

**Before the
Federal Communications Commission
Washington, DC 20554**

In the Matter of)
)
Universal Service Contribution Methodology) WC Docket No. 06-122
)
Petition of the Ad Hoc Coalition of)
International Telecommunications Companies)
for Declaratory Ruling Regarding Universal)
Service Fund Contributions)
)

To: The Commission

**REPLY COMMENTS OF NETWORK ENHANCED TELECOM, LLP, DBA
NETWORKIP**

**NETWORK ENHANCED TELECOM, LLP,
DBA NETWORKIP**
Pete Pattullo
Chief Executive Officer
Toni Van Burkleo
Chief Financial Officer
Jennifer Begin
Regulatory Manager
119 W. Tyler Street, Suite 100
Longview, Texas 75601

June 22, 2009

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Network Enhanced Telecom, LLP dba NetworkIP (“NetworkIP”) presents these reply comments in response to the Petition for Declaratory Ruling filed by the Ad Hoc Coalition of International Telecommunications Companies (“Ad Hoc Coalition”).¹ As discussed in more detail below, NetworkIP agrees with the Ad Hoc Coalition that serious flaws exist in the current Instructions to FCC Form 499-A regarding the reporting of prepaid card revenue. NetworkIP has previously supported similar arguments in response to a request for review of a contributor audit decision filed by IDT Corporation.²

¹ *Comment Sought on Petition of the Ad Hoc Coalition of International Telecommunications Companies for Declaratory Ruling Regarding Universal Service Fund Contributions*, WC Docket No. 06-122, Public Notice, DA 09-1023 (rel. May 7, 2009). *Petition of the Ad Hoc Coalition of International Telecommunications Companies for Declaratory Rulings*, WC Docket No. 06-122 (filed Feb. 12, 2009) (“Ad Hoc Petition”).

² *Comments of Network Enhanced Telecom, LLP, dba NetworkIP, in Support of Request for Review*, WC Docket No. 06-122 (filed Sept. 5, 2008), responding to *Comment Sought on IDT Corporation and IDT Telecom Request for Review of a Decision by the Universal Service* (continued on next page)

As NetworkIP pointed out in its comments on the IDT Petition, the Commission’s prepaid card rules reflect an ultimately detrimental attempt to impose regulations designed for traditional, direct-to-consumer marketed telecommunications services onto services like prepaid cards that involve more innovative and diverse distribution channels. The current rules also hamper emerging efforts to use the prepaid card model to sell professional services, such as technical support or legal services, with value that greatly exceeds the telecommunications capability included with the card.³

NetworkIP therefore supports wholesale reform of the contribution rules for prepaid card revenues, including the Ad Hoc Coalition’s request that the Commission clarify that distributor revenues are not end-user revenues and allow prepaid calling card providers to report actual revenues from distributors rather than the “face value” of cards.

NetworkIP does not provide prepaid card services but, as a provider of services to the prepaid card industry, is well aware of the confusion that the current rules engender for all involved, including the Universal Service Administrative Company (“USAC”), which must administer the revenue reports and contributions on a day-to-day basis. NetworkIP is a provider of services to the prepaid card provider industry, offering a virtual switch platform that enables them to develop their own prepaid offerings. NetworkIP’s software applications enable its prepaid card provider customers to create their own prepaid offerings by using NetworkIP’s platform to control and manage all features of their cards, including value and price, number of

Administrative Company, WC Docket No. 06-122, Public Notice, 23 FCC Rcd 11940 (WCB 2008) (“IDT Appeal”).

³ See, e.g., 47 C.F.R. § 64.5000(a) (defining prepaid card as “a card or similar device that allows users to pay in advance for a specified amount of calling, without regard to additional features, functions, or capabilities available in conjunction with the calling service.”).

minutes, rate of decrement, recharges, billing and back office support. NetworkIP also sells wholesale long distance minutes, and prepaid card providers may develop cards using NetworkIP's billing platform using some, all, or none of NetworkIP's underlying carriers. NetworkIP's customers maintain independent relationships with end user customers and/or third party distributors and retailers.

For the reasons discussed below, the Commission should grant the Ad Hoc Coalition's petition and determine that the current instructions for revenues from prepaid calling card services are invalid, clarify the revenue reporting rules applicable to prepaid cards consistent with the existing end-user contribution methodology, and amend the rules as necessary on a prospective basis.

I. THE WORKSHEET INSTRUCTIONS REQUIRING THE REPORTING OF PREPAID CARD REVENUES AS "END-USER" REVENUES AND AT "FACE VALUE" NOT ENFORCEABLE

The Ad Hoc Coalition accurately argues that the instructions requiring prepaid card revenue to be reported as "end-user" revenue and at the "face value" of cards constitute a substantive rule that was adopted without the notice and comment or Federal Register publication required by the Administrative Procedure Act ("APA").⁴ NetworkIP fully supports Ad Hoc Coalition's arguments, and also draws the Commission's attention to the analysis of this issue in the IDT Appeal.⁵

In addition, NetworkIP supports the Ad Hoc Coalition's observation that these instructions are invalid because they conflict with the end-user contribution mechanism that the

⁴ Ad Hoc Petition at 11.

⁵ See *supra* note 2. See also Request for Review of Decision of the Universal Service Administrator by IDT Corporation and IDT Telecom, WC Docket No. 06-122 (filed June 30, 2008) at 7-13.

Commission adopted.⁶ While the Instructions are not rules, because they were never adopted pursuant to the requirements of the APA, the Commission has validly adopted a number of “rules” for the universal service contribution system.⁷ First, the Commission has adopted a universal service contribution methodology based on *end-user telecommunications revenues*.⁸ Yet the Form 499-A instructions provide that “[a]ll prepaid card revenues are classified as end-user revenues,” whether those revenues result from sales to “customers, distributors or to retail establishments”⁹ – i.e., whether or not the revenues are in fact derived from end-user customers. The Commission has never discussed this issue in any order. The instructions thus result in an unsanctioned departure from the Commission’s adopted contribution methodology and cannot stand. The Commission cannot adopt an end-user contribution methodology in its rules and orders, and then release form instructions that apply a totally different contribution methodology to prepaid card revenues.¹⁰

⁶ Ad Hoc Petition at 11.

⁷ See generally *Central Texas Telephone Cooperative v. FCC*, 402 F.3d 205, 210-11 (D.C. Cir. 2005) (discussing the status of FCC rulemaking “orders” as rules under the APA).

⁸ See generally Ad Hoc Petition at 12-13 (citing and discussing authorities).

⁹ FCC Form 499-A, Instructions (2009) at 27-28.

¹⁰ While Commission may “clarify” an existing rule without a notice and comment rulemaking, any “substantive changes in prior regulations” are subject to APA notice and comment procedures. 5 U.S.C. § 553(c); *Sprint Corp. v. FCC*, 315 F.3d 369, 374 (D.C. Cir. 2003) (“when an agency changes the rules of the game. . . more than a clarification has occurred.”); see also *SBC Inc. v. FCC*, 414 F.3d 486, 501 n.8 (3d Cir. 2005) (“because the initial rule did not address the issue of sightlines over standing spectators, the subsequent interpretation of that rule to include such a requirement was really an adoption of a new regulation without notice and comment”, describing *Caruso v. Blockbuster-Sony Music Entertainment Centre*, 193 F.3d 730 (3d Cir. 1999)); *Caruso v. Blockbuster-Sony Music Entertainment Centre*, 968 F.Supp. 210, 216 (D.N.J. 1997), *aff’d in relevant part* 193 F.3d 730, 736-37 (3d Cir. 1999) (“[w]hen the ‘legislative history’ of an administrative regulation evinces an intent not to cover certain subject matter, the notice-and-comment requirements of the APA cannot be evaded merely by interpreting an existing regulation to cover subject matter consciously omitted from its scope.”);

(continued on next page)

In adopting the end-user approach, the Commission reviewed a number of different potential contribution methodologies and chose end-user revenues primarily because it avoided the double counting of revenues.¹¹ Indeed, the Commission concluded that, in order to comply with the statutory mandate for an “equitable and nondiscriminatory” contribution methodology, it “must assess contributions in a manner that eliminates the double payment problem.”¹² Thus, it is a statutory imperative for the contribution methodology to avoid double payment.

In fact, however, the gravest danger about the current instructions is that they could be read to impose a contribution obligation on *every entity in the distribution chain* for a card. First, the Instructions define a Prepaid Card provider as an entity that “provides prepaid calling card services by selling prepaid cards to the public, to distributors, or to retailers.” Under this definition, if a card were created by a carrier and sold to a distributor, who then sold it to a retailer, who then sold it to a member of the public, each entity would be deemed a prepaid card provider (and, presumably, be required to contribute). The 2009 revision to the Form Instructions are helpful by clarifying that “[c]ompanies that do not assign PINs but rather sell cards created by others are marketing agents and do not file,”¹³ but this information was provided for the first time this year. Moreover, the instruction for reporting revenue on Line 411, the prepaid card category, still specifies that prepaid card revenue “includes revenues from

Shalala v. Guernsey Memorial Hosp., 514 U.S. 87 (1995) (agency may not modify a definitive interpretation of a regulation without notice and comment); *Alaska Professional Hunters Ass’n, Inc. v. FAA*, 177 F.3d 1030, 1034 (D.C. Cir. 1999) (same); *Paralyzed Veterans of America v. D.C. Arena*, 117 F.3d 579, 586 (D.C. Cir. 1997) (same).

¹¹ *USF First Report and Order*, 12 FCC Rcd at 9206-08 ¶¶ 843-849.

¹² *Id.* at 9206 ¶ 843.

¹³ FCC Form 499-A (2009), Instructions at 14. *Wireline Competition Bureau Announces Release of the Revised 2009 FCC Form 499-A and Accompanying Instructions*, Public Notice, DA 09-454 (rel. Feb. 25, 2009) (“2009 Public Notice”).

prepaid calling cards provided either to customers, distributors, or to retail establishments”¹⁴ – again suggesting that every entity in a card’s distribution chain should be reporting their revenue on this line.

NetworkIP assumes that the Instructions with regard to prepaid card revenue are intended to prevent prepaid card providers from claiming that their distributors should be paying instead of them. The contribution obligation must lie clearly on one party, however, and the Instructions historically have created the threat that multiple entities in the distribution chain of a card will face a contribution obligation. This threat runs counter to the Commission’s stated intention of requiring contribution only on end-user revenue, and thus violates the statutory mandate for an “equitable and nondiscriminatory” contribution mechanism.

The instructions also compound the risk that USAC or an auditor would use them to require recovery from multiple entities in the distribution chain of a prepaid card by requiring that prepaid calling card revenues be reported “at the face value of the card”¹⁵ – that is, filers are directed to report “the amounts actually paid by end user customers and not the amounts paid by distributors or retailers, and [reported revenues] should not be reduced or adjusted for discounts provided to distributors or retail establishments.”¹⁶ Thus, not only might the instructions be used to justify requiring reporting (and thus contribution) by multiple entities for the same card, but they could be used to justify contributions by all such entities at the price paid by the ultimate consumer of the card, even though entities at earlier stages in the process would have received substantially less revenue.

¹⁴ *Id.* At 27.

¹⁵ FCC Form 499-A (2009) at 6, Line 411.

¹⁶ FCC Form 499-A (2009), Instructions at 27.

The Ad Hoc Coalition correctly depicts the “face value” reporting instruction as discriminatory.¹⁷ As the Ad Hoc Coalition notes, wholesale prepaid card providers often “receive less than the value of the card, but must nonetheless report the entire value of the card as if it was actually received.”¹⁸ As the Petition points out, this approach is inconsistent with the Instructions’ treatment of similar situations, such as bad debt – “other carriers are entitled to deduct uncollected debt from their total reported revenues.”¹⁹ This result also is contrary to the Commission’s mandate under Section 254(d) of the Act to impose contribution obligations on “an equitable and nondiscriminatory basis.”²⁰

The instructions purporting to require the reporting of prepaid card revenue as “end-user” revenue and at “face value” were adopted without regard to the notice and comment requirements of the APA, and they conflict with fundamental statutory principles and Commission decisions for the universal service contribution mechanism. Thus, they cannot be enforced.²¹

¹⁷ Ad Hoc Petition at 13.

¹⁸ Ad Hoc Petition at 13.

¹⁹ Ad Hoc Petition at 14.

²⁰ 47 U.S.C. § 254(d).

²¹ See *Universal Service Contribution Methodology, Petition for Declaratory Ruling of CTIA—The Wireless Association on Universal Service Contribution Obligations; Petition for Declaratory Ruling of Cingular Wireless LLC*, WC Docket No. 06-122, Declaratory Order, 23 FCC Rcd 1411 at ¶ Section I (2007) (“Although the definition of toll service reflected in the FCC Form 499 instructions predates the *2006 Contribution Methodology Order*, we recognize that the Commission had not addressed the application of that definition to wireless services prior to that order. Thus, we agree with CTIA that the definition of wireless toll services applies from the effective date that order.”).

II. EVEN IF VALID, THE WORKSHEET INSTRUCTIONS ARE IMPOSSIBLE TO APPLY IN PRACTICE

Not only are the Worksheet instructions for reporting prepaid card revenue legally unenforceable, they are also impossible to apply in practice. For this reason, too, the Commission must take the opportunity presented in the Ad Hoc Coalition's petition to issue a declaratory rulemaking to establish workable reporting standards for prepaid card revenues.

The instruction to report prepaid card revenue at the "face value" of a card is in many situations today impossible to implement. Because of the cost fluctuations and market trends toward products that are more transparent to the customer, some of the service providers who are utilizing NetworkIP's virtual services solution are creating and marketing prepaid cards that no longer have a "face value." For example, one of the largest grocery retail chains in the US is currently selling prepaid phone cards provided by one of the service providers utilizing NetworkIP's virtual services solution that only have the number of domestic minutes printed on the cards. This has allowed them to print millions of cards (saving printing cost) without the possible waste of obsolete product due to cost changes related to industry or regulatory changes. Printing cards that included both the face value and minutes (i.e. \$5 and 100 minutes) would make it impossible or confusing to the consumer to adjust the value of the cards if cost changes needed to be passed on to the consumer. Also, the retailer wanted to take a leadership position in making the products it sells to the consumer simple and absolutely guarantee the consumer they would receive the advertised minutes on the card. The final sales price for a card is not printed on the card, but instead is to be on a price tag or sales rack end cap like the price for any other retail product, and is expected to change while the card sits on the rack during promotional sales or due to costs changes being passed on to the consumer.

These innovations clearly improve the prepaid card marketplace, yet reporting prepaid card revenue at the “face value of the card” on these types of products is impossible from a practical perspective.²²

III. THE COMMISSION SHOULD CLARIFY THE REVENUE REPORTING RULES APPLICABLE TO PREPAID CARDS UNDER THE CURRENT RULES, AND AMEND THE RULES AS NECESSARY GOING FORWARD

NetworkIP recognizes that assessing end-user revenues can present unique difficulties in the prepaid card context. The prepaid card market is complex and characterized by a variety of different players that package and sell different combinations of services at a variety of levels in the distribution chain. Prepaid cards are often sold to consumers by non-carriers; however, given the Commission’s exercise of its permissive authority to assess contributions from non-carrier providers of telecommunications, an entity’s status as a carrier does not definitively indicate whether it will (or will not) be expected to contribute. The prepaid card market also is constantly evolving, and today it is impractical to require telecommunications carriers higher up in the prepaid card distribution chain to have the ability to know the “face value” for which a prepaid card ultimately is sold.²³

²² In the context of the IDT Appeal, AT&T asserted that it obtains face-value information from distributors and retailers of its prepaid cards. Comments of AT&T Inc. on Request for Review of Decision of the Universal Service Administrator by IDT Corporation, CC Docket No. 96-45 [sic] (filed Sept. 5, 2008) at 6. To require that all prepaid card providers do so, however, would significantly limit distribution options for prepaid cards, particularly to small and family-run retailers like convenience stores, which will not be able to track face value for every card sold. Also, such a requirement would compromise retailers’ ability to market cards with “face values” expressed in minutes rather than dollars, to the ultimate detriment of consumers.

²³ See *supra* Section II.

Unquestionably, the Commission must implement contribution requirements that prevent prepaid card providers from shirking their obligation to contribute to universal service. The Commission must do so, however, through proper legal processes and in a way that is consistent with the statutory requirement for an equitable and non-discriminatory contribution mechanism – as well as a way that is consistent with the realities of the marketplace.

With all of this in mind, the Commission should issue the requested declaratory ruling that the Form Instructions with regard to “end-user” and “face-value” reporting for prepaid card revenue have conflicted with APA requirements and fundamental USF contribution principles and thus cannot be enforced. The Commission further should prospectively establish an equitable and nondiscriminatory prepaid card contribution mechanism through an APA-compliant rulemaking process. That mechanism should include a rule that prepaid card providers’ revenues will be on the basis of the revenue received by the last telecommunications carrier in the distribution chain. Such rule will ensure that USF contributions are based on the full amount of revenue received by telecommunications carriers for the sale of prepaid cards. Additional revenues received by non-carrier distributors (i.e., mark-up amounts) are not telecommunications revenues and are not appropriately assessed for USF contributions.²⁴

²⁴ 47 U.S.C. § 254(d) (limiting the FCC’s jurisdiction to impose USF contribution obligations to providers of telecommunications).

CONCLUSION

NetworkIP urges the Commission to undertake wholesale reform of the prepaid card contribution process and, in the interim, to grant the Ad Hoc Coalition's petition to the extent described herein.

Respectfully submitted,

**NETWORK ENHANCED TELECOM, LLP,
DBA NETWORKIP**

By: _____/s/_____
Pete Pattullo
Chief Executive Officer
Toni Van Burkleo
Chief Financial Officer
Jennifer Begin
Regulatory Manager
119 W. Tyler Street, Suite 100
Longview, Texas 75601

June 22, 2009