.sl.universalservice.org/applicants/sld\\_flowchart.pdf](http://www.sl.universalservice.org/applicants/sld_flowchart.pdf) describes the application process including payment of supported services.

<sup>181</sup> Currently, USAC's procedures requires that, in order to receive support, an invoice must be submitted with Form 473 or Form 474 by the later of (a) 120 calendar days after the last date of service, or (b) 120 calendar days after the receipt of Form 486, notifying the applicant of the decision to provide support for discounts. *See* <http://www.sl.universalservice.org/reference/InvoicingDeadlines.asp>.



invoice; (6) documentation requirements that necessitate third party contact or certification; (7) natural or man-made disasters that prevent timely filing of invoices; (8) good Samaritan BEARs; and (9) circumstances beyond the service providers control.<sup>182</sup> We seek comment on whether to codify the above-described procedures providing for an extension of the deadline to file invoices.

94. *Technology Plans.* We seek comment on whether the Commission should revise its rules regarding technology plans.<sup>183</sup> To ensure applicants make a *bona fide* request for services, the Commission requires applicants to undertake a technology assessment before making a request for services.<sup>184</sup> Section 54.504(b)(vii) states that in its FCC Form 470 the applicant must certify that it has a technology plan that has been certified by its state, the Administrator, or an independent entity approved by the Commission.<sup>185</sup> The instructions for FCC Form 470 permit applicants to certify that their technology plan will be approved by the relevant body no later than the time when service commences.<sup>186</sup> The Commission adopted specific requirements for information that must be included in the FCC Form 470,<sup>187</sup> but did not adopt specific rules addressing what should be included in a technology plan. In the *Universal Service Order*, however, the Commission set forth what applicants should address in their technology plans,<sup>188</sup> which USAC implemented in its guidelines for technology plans. We seek comment on whether we should codify USAC's current guidelines regarding technology plans.<sup>189</sup> Should we require that, as part of the technology plan process, applicants analyze the cost of leasing versus purchasing E-rate eligible products and services? Should we require the applicant to consider the most cost-effective way to meet its educational objectives? In addition, we seek comment on whether the Commission's technology planning requirements should be amended to be made more consistent with the technology planning goals and requirements of the U.S. Department of

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<sup>182</sup> See <http://www.sl.universalservice.org/reference/InvoicingDeadlines.asp>.

<sup>183</sup> See, e.g., *E-rate Public Forum*, BellSouth Statement at 12 (Commission could require more rigorous needs assessment and compliance with technology plans to ensure applicants are ready to fully utilize supported products and services).

<sup>184</sup> See 47 U.S.C. § 254(h)(1)(B); *Universal Service Order*, 12 FCC Rcd at 9077-78 paras. 572-574.

<sup>185</sup> 47 C.F.R. § 54.505(b)(vii); see also *Universal Service Order*, 12 FCC Rcd at 9078 para. 574.

<sup>186</sup> FCC Form 470 Instructions.

<sup>187</sup> 47 C.F.R. § 54.504(b).

<sup>188</sup> *Universal Service Order*, 12 FCC Rcd at 9077 para. 572.

<sup>189</sup> See <http://www.sl.universalservice.org/apply/step2.asp>. Under USAC's guidelines, a technology plan should address the following areas. The plan must establish clear goals and a realistic strategy for using telecommunications and information technology to improve education or library services. The plan must have a professional development strategy to ensure that the staff understands how to use these new technologies to improve education or library services. The plan must include an assessment of the telecommunication services, hardware, software, and other services that will be needed to improve education or library services. The plan must provide for a sufficient budget to acquire and support the non-discounted elements of the plan: the hardware, software, professional development, and other services that will be needed to implement the strategy. Finally, the plan must include an evaluation process that enables the school or library to monitor progress toward the specified goals and make mid-course corrections in response to new developments and opportunities as they arise.

Education and the U.S. Institute for Museum and Library Services.<sup>190</sup> We also seek comment on whether the Commission's technology planning requirements could be strengthened through additional or different qualifications for entities, including states, which approve technology plans.

95. *Prevention of Unauthorized Applications by Subunits.* We seek comment on whether the Commission should adopt rules to prevent subunits, such as individual schools or library branches, from filing applications without the authorization of the central authorities over those subunits, such as school districts and library systems.<sup>191</sup> We also seek comment on how such restrictions should be implemented, if adopted. For example, should an applicant be required to certify that it has the appropriate authorization from its central authority, or should a central authority be permitted to request the Administrator to reject any application filed by one of its subunits?

96. *Use of Surveys to Determine School Lunch Eligibility.* The *Universal Service Order* stated that a school may use federally-approved alternative mechanisms which rely on actual counts of low-income children to determine the level of poverty for purposes of the schools and libraries universal service discount mechanism.<sup>192</sup> USAC implemented this provision by permitting schools to collect this information from surveys.<sup>193</sup> Currently, USAC procedures require a response rate of at least 50 percent to ensure a statistically valid sample to project the percentage of eligibility for all students in the school.<sup>194</sup> We seek comment on whether to codify this procedure, and if so, should we alter the required response rate? Is a 50 percent response rate higher than necessary to ensure a statistically valid sample? We seek to streamline program administration in this area while protecting against any potential abuse. Should the required response rate depend on the size of the population being surveyed?

## H. Miscellaneous

97. *Determining Whether Rates Are Affordable.* We seek comment generally on how we can ensure that we continue to meet the requirements of section 254 in an efficient and equitable manner. Congress mandated that schools and libraries across the United States have access to

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<sup>190</sup> See *Task Force Recommendation* at 5; see also <http://www.nationaledtechplan.org/> (seeking comment developing the nation's third National Education Technology Plan).

<sup>191</sup> See *Task Force Recommendation* at 10.

<sup>192</sup> See *Universal Service Order*, 12 FCC Rcd at 9045 para. 510.

<sup>193</sup> *Id.* The *Universal Service Order* stated that a school relying on one of these alternative mechanisms could, for example, conduct a survey of income levels in order to obtain this information.

<sup>194</sup> For example, a school with 100 students sends a questionnaire to 100 households of those students, and 75 of those households return the questionnaire. The school finds that the incomes of 25 of those 75 households are at or below the income eligibility for the National School Lunch Program (NSLP). Consequently, 33 percent of the students from those households can be counted as eligible for NSLP. The school may then project from that sample that 33 percent of the total enrollment, or 33 of the 100 students in the school, can be counted as eligible for NSLP. See <http://www.sl.universalservice.org/reference/alt.asp>.

advanced telecommunications and information services at affordable rates. As the expert agency charged with this critical task, we believe it important to consider periodically how we should determine what funding is necessary to ensure access at “affordable” rates. Give the myriad of service offerings in today’s marketplace, how can we measure our progress in ensuring “affordable” access?

98. *Priority for Applicants that Have Not Achieved Connectivity.* We note that, in 1996, prior to implementation of the E-rate program, 14 percent of public school instructional rooms (*i.e.*, classrooms) were connected to the Internet.<sup>195</sup> According to the most recently available data, in 2002, 92 percent of public school classrooms were connected to the Internet.<sup>196</sup> While considerable progress has been made in achieving the congressional goal of enhancing access of school classrooms and libraries to advanced telecommunications and information services,<sup>197</sup> we are concerned that our rules as currently structured may preclude full attainment of that goal. As noted above, a number of commenters in this proceeding have suggested that altering the discount rate would be an effective way to increase the availability of funds for eligible applicants outside the highest discount band.<sup>198</sup> We seek comment on whether other measures should be adopted to further the objectives set forth in section 254(h)(2)(A). In particular, we seek comment on whether we should provide priority for internal connections to those applicants that have not yet achieved Internet connectivity in their classrooms or libraries. If we were to adopt such a proposal, should the priority for funding be targeted to those entities where 50 percent or more of students are eligible for the school lunch program? Under such a proposal, any entity in an area where 50 percent or more of students are eligible for free school lunch that certifies it has not yet implemented internal connections to achieve Internet connectivity in any classrooms or in the library would receive funding for internal connections in advance of all applicants seeking funding for internal connections that certify that they have implemented internal connections to achieve Internet connectivity in multiple classrooms or locations. Are there other rule changes that would ensure that all entities are able to provide access to the Internet from individual classrooms or the library?

## V. PROCEDURAL MATTERS

### A. Paperwork Reduction Act Analysis

99. The action contained herein has been analyzed with respect to the Paperwork Reduction Act of 1995 (PRA) and found to impose new or modified reporting and/or recordkeeping requirements or burdens on the public. Implementation of these new or modified reporting and/or recordkeeping requirements will be subject to approval by the Office of

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<sup>195</sup> National Center for Education Statistics, U.S. Department of Education, Internet Access in U.S. Public Schools and Classrooms: 1994-2002 (October 2003), at Table 2.

<sup>196</sup> *Id.*

<sup>197</sup> 47 C.F.R. § 254(h)(2)(A).

<sup>198</sup> *See supra* para. 60 and note 116.

Management and Budget (OMB) as prescribed by the PRA. Specifically, section 54.513(c) will go into effect upon announcement in the Federal Register of OMB approval, to the extent OMB approval is required.

## **B. Final Regulatory Flexibility Analysis**

100. As required by the Regulatory Flexibility Act of 1980, as amended (RFA),<sup>199</sup> an Initial Regulatory Flexibility Analysis (IRFA) was incorporated in the *Schools and Libraries NPRM*.<sup>200</sup> The Commission sought written public comment on the proposals in the *Schools and Libraries NPRM*, including comment on the IRFA. This present Final Regulatory Flexibility Analysis (FRFA) conforms to the RFA.<sup>201</sup>

### **1. Need for, and Objectives of, the Third Report and Order**

101. In this *Third Report and Order*, we adopt rules whereby eligible entities may receive discount rates for internal connections services, except for certain basic maintenance services, twice every five years and that prohibit a school or library from transferring equipment purchased with universal service discounts, except in limited circumstances. These rules will advance the goals of the schools and libraries program by making support for internal connections regularly available to a larger number of applicants and by reducing the likelihood of waste, fraud, and abuse.

### **2. Summary of Significant Issues Raised by Public Comments in Response to the IRFA**

102. There were no comments filed specifically in response to the IRFA. Nevertheless, the agency has considered the potential impact of the rules proposed in the IRFA on small entities.<sup>202</sup> Based on analysis of the relevant data, the Commission concludes the new rules limit the burdens on small entities and result in a de minimis recordkeeping requirement. The Commission also concludes that the new rules will positively impact schools and libraries, including small ones, seeking universal service support.<sup>203</sup>

### **3. Description and Estimate of the Number of Small Entities To Which Rules Will Apply**

103. The RFA directs agencies to provide a description of and, where feasible, an

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<sup>199</sup> See 5 U.S.C. § 603. The RFA, see 5 U.S.C. §§ 601 – 612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

<sup>200</sup> *Schools and Libraries NPRM*, 17 FCC Rcd at 1946 paras. 83-106.

<sup>201</sup> See 5 U.S.C. § 604.

<sup>202</sup> See *infra* paras. 106-107.

<sup>203</sup> *Id*; see *supra* paras. 14, 26, 38, 40, 42, and 52.

estimate of the number of small entities that may be affected by the proposed rules, if adopted.<sup>204</sup> The RFA generally defines the term “small entity” as having the same meaning as the terms “small business,” “small organization,” and “small governmental jurisdiction.”<sup>205</sup> In addition, the term “small business” has the same meaning as the term “small business concern” under the Small Business Act.<sup>206</sup> A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the SBA.<sup>207</sup> A small organization is generally “any not-for-profit enterprise which is independently owned and operated and is not dominant in its field.”<sup>208</sup> Nationwide, as of 1992, there were approximately 275,801 small organizations.<sup>209</sup> The term “small governmental jurisdiction” is defined as “governments of cities, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand.”<sup>210</sup> As of 1997, there were about 87,453 governmental jurisdictions in the United States.<sup>211</sup> This number includes 39,044 county governments, municipalities, and townships, of which 37,546 (approximately 96.2%) have populations of fewer than 50,000, and of which 1,498 have populations of 50,000 or more. Thus we estimate the number of small governmental jurisdictions overall to be 84,098 or fewer.

104. The Commission has determined that the group of small entities directly affected by the rules herein includes eligible schools and libraries and the eligible service providers offering them discounted services, including telecommunications service providers, Internet Service Providers (ISPs) and vendors of internal connections.<sup>212</sup> Further descriptions of these entities are provided below. In addition, the Universal Service Administrative Company is a small organization (non-profit) under the RFA, and we believe that circumstances triggering the new reporting requirement will be limited<sup>213</sup> and does not constitute a significant economic impact on that entity.

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<sup>204</sup> 5 U.S.C. § 603(b)(3).

<sup>205</sup> 5 U.S.C. § 601(6).

<sup>206</sup> 5 U.S.C. § 601(3) (incorporating by reference the definition of “small business concern” in 15 U.S.C. § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies “unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register.”

<sup>207</sup> Small Business Act, 15 U.S.C. § 632.

<sup>208</sup> 5 U.S.C. § 601(4).

<sup>209</sup> U.S. Census Bureau, 1992 Economic Census, Table 6 (special tabulation of data under contract to the Office of Advocacy of the U.S. Small Business Administration).

<sup>210</sup> 5 U.S.C. 601(5).

<sup>211</sup> U.S. Census Bureau, Statistical Abstract of the United States: 2000, Section 9, pages 299-300, Tables 490 and 492.

<sup>212</sup> 47 C.F.R. §§ 54.502, 54.503, 54.517(b).

<sup>213</sup> See *supra* para. 27.

**a. Schools and Libraries**

105. As noted, "small entity" includes non-profit and small government entities. Under the schools and libraries universal service support mechanism, which provides support for elementary and secondary schools and libraries, an elementary school is generally "a non-profit institutional day or residential school that provides elementary education, as determined under state law."<sup>214</sup> A secondary school is generally defined as "a non-profit institutional day or residential school that provides secondary education, as determined under state law," and not offering education beyond grade 12.<sup>215</sup> For-profit schools and libraries, and schools and libraries with endowments in excess of \$50,000,000, are not eligible to receive discounts under the program, nor are libraries whose budgets are not completely separate from any schools.<sup>216</sup> Certain other statutory definitions apply as well.<sup>217</sup> The SBA has defined for-profit, elementary and secondary schools and libraries having \$6 million or less in annual receipts as small entities.<sup>218</sup> In Funding Year 2 (July 1, 1999 to June 30, 2000) approximately 83,700 schools and 9,000 libraries received funding under the schools and libraries universal service mechanism. Although we are unable to estimate with precision the number of these entities that would qualify as small entities under SBA's size standard, we estimate that fewer than 83,700 schools and 9,000 libraries might be affected annually by our action, under current operation of the program.

**b. Telecommunications Service Providers**

106. We have included small incumbent local exchange carriers in this RFA analysis. A "small business" under the RFA is one that, *inter alia*, meets the pertinent small business size standard (*e.g.*, a telephone communications business having 1,500 or fewer employees), and "is not dominant in its field of operation."<sup>219</sup> The SBA's Office of Advocacy contends that, for RFA purposes, small incumbent local exchange carriers are not dominant in their field of operation because any such dominance is not "national" in scope.<sup>220</sup> We have therefore included small incumbent carriers in this RFA analysis, although we emphasize that this RFA action has no effect on the Commission's analyses and determinations in other, non-RFA contexts.

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<sup>214</sup> 47 C.F.R. § 54.500(b).

<sup>215</sup> 47 C.F.R. § 54.500(j).

<sup>216</sup> 47 C.F.R. § 54.501.

<sup>217</sup> *See id.*

<sup>218</sup> 13 C.F.R. § 121.201, North American Industry Classification System (NAICS) codes 611110 and 519120 (NAICS 2002 code 519120 was previously 514120).

<sup>219</sup> 5 U.S.C. § 601(3).

<sup>220</sup> *See* Letter from Jere W. Glover, Chief Counsel for Advocacy, SBA, to William E. Kennard, Chairman, FCC, dated May 27, 1999. The Small Business Act contains a definition of "small business concern," which the RFA incorporates into its own definition of "small business." *See* U.S.C. § 632(a) (Small Business Act); 5 U.S.C. § 601(3) (RFA). SBA regulations interpret "small business concern" to include the concept of dominance on a national basis. 13 C.F.R. § 121.102(b).

107. *Incumbent Local Exchange Carriers (LECs).* Neither the Commission nor the SBA has developed a size standard for small incumbent local exchange services. The closest size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>221</sup> According to Commission data,<sup>222</sup> 1,337 incumbent carriers reported that they were engaged in the provision of local exchange services. Of these 1,337 carriers, an estimated 1,032 have 1,500 or fewer employees and 305 have more than 1,500 employees. Consequently, the Commission estimates that most providers of incumbent local exchange service are small businesses that may be affected by the rules and policies adopted herein.

108. *Competitive Local Exchange Carriers (CLECs), Competitive Access Providers (CAPs) and "Other Local Exchange Carriers."* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to providers of competitive exchange services or to competitive access providers or to "Other Local Exchange Carriers." The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>223</sup> According to Commission data,<sup>224</sup> 609 companies reported that they were engaged in the provision of either competitive access provider services or competitive local exchange carrier services. Of these 609 companies, an estimated 458 have 1,500 or fewer employees and 151 have more than 1,500 employees.<sup>225</sup> In addition, 35 carriers reported that they were "Other Local Exchange Carriers." Of the 35 "Other Local Exchange Carriers," an estimated 34 have 1,500 or fewer employees and one has more than 1,500 employees.<sup>226</sup> Consequently, the Commission estimates that most providers of competitive local exchange service, competitive access providers, and "Other Local Exchange Carriers" are small entities that may be affected by the rules and policies adopted herein.

109. *Interexchange Carriers (IXCs).* Neither the Commission nor the SBA has developed a size standard for small businesses specifically applicable to interexchange services. The closest applicable size standard under SBA rules is for Wired Telecommunications Carriers. Under that size standard, such a business is small if it has 1,500 or fewer employees.<sup>227</sup>

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<sup>221</sup> 13 CFR § 121.201, NAICS code 513310 (changed to 517110 in Oct. 2002).

<sup>222</sup> FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, "Trends in Telephone Service" at Table 5.3, Page 5-5 (Aug. 2003). This source uses data that are current as of December 31, 2001.

<sup>223</sup> 13 CFR § 121.201, NAICS code 513310 (changed to 517110 in Oct. 2002).

<sup>224</sup> FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, "Trends in Telephone Service" at Table 5.3, Page 5-5 (Aug. 2003).

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> 13 C.F.R. § 121.201, NAICS code 513310 (changed to 517110 in Oct. 2002).

According to the Commission's most recent data,<sup>228</sup> 261 companies reported that their primary telecommunications service activity was the provision of payphone services. Of these 261 companies, an estimated 223 have 1,500 or fewer employees and 48 have more than 1,500 employees.<sup>229</sup> Consequently, the Commission estimates that the majority of payphone service providers are small entities that may be affected by the rules and policies adopted herein.

110. *Wireless Service Providers.* The SBA has developed a small business size standard for wireless small businesses within the two separate categories of *Paging*<sup>230</sup> and *Cellular and Other Wireless Telecommunications*.<sup>231</sup> Under both SBA categories, a wireless business is small if it has 1,500 or fewer employees. According to the Commission's most recent data,<sup>232</sup> 1,761 companies reported that they were engaged in the provision of wireless service. Of these 1,761 companies, an estimated 1,175 have 1,500 or fewer employees and 586 have more than 1,500 employees.<sup>233</sup> Consequently, the Commission estimates that most wireless service providers are small entities that may be affected by the rules and policies adopted herein.

111. *Private and Common Carrier Paging.* In the *Paging Third Report and Order*, we developed a small business size standard for "small businesses" and "very small businesses" for purposes of determining their eligibility for special provisions such as bidding credits and installment payments.<sup>234</sup> A "small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues not exceeding \$15 million for the preceding three years. Additionally, a "very small business" is an entity that, together with its affiliates and controlling principals, has average gross revenues that are not more than \$3 million for the preceding three years. An auction of Metropolitan Economic Area licenses commenced on February 24, 2000, and closed on March 2, 2000.<sup>235</sup> Of the 985 licenses auctioned, 440 were sold. Fifty-seven companies claiming small business status won. At present, there are

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<sup>228</sup> FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, "Trends in Telephone Service" at Table 5.3, Page 5-5 (Aug. 2003).

<sup>229</sup> *Id.*

<sup>230</sup> 13 CFR § 121.201, North American Industry Classification System (NAICS) code 513321 (changed to 517211 in October 2002).

<sup>231</sup> 13 CFR § 121.201, North American Industry Classification System (NAICS) code 513322 (changed to 517212 in October 2002).

<sup>232</sup> FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, Trends in Telephone Service, Table 5.3, (May 2002).

<sup>233</sup> *Id.*

<sup>234</sup> *220 MHz Third Report and Order*, 12 FCC Rcd 10943, 11068-70 paras. 291-295 (1997), 62 FR 16004 (Apr. 3, 1997), at paras 291-295.

<sup>235</sup> "Revision of Part 22 and Part 90 of the Commission's Rules to Facilitate Future Development of Paging Systems," *Memorandum Opinion and Order on Reconsideration and Third Report and Order*, 14 FCC Rcd 10030, at paras 98 (1999).



approximately 24,000 Private-Paging site-specific licenses and 74,000 Common Carrier Paging licenses. According to Commission data, 474 carriers reported that they were engaged in the provision of either paging and messaging services or other mobile services.<sup>236</sup> Of those, the Commission estimates that 457 are small, under the SBA approved small business size standard.<sup>237</sup>

### c. Internet Service Providers

112. *Internet Service Providers.* The SBA has developed a small business size standard for “On-Line Information Services,” NAICS code 514191.<sup>238</sup> This category comprises establishments “primarily engaged in providing direct access through telecommunications networks to computer-held information compiled or published by others.”<sup>239</sup> Under this small business size standard, a small business is one having annual receipts of \$18 million or less.<sup>240</sup> Based on firm size data provided by the Bureau of the Census, 3,123 firms are small under SBA’s \$18 million size standard for this category code.<sup>241</sup> Although some of these Internet Service Providers (ISPs) might not be independently owned and operated, we are unable at this time to estimate with greater precision the number of ISPs that would qualify as small business concerns under SBA’s small business size standard. Consequently, we estimate that there are 3,123 or fewer small entity ISPs that may be affected by this analysis.

### d. Vendors of Internal Connections

113. The Commission has not developed a small business size standard specifically directed toward manufacturers of internal network connections. The closest applicable definitions of a small entity are the size standards under the SBA rules applicable to manufacturers of “Radio and Television Broadcasting and Communications Equipment” (RTB) and “Other Communications Equipment.”<sup>242</sup> According to the SBA’s regulations, manufacturers of RTB or other communications equipment must have 750 or fewer employees in order to qualify as a small business.<sup>243</sup> The most recent available Census Bureau data indicates that there are 1,187 establishments with fewer than 1,000 employees in the United States that manufacture radio and television broadcasting and communications equipment, and 271 companies with less than 1,000

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<sup>236</sup> FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, Trends in Telephone Service, Table 5.3, p. 5-5 (Aug. 2003).

<sup>237</sup> *Id.*

<sup>238</sup> *See generally* North American Industry Classification System – United States (1997), NAICS code 514191.

<sup>239</sup> *See generally* North American Industry Classification System – United States (1997), NAICS code 514191.

<sup>240</sup> 13 CFR § 121.201, NAICS code 514191.

<sup>241</sup> Office of Advocacy, U.S. Small Business Administration, Firm Size Data by Industry and Location.

<sup>242</sup> 13 C.F.R. § 121.201, NAICS Code 334220, 334290.

<sup>243</sup> *Id.*

employees that manufacture other communications equipment.<sup>244</sup> Some of these manufacturers might not be independently owned and operated. Consequently, we estimate that the majority of the 1,458 internal connections manufacturers are small.

**e. Miscellaneous Entities**

114. *Wireless Communications Equipment Manufacturers.* The SBA has established a small business size standard for radio and television broadcasting and wireless communications equipment manufacturing. Under this standard, firms are considered small if they have 750 or fewer employees.<sup>245</sup> Census Bureau data for 1997 indicate that, for that year, there were a total of 1,215 establishments<sup>246</sup> in this category.<sup>247</sup> Of those, there were 1,150 that had employment under 500, and an additional 37 that had employment of 500 to 999. The percentage of wireless equipment manufacturers in this category is approximately 61.35%,<sup>248</sup> so the Commission estimates that the number of wireless equipment manufacturers with employment under 500 was actually closer to 706, with an additional 23 establishments having employment of between 500 and 999. Given the above, the Commission estimates that the majority of wireless communications equipment manufacturers are small businesses.

**4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements for Small Entities**

115. In this *Third Report and Order*, we adopt a rule that prohibits the transfer of equipment purchased with universal service discount, except in limited circumstances. Further, we provide that the excepted, limited circumstances consist of a discount recipient temporarily or permanently closing its operations where the original equipment was installed. In that instance, we require a recipient, who closes permanently or temporarily and transfers equipment to another eligible entity, to notify the Administrator of a transfer and require the transferring and receiving entities to maintain detailed records of the transfer consistent with the Commission's recordkeeping requirements for five years. We do not believe that these reporting and

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<sup>244</sup> 1997 Economic Census, Manufacturing, Industry Series, Radio and Television Broadcasting and Wireless Communications Equipment Manufacturing, Document No. E97M-3342B (August 1999), at 9; 1997 Economic Census, Manufacturing, Industry Series, Other Communications Equipment Manufacturing, Document No. EC97M-3342C (September 1999), at 9 (both available at <http://www.census.gov/prod/www/abs/97ecmani.html>).

<sup>245</sup> *Id.*

<sup>246</sup> The number of "establishments" is a less helpful indicator of small business prevalence in this context than would be the number of "firms" or "companies," because the latter take into account the concept of common ownership or control. Any single physical location for an entity is an establishment, even though that location may be owned by a different establishment. Thus, the numbers given may reflect inflated numbers of businesses in this category, including the numbers of small businesses. In this category, the Census breaks-out data for firms or companies only to give the total number of such entities for 1997, which was 1,089.

<sup>247</sup> U.S. Census Bureau, 1997 Economic Census, Industry Series: Manufacturing, "Industry Statistics by Employment Size," Table 4, NAICS code 334220 (issued August 1999).

<sup>248</sup> *Id.* Table 5, "Industry Statistics by Industry and Primary Product Class Specialization: 1997."

recordkeeping requirements will result in a significant economic impact.

116. The rule adopted today, limiting the frequency of receiving discount rates for internal connections, does not involve additional reporting, recordkeeping, or compliance requirements for small entities. Similarly, the rule adopted in this *Third Report and Order*, creating a more formal process for annually updating the list of services eligible for support, does not involve additional reporting, recordkeeping, or compliance requirements for small entities. The rules adopted governing cost allocation between eligible and ineligible services, provision of free services, and service substitution do not impose additional reporting, recordkeeping, or compliance requirements for small entities. Finally, the rules regarding carryover of unused funds do not require additional reporting or recordkeeping for small entities participating in the schools and libraries universal support mechanism.

### **5. Steps Taken to Minimize the Significant Economic Impact on Small Entities, and Significant Alternatives Considered**

117. The RFA requires an agency to describe any significant alternatives that it has considered in developing its approach, which may include the following four alternatives (among others): “(1) establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part thereof, for such small entities.”<sup>249</sup>

118. Although we received no IRFA comments, we considered alternatives to the proposed recordkeeping requirements for small entities. In creating the narrow exception to the equipment transfer policy adopted in this *Third Report and Order*, we recognize the Commission’s need to protect the integrity of the schools and libraries support mechanism by curbing waste, fraud, and abuse while acknowledging circumstances that justify permitting the transfer of discounted equipment received by a program beneficiary, small or large. We recognize that we must require certain recordkeeping to verify the appropriate use of universal service funds. Consideration was afforded to having the recipient file equipment transfer records with USAC and having USAC maintain the records. However, we conclude that requiring a filing with USAC would be more burdensome for the recipient than having the recipient collect and maintain its equipment transfer records. Complying with the processes promulgated by USAC would be more burdensome than requiring each beneficiary to retain its own files because the beneficiary would have to do more than send the documents to USAC. The beneficiary would have to comply with the procedural scheme devised by USAC for compiling, and mailing or delivering the records, and quality control measures for assuring that the records submitted were properly identified with the correct beneficiary. In the RFA, an exemption of small entities from the recordkeeping requirements is listed as a possible alternative. In this instance, exemption from the recordkeeping requirement would impede the Commission’s ability to account for funds distributed through the schools and libraries program and would undermine the Commission’s

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<sup>249</sup> 5 U.S.C. § 603(c)(1)-(4).

efforts to prevent waste, fraud, and abuse.

119. **Report to Congress:** The Commission will send a copy of the Order, including this FRFA, in a report to be sent to Congress pursuant to the Congressional Review Act, *see* 5 U.S.C. § 801(a)(1)(A). In addition, the Commission will send a copy of the Order, including the FRFA, to the Chief Counsel for Advocacy of the Small Business Administration. A copy of the Order and FRFA (or summaries thereof) will also be published in the Federal Register.<sup>250</sup>

### C. Initial Paperwork Reduction Act of 1995 Analysis

120. This Second Further Notice of Proposed Rulemaking (*Second FNPRM*) contains either a proposed or modified information collection. As part of a continuing effort to reduce paperwork burdens, we invite the general public and the Office of Management and Budget (OMB) to take this opportunity to comment on the information collections contained in this Further Notice, as required by the Paperwork Reduction Act of 1995, Public Law 104-13. Public and agency comments are due at the same time as other comments on this Further Notice; OMB comments are due 60 days from the date of publication of this Further Notice in the Federal Register. Comments should address: (a) whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission's burden estimates; (c) ways to enhance the quality, utility, and clarity of the information collected; and (d) ways to minimize the burden of the collection of information on the respondents, including the use of automated collection techniques or other forms of information technology.

### D. Initial Regulatory Flexibility Analysis

121. As required by the Regulatory Flexibility Act (RFA),<sup>251</sup> the Commission has prepared this Initial Regulatory Flexibility Analysis (IRFA) of the possible significant economic impact on small entities by the policies and rules proposed in the *Second FNPRM*. Written public comments are requested on this IRFA. Comments must be identified as responses to the IRFA and must be filed by the deadlines for comments on the *Second FNPRM* provided below in section IV.C. The Commission will send a copy of this *Second FNPRM*, including this IRFA, to the Chief Counsel for Advocacy of the Small Business Administration (SBA).<sup>252</sup> In addition, the *Second FNPRM* and IRFA (or summaries thereof) will be published in the Federal Register.<sup>253</sup>

#### 1. Need for, and Objectives of, the Proposed Rules

122. In the *Second FNPRM*, we seek comment on whether the current discount matrix

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<sup>250</sup> *See* 5 U.S.C. § 604(b).

<sup>251</sup> *See* 5 U.S.C. § 603. The RFA, *see* 5 U.S.C. §§ 601 – 612, has been amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

<sup>252</sup> *See* 5 U.S.C. § 603(a).

<sup>253</sup> *See id.*

provides sufficient incentives for schools and libraries to limit funding requests to services that can be efficiently used and whether modifying the discount matrix would make funds available to a greater number of schools and libraries. Further, we ask whether the Commission should adopt rules adjusting the discount matrix for certain supported services.<sup>254</sup> To the extent that commenters support creating a separate discount matrix for priority two services, we seek comment on the structure and implementation issues associated with a new discount matrix.<sup>255</sup> In light of the limitations placed on applications for internal connection discounts, which are Priority Two services, we seek comment on measures to deter the mischaracterization of internal connections as Priority One services.<sup>256</sup>

123. In addition, we seek comment on whether the current process for applying for discounted services sufficiently addresses the Commission's goals of minimizing waste, fraud, and abuse in the program, while encouraging the benefits of competition as set out in the *Universal Service Order*.<sup>257</sup> In that regard, we solicit comment on the current competitive bidding process and the efficiency and effectiveness of using Form 470 and requested comment regarding any means by which the Commission could ensure that applicants select cost-effective services.<sup>258</sup> Also, we seek further comment whether the Commission, as a condition of support, should require that each service provider certify that the prices in its bid have been independently developed.<sup>259</sup> Further, we request comment on whether the Commission's rules should specifically require that records related to the competitive bidding process for services be maintained by both the recipient and service provider for a period of five years.

124. Next, we seek comment on modifications to the definition of "rural area" for the schools and libraries mechanism and ask whether it would be necessary or desirable to use the same definition of "rural" for both the schools and libraries program and rural health care program.<sup>260</sup> Similarly, we seek comment whether the definition of Internet access in the schools context should be changed to mirror the definition of Internet access recently adopted in the *Rural Health Care Order*.<sup>261</sup>

125. In light of the restrictions imposed on receiving discounts for internal connections, we seek comment asking whether any measures should be taken to evaluate service

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<sup>254</sup> See *supra* para. 59.

<sup>255</sup> See *supra*. paras. 61-62.

<sup>256</sup> See *supra* para. 61.

<sup>257</sup> See *supra* paras. 63-66.

<sup>258</sup> *Id.*

<sup>259</sup> See *supra* para. 66.

<sup>260</sup> See *supra* paras. 67-69.

<sup>261</sup> See *supra* paras. 70-71.

provider charges for capital investments for wide area networks, a Priority One service.<sup>262</sup> In that regard, we seek comment whether expenditures that subsidize infrastructure investment, either on-premises or off-premises, may properly be viewed as Priority One services.<sup>263</sup> We also seek comment on funding for unlit (dark) fiber under the E-rate program. In addition, we ask whether we should adopt specific recovery rules for funds – entire or partial commitments – that are disbursed in violation of the statute or programmatic rules or procedures.<sup>264</sup> In that connection, we seek comment regarding measures to prevent waste, fraud, and abuse associated with improper disbursement of E-rate funds.<sup>265</sup>

126. We seek comment on various measures to abate waste, fraud and abuse in the schools and libraries universal service mechanism, including whether a rule should be adopted requiring that all records related to the receipt of or delivery of discounted services be maintained by beneficiaries and service providers for a period of five years after the completion of the discounted services.<sup>266</sup> In addition, we solicit comment whether rules defining “cost-effective” service should be adopted.<sup>267</sup> Also, we seek comment whether applicants should be required to identify any consultants or other outside experts, whether paid or unpaid, that aid in the preparation of the applicant’s technology plan or in the applicant’s procurement process.<sup>268</sup> In addition, we solicit comment on the adoption of a rule requiring the filing of a Service Provider Annual Certification (or FCC Form 473) with the Administrator for remittance of payment.<sup>269</sup> We also seek comment as to whether the Commission should codify rules establishing deadlines for service providers to file invoices with the Administrator and whether the Administrator’s existing policy to deny support for untimely filed invoices, except in limited circumstances, should be codified.<sup>270</sup> In an effort to further reduce waste, fraud and abuse in the E-rate program, we request comment whether current guidelines from the *Universal Service Order* and USAC regarding the content of the applicants’ technology plans should be adopted as Commission rules. We also ask for comments whether the Commission’s technology planning goals should be consistent with the requirements of the U.S. Department of Education and the U.S. Institute for Museum and Library Services. In addition, we seek comment whether the Commission should adopt rules to prevent individual schools and libraries from submitting applications without

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<sup>262</sup> See *supra* paras. 72-73.

<sup>263</sup> See *supra* paras. 73-74.

<sup>264</sup> See *supra* paras. 81-82.

<sup>265</sup> See *supra* paras. 83-84.

<sup>266</sup> See *supra* paras. 88-90.

<sup>267</sup> See *supra* para. 87.

<sup>268</sup> See *supra* para. 91.

<sup>269</sup> See *supra* para. 92. We also noted that current administrative procedures require the filing a FCC Form 473 to receive payment.

<sup>270</sup> See *supra* para 93.

coordination with or authorization from the central authorities, namely school districts and library systems. We solicit comment on whether USAC's policy of accepting surveys to determine National School Lunch eligibility should be codified.

127. Finally, we seek comment whether our rules should be modified to ensure a funding priority for applicants that have not yet achieved internet connectivity in their classrooms or libraries. We also seek comment generally on whether any rules should be adopted to ensure affordable rates for eligible services and ensure access to eligible services.

## **2. Legal Basis**

128. The legal basis for the *Second FNPRM* is contained in sections 1 through 4, 201 through 205, 254, 303(r), and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151 - 154, 201 - 205, 254, 303(r), and 403, and section 1.411 of the Commission's rules, 47 C.F.R. § 1.411.

## **3. Description and Estimate of the Number of Small Entities to Which Rules Will Apply**

129. We have described in detail in the Final Regulatory Flexibility Analysis in this proceeding, *supra*, the categories of entities that may be directly affected by our proposals. For this Initial Regulatory Flexibility Analysis, we hereby incorporate those entity descriptions by reference.<sup>271</sup>

## **4. Description of Projected Reporting, Recordkeeping, and Other Compliance Requirements**

130. With one exception, the specific proposals under consideration in this *Second FNPRM* would not, if adopted, result in additional recordkeeping requirements for small businesses. With regard to the one exception, we propose adoption of a rule that requires each entity receiving supported services to keep all records related to the receipt of or delivery of discounted services for a period of five years after implementation of the discounted services. This proposal includes additional recordkeeping because the current Commission rule requires each entity receiving supported services to keep records related to receipt of discounted services similar to those that the entity maintains for other purchases and does not specify the time period for which such records must be maintained. Thus, the revised rule means that the records need not be kept beyond the five year period.

131. We have sought comments regarding the other proposed rules; however, new recordkeeping requirements are not involved.

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<sup>271</sup> See *supra* para. 102.

## 5. Steps Taken to Minimize Significant Economic Impact on Small Entities, and Significant Alternatives Considered

132. The RFA requires an agency to describe any significant alternatives that it has considered in reaching its proposed approach, which may include the following four alternatives (among others): (1) the establishment of differing compliance and reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance or reporting requirements under the rule for small entities; (3) the use of performance, rather than design, standards; and (4) an exemption from coverage of the rule, or part thereof, for small entities.<sup>272</sup>

133. In the *Second FNPRM*, we seek comment regarding the adoption of rules requiring addition recordkeeping for each entity receiving discounted services. Moreover, we seek comments asking for identification of any recordkeeping measures that would improve the Commission's ability to enforce its rules governing waste, fraud, and abuse in the schools and libraries program. In that regard, we note the findings by recent beneficiary audits conducted by KPMG, which indicate that better documentation would improve the ability to audit beneficiaries. Since abatement of waste, fraud, and abuse in the schools and libraries program is the objective, excluding small entities from such a requirement would contravene that objective and present a loophole that could damage the integrity of the program. Decreasing the likelihood of waste, fraud, and abuse preserves program funding for discounts to all eligible schools and libraries. We invite comment on this recordkeeping requirement and ask that those parties who object to the proposed requirement offer an alternative and explain the merits of their alternative.

## 6. Federal Rules that may Duplicate, Overlap, or Conflict with the Proposed Rules

134. None.

### E. Comment Filing Procedures

135. We invite comment on the issues and questions set forth in the *Second FNPRM* and Initial Regulatory Flexibility Analysis contained herein. Pursuant to applicable procedures set forth in sections 1.415 and 1.419 of the Commission's rules,<sup>273</sup> interested parties may file comments on or before **30** days after publication in the Federal Register of this *Second FNPRM*, and reply comments on or before **60** days after publication in the Federal Register of this *Second FNPRM*. All filings should refer to CC Docket No. 02-6. Comments may be filed using the Commission's Electronic Comment Filing System (ECFS) or by filing paper copies.<sup>274</sup>

136. Comments filed through the ECFS can be sent as an electronic file via the Internet

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<sup>272</sup> See 5 U.S.C. § 603(c).

<sup>273</sup> 47 C.F.R. §§ 1.415, 1.419.

<sup>274</sup> See Electronic Filing of Documents in Rulemaking Proceedings, 63 FR 24121 (1998).



to <http://www.fcc.gov/cgb/ecfs/>. Generally, only one copy of an electronic submission must be filed. If multiple docket or rulemaking numbers appear in the caption of this proceeding, however, commenters must transmit one electronic copy of the comments to each docket or rulemaking number referenced in the caption. In completing the transmittal screen, commenters should include their full name, U.S. Postal Service mailing address, and the applicable docket or rulemaking number. Parties may also submit an electronic comment by Internet e-mail. To receive filing instructions for e-mail comments, commenters should send an e-mail to [ecfs@fcc.gov](mailto:ecfs@fcc.gov), and should include the following words in the body of the message, "get form ." A sample form and directions will be sent in reply.

137. Parties who choose to file by paper must file an original and four copies of each filing. If more than one docket or rulemaking number appears in the caption of this proceeding, commenters must submit two additional copies for each additional docket or rulemaking number.

138. Filings can be sent by hand or messenger delivery, by commercial overnight courier, or by first-class or overnight U.S. Postal Service mail (although we continue to experience delays in receiving U.S. Postal Service mail).

139. The Commission's contractor, Natek, Inc., will receive hand-delivered or messenger-delivered paper filings for the Commission's Secretary at 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002.

-The filing hours at this location are 8:00 a.m. to 7:00 p.m.

-All hand deliveries must be held together with rubber bands or fasteners.

-Any envelopes must be disposed of before entering the building.

-Commercial overnight mail (other than U.S. Postal Service Express Mail and Priority Mail) must be sent to 9300 East Hampton Drive, Capitol Heights, MD 20743.

-U.S. Postal Service first-class mail, Express Mail, and Priority Mail should be addressed to 445 12th Street, SW, Washington, D.C. 20554.

-All filings must be addressed to the Commission's Secretary, Office of the Secretary, Federal Communications Commission.

140. Parties filing electronic media should be advised that the Commission released a public notice on August 22, 2003 providing new guidance for mailing electronic media.<sup>275</sup> In brief, electronic media should NOT be sent through USPS because of the radiation process USPS mail must undergo to complete delivery. Hand or messenger delivered electronic media for the Commission's Secretary should be addressed for delivery to 236 Massachusetts Avenue, N.E., Suite 110, Washington, D.C. 20002, and other messenger-delivered electronic media should be

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<sup>275</sup> *Reminder – Filing Locations for Paper Documents and Instructions for Mailing Electronic Media*, Public Notice, DA 03-2730 (rel. Aug. 22, 2003).

addressed for delivery to 9300 East Hampton Drive, Capitol Heights, MD 20743.

141. Parties who choose to file by paper should also submit their comments on diskette to Sheryl Todd, Telecommunications Access Policy Division, Wireline Competition Bureau, Federal Communications Commission, 445 12th Street, SW, Room 5-B540, Washington, DC, 20554. Such a submission should be on a 3.5 inch diskette formatted in an IBM compatible format using Microsoft Word or compatible software. The diskette should be accompanied by a cover letter and should be submitted in “read only” mode. The diskette should be clearly labeled with the commenter’s name, proceeding (including the docket number, in this case, CC Docket No. 02-6), type of pleading (comment or reply comment), date of submission, and the name of the electronic file on the diskette. The label should also include the following phrase “Disk Copy - Not an Original.” Each diskette should contain only one party’s pleading, preferably in a single electronic file. In addition, commenters must send diskette copies to the Commission’s copy contractor, Natek, Inc., Portals II, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554.

142. Regardless of whether parties choose to file electronically or by paper, parties should also file one copy of any documents filed in this docket with the Commission’s copy contractor, Qualex, International Inc., Portals II, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC Reference Center, Room CY-A257, 445 12th Street, SW, Washington, DC, 20554. In addition, the full text of this document is available for public inspection and copying during regular business hours at the FCC Reference Information Center, Portals II, 445 12th Street, SW, Room CY-A257, Washington, DC, 20554. This document may also be purchased from the Commission’s duplicating contractor, Qualex International, Inc., Portals II, 445 12th Street, SW, Room CY-B402, Washington, DC, 20554, telephone 202-863-2893, facsimile 202-863-2898, or via e-mail [qualexint@aol.com](mailto:qualexint@aol.com).

143. Comments and reply comments must include a short and concise summary of the substantive arguments raised in the pleading. Comments and reply comments must also comply with section 1.49 and all other applicable sections of the Commission’s rules.<sup>276</sup> We direct all interested parties to include the name of the filing party and the date of the filing on each page of their comments and reply comments. All parties are encouraged to utilize a table of contents, regardless of the length of their submission. We also strongly encourage parties to track the organization set forth in the FNPRM in order to facilitate our internal review process.

#### **F. Further Information**

144. Alternative formats (computer diskette, large print, audio recording, and Braille) are available to persons with disabilities by contacting Brian Millin at (202) 418-7426 voice, (202) 418-7365 TTY, or [bmillin@fcc.gov](mailto:bmillin@fcc.gov). This Third Report and Order and Second FNPRM can also be downloaded in Microsoft Word and ASCII formats at [http://www.fcc.gov/web/universal\\_service/schoolsandlibs.html](http://www.fcc.gov/web/universal_service/schoolsandlibs.html).

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<sup>276</sup> See 47 C.F.R. § 1.49.

145. For further information, contact Kathy Tofigh at (202) 418-1553, Karen Franklin at (202) 418-7706, or Jennifer Schneider at (202) 418-0425 in the Telecommunications Access Policy Division, Wireline Competition Bureau.

## **VI. ORDERING CLAUSES**

146. Accordingly, IT IS ORDERED that, pursuant to the authority contained in sections 1, 4(i), 4(j), 201-205, 214, 254, and 403 of the Communications Act of 1934, as amended, this Third Report and Order IS ADOPTED.

147. IT IS FURTHER ORDERED that Part 54 of the Commission's rules, 47 C.F.R. Part 54, IS AMENDED as set forth in Appendix A attached hereto, effective thirty (30) days after the publication of this Third Report and Order in the Federal Register.

148. IT IS FURTHER ORDERED that, pursuant to the authority contained in sections 1, 4(i), 4(j), 201-205, 214, 254, and 403 of the Communications Act of 1934, as amended, this Second Further Notice of Proposed Rulemaking IS ADOPTED.

149. IT IS FURTHER ORDERED that the Commission's Consumer and Governmental Affairs Bureau, Reference Information Center, SHALL SEND a copy of this Third Report and Order and Second Further Notice of Proposed Rulemaking, including the Final Regulatory Flexibility Analysis and Initial Regulatory Flexibility Analysis, to the Chief Counsel for Advocacy of the Small Business Administration.

FEDERAL COMMUNICATIONS COMMISSION

Marlene H. Dortch  
Secretary

## APPENDIX A -- FINAL RULES

Part 54 of the Code of Federal Regulations is amended as follows:

### PART 54 -- UNIVERSAL SERVICE

1. The authority citation continues to read as follows:

Authority: 47 U.S.C. § 1, 4(i), 201, 205, 214, and 254 unless otherwise noted.

#### Subpart F -- Universal Service Support for Schools and Libraries

2. Section 54.504 is amended by revising subparagraph (b)(2)(iii) and adding paragraphs (f) and (g) as follows:

#### **54.504            Requests for services.**

(a) \* \* \*

(b) \* \* \*

(2) \* \* \*

(iii) The services will not be sold, resold, or transferred in consideration for money or any other thing of value, and will not be transferred, with or without consideration for money or any other thing of value, except as permitted by the Commission's rules;

\* \* \*

(e) \* \* \*

(f) *Service Substitution.*

(1) The Administrator shall grant a request by an applicant to substitute a service or product for one identified on its FCC Form 471 where:

(A) the service or product has the same functionality;

(B) the substitution does not violate any contract provisions or state or local procurement laws;

(C) the substitution does not result in an increase in the percentage of ineligible services or functions; and

(D) the applicant certifies that the requested change is within the scope of the controlling FCC Form 470, including any associated Requests for Proposal, for the original services.

(2) In the event that a service substitution results in a change in the pre-discount price for the supported service, support shall be based on the lower of either the pre-discount price of the service for which support was originally requested or the pre-discount price of the new, substituted service.

(3) For purposes of this rule, the broad categories of eligible services (telecommunications service, Internet access, and internal connections) are not deemed to have the same functionality with one another.

(g) *Mixed eligibility services.* A request for discounts for a product or service that includes both eligible and ineligible components must allocate the cost of the contract to eligible and ineligible components.

(1) *Ineligible components.* If a product or service contains ineligible components, costs must be allocated to the extent that a clear delineation can be made between the eligible and ineligible components. The delineation must have a tangible basis, and the price for the eligible portion

must be the most cost-effective means of receiving the eligible service.

(2) *Ancillary ineligible components.* If a product or service contains ineligible components that are ancillary to the eligible components, and the product or service is the most cost-effective means of receiving the eligible component functionality, without regard to the value of the ineligible component, costs need not be allocated between the eligible and ineligible components. Discounts shall be provided on the full cost of the product or service. An ineligible component is “ancillary” if (1) a price for the ineligible component cannot be determined separately and independently from the price of the eligible components, and (2) the specific package remains the most cost-effective means of receiving the eligible services, without regard to the value of the ineligible functionality.

(3) The Administrator shall utilize the cost allocation requirements of this subparagraph in evaluating mixed eligibility requests under section 54.504(d)(1).

3. Section 54.506 is amended to place the existing text in subparagraph (a), and to add subparagraphs (b) and (c) as follows:

#### **54.506 Internal Connections**

(a) A service is eligible for support as a component of an institution’s internal connections if such service is necessary to transport information within one or more instructional buildings of a single school campus or within one or more non-administrative buildings that comprise a single library branch. Discounts are not available for internal connections in non-instructional buildings of a school or school district, or in administrative buildings of a library, to the extent that a library system has separate administrative buildings, unless those internal connections are essential for the effective transport of information to an instructional building of a school or to a non-administrative building of a library. Internal connections do not include connections that extend beyond a single school campus or single library branch. There is a rebuttable presumption that a connection does not constitute an internal connection if it crosses a public right-of-way.

(b) *Basic maintenance services.* Basic maintenance services shall be eligible as an internal connections service if, but for the maintenance at issue, the internal connection would not function and serve its intended purpose with the degree of reliability ordinarily provided in the marketplace to entities receiving such services. Basic maintenance services do not include services that maintain equipment that is not supported or that enhance the utility of equipment beyond the transport of information, or diagnostic services in excess of those necessary to maintain the equipment’s ability to transport information.

(c) *Frequency of Discounts for Internal Connections Services.* Each eligible school or library shall be eligible for support for internal connections services, except basic maintenance services, no more than twice every five funding years. For the purpose of determining eligibility, the five-year period begins in any funding year, starting with Funding Year 2005, in which the school or library receives discounted internal connections services other than basic maintenance services. If a school or library receives internal connections services other than basic maintenance services that are shared with other schools or libraries (for example, as part of a consortium), the shared services will be attributed the school or library in determining whether it is eligible for support.

4. Section 54.507 is amended by adding paragraphs (a)(1) and (a)(2) to read as follows:

**§ 54.507 Cap.**

(a) \*\*\*\*\*

(1) *Amount of Unused Funds.* The Administrator shall report to the Commission, on a quarterly basis, funding that is unused from prior years of the schools and libraries support mechanism.

(2) *Application of Unused Funds.* On an annual basis, in the second quarter of each calendar year, all funds that are collected and that are unused from prior years shall be available for use in the next full funding year of the schools and libraries mechanism in accordance with the public interest and notwithstanding the annual cap, as described in paragraph (a) of this section.

5. Section 54.509(b) is revised to read as follows:

**§ 54.509 Adjustments to the discount matrix.**

(b) *Reduction in percentage discounts.* At all times other than within a filing period described in § 54.507(c), if the estimates schools and libraries make of their future funding needs lead the Administrator to predict that total funding request for a funding year will exceed the available funding, the Administrator shall calculate the percentage reduction to all schools and libraries, except those in the two most disadvantaged categories, necessary to permit all requests in the next funding year to be fully funded.

6. Section 54.513 is amended by revising the title of the section and adding paragraph (c) as follows:

**54.513 Resale and transfer of services.**

(a) \* \* \*

(b) \* \* \*

(c) Eligible services and equipment components of eligible services purchased at a discount under this subpart shall not be transferred, with or without consideration of money or any other thing of value, for a period of three years after purchase, except that eligible services and equipment components of eligible services may be transferred to another eligible school or library in the event that the particular location where the service originally was received is permanently or temporarily closed. If an eligible service or equipment component of a service is transferred due to the permanent or temporary closure of a school or library, the transferor must notify the Administrator of the transfer, and both the transferor and recipient must maintain detailed records documenting the transfer and the reason for the transfer for a period of five years.

7. Section 54.516 is amended by adding a sentence to paragraph (b) as follows:

**54.516 Auditing.**

(a) \* \* \* Schools and libraries shall be required to maintain asset and inventory records of equipment purchased as components of supported internal connections services sufficient to verify the actual location of such equipment for a period of five years after purchase.

8. Section 54.522 is added as follows:

**54.522 Eligible services list.**

The Administrator shall submit by June 30 of each year a draft list of services eligible for support, based on the Commission's rules, in the following funding year. The Commission will issue a Public Notice seeking comment on the Administrator's proposed eligible services list. At least 60 days prior to the opening of the window for the following funding year, the Commission shall release a Public Notice attaching the final eligible services list for the upcoming funding year.

9. Section 54.523 is added as follows:

**54.523 Payment for the non-discount portion of supported services.**

An eligible school, library, or consortium must pay the non-discount portion of services or products purchased with universal service discounts. An eligible school, library, or consortium may not receive rebates for services or products purchased with universal service discounts. For the purpose of this rule, the provision, by the provider of a supported service, of free services or products unrelated to the supported service or product constitutes a rebate of the non-discount portion of the supported services.



**APPENDIX B**  
**DISCOUNT MATRIX**  
**47 C.F.R. § 54.505(c)**

Percentage of Students Eligible for School Lunch Program	Urban Discount Level	Rural Discount Level
<1	20%	25%
1-19	40%	50%
20-34	50%	60%
35-49	60%	70%
50-74	80%	80%
75-100	90%	90%

## APPENDIX C

## Examples of Permissible Funding Under Twice-Every-Five-Years Rule for Internal Connections

	Example 1	Example 2	Example 3	Example 4	Example 5	Example 6
2005	<b>Funding Received</b>	<b>Funding Received</b>	<b>Funding Received</b>	<b>Funding Received</b>	<b>Eligible</b> , but no Funding Received	<b>Funding Received</b>
2006	<b>Funding Received</b>	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received
2007	Not Eligible for Funding	<b>Eligible</b> , but no Funding Received	<b>Funding Received</b>	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received
2008	Not Eligible for Funding	<b>Funding Received</b>	Not Eligible for Funding	<b>Funding Received</b>	<b>Eligible</b> , but no Funding Received	<b>Eligible</b> , but no Funding Received
2009	Not Eligible for Funding	Not Eligible for Funding	Not Eligible for Funding	Not Eligible for Funding	<b>Funding Received</b>	<b>Funding Received</b>
2010	<b>Funding Received</b>	<b>Eligible</b> , but no Funding Received	<b>Funding Received</b>	<b>Funding Received</b>	<b>Funding Received</b>	<b>Funding Received</b>
2011	<b>Funding Received</b>	<b>Funding Received</b>	Not Eligible for Funding	Not Eligible for Funding	Not Eligible for Funding	Not Eligible for Funding
2012	Not Eligible for Funding	Not Eligible for Funding	<b>Funding Received</b>	Not Eligible for Funding	Not Eligible for Funding	Not Eligible for Funding
2013	Not Eligible for Funding	<b>Eligible</b> , but no Funding Received	Not Eligible for Funding	<b>Funding Received</b>	Not Eligible for Funding	Not Eligible for Funding
2014	Not Eligible for Funding	<b>Funding Received</b>	Not Eligible for Funding	Not Eligible for Funding	<b>Funding Received</b>	<b>Funding Received</b>

## APPENDIX D

**List of Parties Filing Comments in response to Schools and Libraries Notice of Proposed  
Rulemaking  
CC Docket No. 02-6  
(filed July 1, 2002)**

<b><u>Commenter</u></b>	<b><u>Abbreviation</u></b>
Access Living of Metropolitan Chicago Airoldi, Joan	AL
Alaska, State of (Department of Education and Early Development)	Alaska
Alaska Telephone Association, The	ATA
American Association of School Administrators	AASA
American Library Association	ALA
Arkansas E-rate Workgroup, The State of	Arkansas E-rate
AT&T Corp.	AT&T
AT&T Wireless Services, Inc.	AWS
Avella Area School District	Avella
Bakersfield School District	Bakersfield
BellSouth and SBC Comm., Inc.	BellSouth/SBC
Benton Foundation	
Bibbey, David	
Boston, City of	Boston
Bowe, Marty	
California Department of Education, The	California DOE
Carnegie Library of Pittsburgh	Carnegie Library
Cellular Telecommunications & Internet Association	CTIA
Central Susquehanna Intermediate Unit	Central Susquehanna
Cleveland Municipal School District	Cleveland MSD
Coalition for E-rate Reform	E-rate Reform
Colorado Department of Education	Colorado DOE
Community Technology Centers' Network, The Benton Foundation, Association for Community Networking, California Community Technology Policy Group, Santa Barbara College, Casa Foundation	CTCNet
Council of Chief State School Officers	CCSSO
Council of the Great City Schools, The	Great City
Delaware Center for Educational Technology	
Dell Computer Corporation	Dell
eChalk LLC	eChalk
Edison Schools, Inc.	Edison Schools
Educational Services District 101	Edu. Service D. 101
Education and Library Networks Coalition	EdLINC

Emilienburg, Steven	
E-Rate Elite Services, Inc.	E-Rate Elite
Excaliber Internet Corp.	Excaliber
Florida Division of Library and Information Services	
Florida Public Service Commission	Florida PSC
Florida State of Dept. of Ed.	Florida DOE
Funds For Learning, LLC	
General Communications, Inc.	GCI
Gibson, Jeffrey	
Grainger, Kathleen Bond	
Gregory, James D.	
Harris, Jim	Harris (Alabama DOE)
Harvey ESD	Harney
Hawaii State Public Library	Hawaii
Illinois State Board of Education	Illinois BOE
Inclusive Technologies	
Information Institute	
Information Renaissance	
Integrity Networking Systems, Inc.	Integrity
Intelenet Commission, Indiana Department of Education and Indiana State Library	Intelenet
Iowa Communications Network	
Iowa Department of Education	Iowa DOE
Iversen, Sarah L.	
Johnson, Jack	
Jones Public Schools	
Kellogg Consulting, LLC	Kellogg Consulting
Kentucky Department for Libraries and Archives	
Kentucky Department of Education	
Kila School District #20	Kila
Lawton-Bronson Community School, Norman Washburn	
Lebanon School District	
Los Angeles Unified School District	LA USD
Madison School District	
Maine Public Utilities Commission	Maine PUC
Marian High School	
Megdad, Diane	
Memphis City Schools	
Michigan Information Network, The	Michigan
Missouri Office of the Public Counsel	Missouri OPC
Missouri Research and Education Network	MOREnet
Montana Independent Telecommunications Systems	MTIS
Montana Public Service Commission	Montana PSC
Montgomery, Ruth Ann	

Nassau-Suffolk School Boards Association	N-SSBA
National Council on Disability	NCD
National Education Association, the International Society for Technology in Education and The Consortium for School Networking	NEA et al
New Jersey Library Association, The	
New York City Board of Education, The	NYCBOE
New York Public Library, The	NYPL
New York State Education Department, The	
Nextel Communications, Inc.	Nextel
North Attleborough Public Schools	
North Carolina State Library	NCL
North of Boston Library Exchange	NOBLE
Northwood School District	
O'Donnell, Tracey	
Office of Information Technology Services of North Carolina, The	OIT NC
Office of the Public Counsel	
Ogden, Jeffrey C.	
Pennsylvania Department of Education	Pennsylvania DOE
Philadelphia School District	
Pisano, Vivian M.	
Plummer, Jamie	
Quaker Valley School District	
Queens Borough Public Library	
Richardson Associates Electronics	
Rural School and Community Trust	
Scranton Public Library	Scranton PL
Lackawanna County Library System	
Seattle Public Library	Seattle PL
Segalman and Nixon	
Sharer, Judy	
Skiatook Public Schools	
Software & Information Industry Association	Software & Info
Sorenson, Doug	
Spectrum Communications Cabling Services, Inc.	Spectrum
Sprint Corporation	Sprint
Sterling, Jack	
St. Louis Public Library	
Southwest Virginia Education and Training Network	SVETV
TAMSCO Telecommunications Division	TAMSCO
Tel/Logic Inc.	Tel/Logic
Telecommunications for the Deaf, Inc.	TDI
Three Rivers	
Trillion Digital Communications, Inc.	Trillion

United Cerebral Palsy of Michigan/Pam Schuster	
Universal Service Administrative Company	USAC
Verizon Telephone Companies	Verizon
Warwick Communications, Inc.	Warwick
Weisiger, Greg	Weisiger
West Virginia Department of Education	West Virginia DOE
WiscNet	
Wisconsin Department of Public Instruction, The	WDPI
WorldCom, Inc.	WorldCom
York County Library System	York County Library
Martin Library Association	

**List of Parties Filing Reply Comments in response to Schools and Libraries Notice of  
Proposed Rulemaking  
CC Docket No. 02-6  
(filed July 31, 2002)**

<u>Commenter</u>	<u>Abbreviation</u>
Alaska, State of (Department of Education and Early Development)	Alaska
American Association of School Administrators	AASA
American Library Association	ALA (late)
Arkansas E-rate Workgroup, State of	AEWG
AT&T Wireless Services, Inc.	AWS
Council of Chief State School Officers	CCSSO
Cox Communications, Inc.	COX
Dell Computer Corporation	Dell
Education and Library Networks Coalition	EdLiNC
Florida Public Service Commission	FPSC
Funds For Learning, LLC	
Information Technology Industry Council	ITI
Iowa, State Library	
Merit Network, Inc.	Merit
National Association of State Telecommunications Directors	NASTD
National Education Association, The International Society for Technology in Education, and the Consortium for School Networking	NEA et al
New York State Education Department	New York
Nextel Communications, Inc.	Nextel
Qwest Communications International Inc.	Qwest
Siemens Enterprise Networks	Siemens
Spectrum Communications Cabling Services, Inc.	Spectrum
Sprint Corporation	Sprint
Verizon	Verizon
Weisiger, Greg	
WorldCom, Inc.	WorldCom

**List of Parties Filing Comments in response to Schools and Libraries Further Notice of  
Proposed Rulemaking  
CC Docket No. 02-6  
(filed July 21, 2003)**

**Commenter****Abbreviation**

Alaska State Library and Department of Education and Early Development	EED
American Library Association	ALA
Arkansas E-rate Work Group	AEWG
Association for Telecommunications and Technology Professionals Serving State Government	NASTD
AT&T Corp.	AT&T
BellSouth Corporation	BellSouth
Comtec Business Systems, Inc.	Comtec
Consortium for School Networking	CoSN
Dell Computer Corporation	Dell
Education and Library Networks Coalition	EdLiNC
Fibertech Networks, LLC	Fibertech
Florida Public Service Commission	FPSC
Funds For Learning, LLC	
Greg Weisiger	Weisiger
Illinois State Board of Education	ISBE
Information Technology Group of the New York Public Library	NYPL
National Association of State Utility Consumer Advocates	NASUCA
New York City Department of Education	NYCDOE
Sprint Corporation	Sprint
State E-Rate Coordinators' Alliance	Alliance
StateNets	StateNets
Tel/Logic Inc.	d/b/a E-Rate Central
Verizon telephone companies	Verizon
Wisconsin Department of Public Instruction	Wisconsin DPI
WorldCom, Inc.	d/b/a MCI



**List of Parties Filing Reply Comments in response to Schools and Libraries Further Notice  
of Proposed Rulemaking  
CC Docket No. 02-6  
(filed August 19, 2003)**

<b><u>Commenter</u></b>	<b><u>Abbreviation</u></b>
Consortium on School Networking	CoSN
International Society of Technology in Education	ISTE
Council of the Great City Schools	Council
Education and Library Networks Coalition	EdLiNC
Funds For Learning, LLC	
National Association of Independent Schools	NAIS
National Education Knowledge Industry Association	NEKIA
Nextel Communications, Inc.	Nextel
Pennsylvania Department of Education	
State of Alaska Department of Education and Early Development	
Alaska State Library	EED
State E-rate Coordinators Alliance	SECA
Verizon	
Weisiger, Greg	

**SEPARATE STATEMENT OF  
CHAIRMAN MICHAEL K. POWELL**

*Re: In the Matter of Schools and Libraries Universal Service Support Mechanism  
CC Docket No. 02-6*

Today marks another milestone in our ongoing and systematic efforts to improve the effectiveness of the schools and libraries fund. Today, we adopt a variety of measures designed to simplify fund administration, ensure the equitable distribution of monetary support, and to protect against waste, fraud, and abuse. The rules we adopt today should increase the accuracy and effectiveness of disbursements by, for example, precluding eligible entities from upgrading or replacing internal connections with universal service funds on a yearly basis, clarifying what constitutes permissible maintenance costs, and limiting the transfer of equipment purchased with universal service discounts.

Many of the actions we take today draw from previous events, including the May 2003 public forum on universal service reform and the activities of the Universal Service Administrative Company's Waste, Fraud, and Abuse Task Force. Taken together, these measures advance our mission of ensuring efficient, accurate and timely fund disbursements to promote the nation's universal service objectives. Yet our task is not yet complete. As indicated in our *Further Notice*, the agency seeks comment on how to further enhance the ability of limited funds to do the most good for the most Americans.

**SEPARATE STATEMENT OF  
COMMISSIONER KATHLEEN Q. ABERNATHY**

*Re: In the Matter of Schools and Libraries Universal Service Support Mechanism  
CC Docket No. 02-6*

I am extremely pleased to support this Order and Further Notice. Today we make real progress in improving the efficiency and effectiveness of the Schools and Libraries program. In April of this year, the Commission took an initial step to bolster our defenses against waste, fraud, and abuse in the program by adopting a debarment rule for bad actors. At that time, we solicited comment on additional measures to prevent waste, fraud, and abuse, and in May, I organized a public forum to develop more concrete recommendations. On the heels of the public forum, the Universal Service Administrative Company formed a task force to provide additional proposals.

This item represents the initial fruit of those efforts. Many participants in the public forum argued that the Commission should limit the frequency of discounts for internal connections and also restrict transfers of equipment among schools. The USAC task force made similar recommendations. The Commission has appropriately responded — quite promptly — by limiting funding for internal connections to twice every five years and barring most equipment transfers. These new rules will give applicants flexibility to spread expenditures over two years, but will prevent the same applicants from being funded year after year. Given the scarcity of priority two funds in recent years, the changes will result in extending discounts to schools and libraries in lower discount bands that have yet to receive any funding for internal connections. While we have effectively authorized applicants to upgrade their internal connections every three years, I want to stress that this is a *minimum* period of time that must elapse; in most circumstances, I would expect applicants to recognize that cables, routers, and the like will have significantly longer useful lives.

I am also encouraged by the recommendation of the USAC task force, among others, to lower the maximum discount percentage for internal connections. Common sense suggests that once schools and libraries have been wired, they should not need significant funding again for many years. In practice, however, many applicants in the 80-90 percent discount range have sought increasing funding every year. This pattern suggests that a “copay” of only 10-20 percent may be insufficient to ensure cost-effective expenditures. I look forward to further developing the record on this issue and hopefully making additional rule changes next year.

Finally, I am pleased that the Order continue our search for additional ways to simplify the application process. Although our primary focus has appropriately been ensuring program integrity, we should remain mindful of the need to make it easier for deserving applicants to obtain access to funding. The April Order and today’s Order made several improvements, but we should continue to work on minimizing red tape in the next phase of this rulemaking.

**SEPARATE STATEMENT OF  
COMMISSIONER MICHAEL J. COPPS**

*Re: In the Matter of Schools and Libraries Universal Service Support Mechanism  
CC Docket No. 02-6*

Great programs like E-Rate do not thrive without regular review and care. With justifiable pride we can now say that 92 percent of public school classrooms are connected to the Internet. Only 14 percent of these classrooms were connected when Congress passed the Telecommunications Act in 1996. Yet the gains we have made will evaporate without our continued vigilance. This leads me to support today's decision. It is one in a series of positive steps we are taking at the Commission to ensure that the E-Rate program functions with the integrity it must have.

I am particularly pleased that today we finally formalize the process for making available carryover funds from prior years. This is a major step forward. I also think our new rule limiting support for internal connections to two times within a five-year period strikes the right balance between applicant needs and efficient use of program support. These are but two of numerous positive steps contained in this item.

We don't solve all problems today, however. An abrupt change in the eligible services list has left applications from rural schools and libraries in North Dakota and elsewhere high and dry. These rural schools and libraries have built cost-effective networks based on the use of dark fiber. Now the signals have changed and dark fiber is no longer eligible. We need to reverse this recent action and get our policy regarding support for dark fiber straight once and for all. I see nothing in Section 254(h) that compels the exclusion of dark fiber facilities from E-Rate program support. I hope we can correct this mistake as soon as possible.

Finally, I think all supporters of the E-rate should frequently caution themselves that we not add to the growing complexity of the application process. As we tighten procedures and take necessary steps to weed out waste and fraud in the program, we could unwittingly make the application process so daunting as to discourage needy schools and libraries from even applying. As we strive to improve accountability, so also should we commit ourselves to ensuring that as the program evolves, it continues to serve the needs of students and patrons of our schools and libraries—the real beneficiaries of support.

**SEPARATE STATEMENT OF  
COMMISSIONER JONATHAN S. ADELSTEIN**

*Re: In the Matter of Schools and Libraries Universal Service Support Mechanism  
CC Docket No. 02-6*

In 1996, prior to the implementation of the E-rate program, only 14 percent of public classrooms were connected to the Internet. According to the most recently available data, in 2002, 92 percent of public school classrooms were connected to the Internet. In addition, 85 percent of the public schools that are connected to the Internet reported in 2001 that they had a broadband connection.

In 1997, only 60 percent of library systems provided public access in one of their outlets. While in 2002, 95 percent of public library outlets provided public access. The E-rate program has become a necessary tool to facilitate access to the myriad of opportunities that the Internet offers to students and library patrons alike.

Clearly, this has been a very successful program. But even successful programs can be improved.

Today we adopt an item which is just one in a series of steps we are taking to improve the Schools and Libraries Program. Over the years, this Commission has addressed matters related to the administration of this program to make it more user-friendly and help prevent waste, fraud and abuse. In this last year, this Commission has made a more concerted effort to address these issues.

In April, we issued a Second Order and Further Notice which adopted a debarment rule and other measures to ensure that this program is utilized in the best manner possible. We also sought comment on other issues, some of which we address in this item. In May of this year, we held a Forum on "Improving Administration of the Schools and Libraries Support Mechanisms" and had the opportunity to learn more about the use of this program from a number of different sources.

In addition, we have benefited from the recommendations of USAC's Waste, Fraud and Abuse Task Force and have had the opportunity to review beneficiary audit reports and the Office of Inspector General's semi-annual report. Today's decision draws upon a great deal of information from a number of knowledgeable sources. As I had anticipated in my Separate Statement in April, we have taken more steps forward with this latest addition in our efforts to reform the program and ensure that it inures to the benefit of those schools and libraries across the nation that participate

When private companies make decisions about their telecommunications investments, particularly when it comes to investments in equipment, they generally do not expect to replace their equipment year after year. Our rules in the Schools and Libraries program have permitted schools and libraries to do just that. But today we change that. And I support that change.

In April, I said that perhaps we should apply a service life to the equipment. USAC's Waste Fraud and Abuse Task Force recommended the same. This program-specific service life would require program participants to keep the equipment for a particular period of time rather than applying annually for discounts for duplicative equipment.

Although we did not adopt such a "service life" for equipment, we may have addressed my concern about ensuring the fair and even distribution among requesting users by adoption of two different measures. As a caution, however, we may need to address the issue of service specific lives in the event that the rule we adopt today does not go far enough to prevent waste, fraud and abuse.

We have addressed my concerns by limiting the frequency of requests from entities for Priority Two discounts, and restricting the transfer of equipment purchased with discounts from the schools and libraries support mechanism. Implementation of the "twice-every-five-years" rule will facilitate the availability of funds to more eligible schools and libraries on a regular basis. The fact that we include in that the opportunity to have those two years be consecutive addresses concerns that some schools may need two successive years to complete their projects by spreading the costs over that time. I am also pleased that we exempt maintenance costs from the twice-every-five-years restriction. We clearly define what basic maintenance services are in order to avoid future confusion about what is, and what is not exempt from the basic rule. Clarity is imperative to making this program more user-friendly, as requested by so many of the Forum participants.

Today we extend the Act's prohibition on sale or transfer of equipment purchased with discounts from the universal service program in consideration of money or anything else of value. In order to help prevent waste, fraud and abuse, we prohibit transfer of equipment, without regard to whether money or anything else of value has been received in return, for a period of three years after purchase. We do recognize, however, that applicants may have legitimate reasons to transfer internal connections equipment due to the closing of a school or other eligible entity. I believe that this provides the necessary flexibility to our new rule.

The Waste Fraud and Abuse Task Force has recommended a reconfiguration of our discount matrix. In April, I stated that it was important for us to address the possibility of changing the discount levels for this program. Many have suggested that the 90% discount level is too high because it does not require enough of an investment by the school or library. Reducing the discount levels can introduce more accountability, and better control the costs of the program. At the same time, I realize that there may very well be some schools and libraries that could not afford the benefits of this program if we reduced the discounts. Today, we ask those questions, and others, in order to explore the efficacy of these changes.

I support this item as another continuing opportunity to improve an already outstanding program. We cannot afford to let any abusive practices overshadow the enormous success of this program. I look forward to working with my colleagues, USAC, the service providers, and the schools and libraries as we undertake this endeavor.