E-Rate Central

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

In the Matter of:	)	
	)	
Modernizing the E-Rate Program for Schools and Libraries	)	WC Docket No. 13-184
	)	

REPLY COMMENTS IN RESPONSE TO THE WIRELINE COMPETITION BUREAU'S PUBLIC NOTICE OF MARCH 6, 2014 SEEKING FOCUSED COMMENT ON E-RATE MODERNIZATION (DA 14-308)

Introduction

At the heart of the E-rate modernization proposals put forth in the Wireline Competition Bureau's Public Notice (DA 14-308) are the following four key elements:

1. Replace the current two-priority system with a new two-category system, each separately funded.
2. Within each category, emphasize broadband services and phase out support for voice and other "legacy" services.
3. Consider several ways to allocate funding for the broadband internal connections category.
4. Provide an additional $2 billion in E-rate funding for FY 2015 and FY 2016.

Based on a preliminary review of the initial comments filed in this proceeding, it appears that there is widespread agreement on the basic issues and goals, but equally widespread disagreement on the detailed nature or timing of the changes required. In particular:

1. Almost all agree with the Commission's focus on broadband, and that support for broadband services must extend all the way to the classroom.
    a. Many agree that it would be advantageous to treat broadband internal connections as a separately funded category rather than as a lower priority.
    b. There appears to be no consensus as to which of the three alternative proposals to allocate broadband internal connections funding is best.
2. All agree that E-rate funding is limited, and that, even with the infusion of an additional $2 billion over the next two years, a long-term solution will require some combination of additional funding, the narrowing of eligible products and services, and/or reductions in discount rates.
3. There is a general acceptance of the need to phase out eligibility of voice and other "legacy" services, but the extent and timing of the phase-out(s) remain controversial.

The biggest problem we see with the FCC's E-rate modernization efforts to date is that most of the changes being discussed remain at a conceptual level. Neither the Public Notice, nor many of the initial comments submitted, addressed the myriad of details needed to implement any of these concepts. It's these devilish details — not to mention the ability of USAC's IT system to handle them — that will make or break the transition from E-Rate 1.0 to E-Rate 2.0.

E-Rate Central's reply comments deal with the financial and operational challenges of the forthcoming transition and with the details required for implementing the allocation of limited funding for the broadband internal connections category. Our comments also address changes to the discount matrix.

Transitional Financial Issues

The current E-rate program is about to enter its seventeenth funding year. E-Rate 1.0 may appear outdated, but, to continue the software analogy, the program is well beyond Beta. Aside from some tweaking, the E-Rate 1.0 rules and procedures are well-known and working. Although funding is limited, there is a single mechanism to deal with shortages. Recent shortfalls in Priority 2 funding, while disappointing to many, have been relatively predictable.

All of this is about to change in an unpredictable way, particularly for applicants and service providers — and, perhaps also for USAC and the FCC. Consider first the available funding. Currently there is one funding pool made up of the inflation-adjusted cap plus roll-over. Whatever isn't used for Priority 1 defaults to Priority 2 (or, at least, has in FY 2012 and earlier).

Under E-Rate 2.0, total available funding will still presumably include the inflation-adjusted cap plus roll-over, but may also include an additional $2 billion over the next two years. The source of this additional funding is not clear from the Public Notice. To the extent it includes previously committed, but unused, E-rate funding, this is not "additional funding", but rather just another form of roll-over.

Depending upon how E-Rate 2.0 is configured, total funding may be split into two or more separate pools with the following characteristics:

1. The Priority 1 — which we have now begun to call "Category 1" — funding pool will cover regular Internet and broadband network costs, plus whatever other traditional Priority 1 services have not yet been phased out. Traditional Priority 1 service requests have been a relatively projectable figure in total. The financial impact of phasing out of these legacy services, however, may not be so easily calculated as service packages are revamped and as new allocation rules are developed.
2. A new Priority 2 — perhaps now called "Category 2" — funding pool may be separately established to cover the costs of broadband internal connections equipment. At present, there is no clear definition of exactly what equipment will be eligible, much less any estimate of likely demand under alternative allocation mechanisms.
3. The Public Notice suggests that an additional funding pool(s), perhaps kept separate from the basic Category 1 and Category 2 pools, and perhaps with different rules, may be established to help jump start those applicants without adequate broadband capability.
4. The Public Notice also suggests setting aside other funding for demonstration projects.

The key point on which to focus in this discussion is that the financial success of establishing separate funding pools depends upon USAC's and the FCC's ability to accurately forecast demand for each pool and to develop rules and procedures for (a) allocating, or even reallocating, funds between the pools, and/or (b) developing funding prioritization rules to deal with excess demand within any individual pool.

Projecting demand for E-rate funding is never easy, but is likely to be even more difficult in the early years of E-Rate 2.0. In particular:

1. Calibrating the impact of phasing out support for legacy services will have to rely on less than precise estimates of the historic demand for these services on a stand-alone basis.
2. The pent up demand for Category 2 services, following the last few years of limited or no Priority 2 funding, is immeasurable.
3. New rules and procedures will change applicant and service provider incentives in ways that are difficult to project.

As the FCC decides how to allocate limited E-rate funds to various services, we encourage it to:

1. Establish interim rules and procedures that would permit the FCC to reallocate funds from one category to another within a given funding year to better balance realized funding demands; and/or
2. Initially hold back, in reserve, a portion of the additional $2 billion identified for use during the first two years. To the extent this reserve is not fully utilized during the initial two-year period, it could be used to supplement funding beyond FY 2016.

Category 2 Funding Allocation

Based on the initial comments, the FCC's most controversial challenge is to develop a fair and predictable mechanism for allocating limited funding within the broadband internal connections category. The Public Notice proposes three alternative allocation methods, none of which are free of problems.

Whichever method is selected, a secondary issue concerns the calculation of discounts for school districts (and presumably for multi-site schools and consortia[1]). Most comments addressing this issue favored the use of single matrix discounts for school districts rather than the use of individual discounts for individual sites. E-Rate Central agrees that this approach will simplify school discount rate calculations, much as it has done with libraries. As noted below, however, the "bunching" of applicants at various matrix discount levels may complicate certain allocation approaches.

Of the allocation mechanisms proposed, E-Rate Central believes that the annual budget cap approach is the lesser of the three evils. As discussed below, whatever its drawbacks, budget caps do provide funding to all applicants on a consistent and largely predictable basis.

One-in-Five Funding:

There is widespread agreement that the FCC's current two-in-five rule has failed. It is not quite clear how changing the current rule from two-in-five to one-in-five[2] is likely to be much better. One-in-five should be easier to administer, particularly if applied to applicants as a whole, rather than to individual buildings, but there are significant downsides. In particular:

1. Such a rule would incentivize applicants to apply for large amounts of funding, often well in advance of their needs, and to attempt to stretch out funding utilization over longer periods of time (likely with many more service substitutions).
2. The demand in any given year, particularly in the beginning, is likely to far exceed available funding. Unless a new plan is put in place, this puts the program back in the position of allocating funding in any given year by setting a discount threshold.
3. The use of the traditional discount threshold approach would be greatly complicated if applicants are further restricted to matrix level discounts. This would increase the need (under current rules) for proration, not just at 90%, but at lower matrix discount points as well. Rather than proration, the FCC may have to resort to sub-matrix band thresholds based on actual NSLP eligibility percentages.
4. One or more rules would have to be developed to deal with consortium applicants.

[1] If single matrix discounts are used for consortia, E-Rate Central suggests that this be done on an FRN-by-FRN basis, differentiated by individual Block 4 worksheets.

[2] Equally unsatisfying would be to change the rule to any other numerical combination such as one-in-three or one-in-four.

E-Rate Central believes that the one-in-five approach would provide little predictability to the funding of broadband internal connections to any but perhaps the highest discount applicants.

Rotating Band Funding:

The "rotating band" approach was initially proposed by the State E-Rate Coordinators' Alliance ("SECA"), of which E-Rate Central is a member, in its initial NPRM comments. In its Public Notice comments, SECA still supports the concept, but notes several concerns that would need to be addressed. We agree that rotating bands would assure broadband internal connections funding to all applicants over the cycle, but have identified several additional concerns beyond those raised by SECA. In particular:

1. While funding is assured within a cycle, it would be difficult for any given applicant — except perhaps the lowest income applicants in the first year — to predict the year in which funding would be provided. This makes planning and procurement difficult, and, to be safe, probably requires applicants to file continuously 1-2 years in advance of the year in which funding does, in fact, become available.
2. Out-of-cycle exceptions might have to be made for new schools whose greatest need for funding is in the year leading up to their openings. Rule exceptions to deal with new schools must include a reasonable definition of "new."
3. SECA's comments properly recognize the likely problem of implementing a rotating band strategy with applicants bunched at matrix discount levels. When — probably not "if" — this occurs, SECA recommends that rotation be governed by the applicants' actual NSLP eligibility percentages as in the one-in-five approach discussed above. One difficulty, as SECA recognizes, is that NSLP percentages tend to fluctuate year-to-year. To make this approach work, applicants "would need to be willing to retain the same base year" NSLP percentage "throughout one life cycle." Given that the length of the cycle is unknown, and that a cycle is unlikely to end neatly with the funding of the lowest NSLP percentage applicants before rotating back to the top, complications abound.

E-Rate Central agrees that the rotating band approach does provide assurances of ultimate funding opportunities for all applicants. At least in the beginning, however, it provides little predictability as to when such funding would be available. We also agree with SECA that there are several complexities that would need to be addressed.

Annual Budget Funding:

The third approach proposed, which would provide smaller amounts of broadband internal connections funding annually to all applicants, has a different set of pluses and minuses. On the plus side, it would provide all applicants with a predictable source of ongoing E-rate support. It does, however, change the nature of the support and introduces its own complexities. In particular:

1. Rather than focusing on new internal construction projects, the annual funding approach may be best suited to support continuous improvements to internal broadband infrastructures.

2. Assuming that the E-rate rules are changed to include the approval of multi-year contracts and the repeal of the two-in-five restriction, new system construction or major upgrades could be supported under this approach by applicants applying annual E-rate discounts to equipment leases.
3. The allocation formulas[3] set forth in the Attachment to the Public Notice are conceptually clear, but do not address the critical determinants of the associated "Per–Student" and "Per-Building" allocations, including:
    a. A "per-patron" equivalent for libraries;
    b. Estimates of students associated with actual applicants (including expanded student eligibility in some states);
    c. Estimates of buildings associated with actual applicants; and
    d. Possible premiums proposed by some for rural and other high cost factors.
4. One conceptual problem which needs to be addressed under this approach is how to deal with consortia. Although we believe that consortium applications have historically been more common with Priority 1 services, it may be necessary to limit annual Category 2 funding opportunities to schools, districts, and libraries either applying on their own or as members of a consortium.

Overall, E-Rate Central believes that annual budget funding provides the fairest and most predicable approach to allocating limited funding within the broadband internal connections category.

Discount Matrix Revisions

SECA's comments in this Public Notice propose lowering discounts for the broadband internal connections to a maximum of 70%. Comments by SECA and others in previous E-rate proceedings have made similar suggestions to cap the maximum discount in the 70-80% range. The two basic arguments in favor of a downward adjustment of the discount matrix, at least for Priority 2, have been:

1. The 10% non-discounted portion, associated with the maximum 90% discount, does not provide enough "skin in the game" to ensure cost-effective procurement decisions; and
2. Lowering discounts across the board would reduce funding demand.[4]

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[3] Comments filed by Funds for Learning (and others) in the original NPRM proceeding proposed more detailed formulas for calculating per student and/or per site allocation figures. Our analysis of these formulas indicates:
   a. A conceptual disconnect in the funding floor calculation; and
   b. A small mathematical error in the rural premium adjustment factor.

[4] SECA's comments estimate that Priority 2 demand in FY 2011 could have been reduced by over $500 million under SECA's proposed Priority 2 discount schedule. Taking into account probable reductions in the pre-discount demand triggered by higher requirements for the applicants' non-discount share, the reduction in funding demand could have been even greater.

E-Rate Central concurs with the need to lower discount rates, particularly in the internal connections category. We believe that a reduction in discount rates is needed both to lower overall funding demand and to realign applicant budget priorities at the higher discount rates.

E-Rate Central is attracted to the straight-forwardness of SECA's proposed 20, 30, 40.., 70% discount rate schedule. Perhaps there is no need for an actual matrix. An alternative might be to adopt the 20-70% steps as a base discount rate schedule for both Category 1 and Category 2 E-rate services. As such, the schedule could be incrementally modified, for example, by:

1. Adding 10% for Category 1 services;
2. Adding 5% for rural and/or consortium applicants; and/or possibly
3. Including an adjustment factor (plus or minus 5%) set annually post-window, pre-commitment, to more closely align funding supply and demand imbalances.

Conclusion

E-Rate Central recognizes the scope of the Commission's efforts to modernize the E-rate program, and appreciates the opportunity provided to comment on last summer's NPRM and on this recent Public Notice. Getting this right the first time will be difficult. As suggested in several of our comments above, we encourage the FCC to include flexibility in its impending order to account for transitional issues as they will surely arise.

Respectfully submitted by:

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