

REDACTED FOR PUBLIC INSPECTION

Before the  
Federal Communications Commission  
Washington, DC 20554

In the Matter of )

Request for Review by Network Enhanced )  
Telecom, LLP, of Decision of Universal )  
Service Administrator )

WC Docket No. 06-122

To: The Commission

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REQUEST FOR REVIEW OF NETWORK ENHANCED TELECOM, LLP  
OF A DECISION OF THE UNIVERSAL SERVICE ADMINISTRATOR  
IN A CONTRIBUTOR AUDIT

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**SUMMARY**

Network Enhanced Telecom, LLP (“NetworkIP”) is a provider of sophisticated software solutions and wholesale long distance capacity to prepaid card providers. The Universal Service Administrative Company (“USAC”) Internal Audit Division conducted a contributor audit of NetworkIP in 2008. Detailed Audit Finding #2 (“Finding #2”) in the Audit Report erroneously concluded that NetworkIP’s platform service offering constitutes prepaid card services, and that NetworkIP’s reseller certifications were invalid. Because NetworkIP’s platform service offering is in no way consistent with the definition of prepaid card service, and because NetworkIP had reasonable reseller certification procedures in place, its revenue was properly reported as reseller telecommunications revenue on Line 311. In these respects, then, Finding #2 is in error.

NetworkIP’s platform offering has none of the characteristics of prepaid card service, as defined in the Instructions or the Commission’s rules. It is not sold on a prepaid basis and is not a finished retail product. NetworkIP’s customers (who are in fact prepaid card providers) control the price of the cards, the number of minutes on the cards and the rate at which value and minutes are decremented, and assign the cards’ personal identification numbers (“PINs”).

NetworkIP also had a reasonable expectation that its customers were contributors, and thus appropriately reported revenue in the reseller category. NetworkIP had performed due diligence by obtaining detailed certification forms from its carrier customers clarifying that the customers were contributors and requiring the customers to notify NetworkIP of any change in their contributor status. These certifications included the crucial information set out in the Form 499-A Instructions during the audit period.

Further, USAC exceeded its authority in concluding that NetworkIP’s platform service offering was equivalent to prepaid card service. This issue, which the Commission has never addressed, clearly required considerable “interpretation” in contravention of section 54.702(c) of the Commission’s rules.

Even if the Commission somehow concludes that NetworkIP’s platform offering constitutes prepaid card service, as defined in the Instructions, NetworkIP cannot be required to report such revenue as end-user revenue, or to report it at the face value of the cards, because the Instructions that so require are invalid. These Instructions directly conflict with statutory provisions limiting Commission authority to collect contributions to telecommunications revenues and requiring that contributions be assessed on an equitable and non-discriminatory basis. They further conflict with validly adopted Commission rules and orders requiring that contributions be assessed based on end-user, collected revenues. Finally, these Instructions were never subjected to the mandatory process under the Administrative Procedure Act, and thus are not valid rules.

For all of these reasons, the Commission should reverse the conclusions in Finding #2 of the Audit Report that NetworkIP’s platform revenue must be reported as prepaid card revenue and that it lacked adequate documentation to report revenue in the reseller category.

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**REQUEST FOR REVIEW OF NETWORK ENHANCED TELECOM, LLP, OF  
DECISION OF UNIVERSAL SERVICE ADMINISTRATOR IN CONTRIBUTOR  
AUDIT**

Network Enhanced Telecom, LLP (“NetworkIP”) hereby requests review, pursuant to sections 54.719 – 54.725 of the Commission’s Rules, of the final report of an audit performed by the Universal Service Administrative Company (“USAC”) of NetworkIP’s FCC Form 499-A filings for calendar years 2005 and 2006 (due April 1, 2006 and April 1, 2007, respectively).<sup>1</sup> Detailed Audit Finding #2 (“Finding #2”) in the Audit Report erroneously concludes that NetworkIP’s platform service offering constitutes prepaid card services, and that NetworkIP’s reseller certifications were invalid.<sup>2</sup> For the reasons discussed herein, these findings should be reversed.

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<sup>1</sup> Independent Auditor’s Report of Network Enhanced Telecom, LLP (USAC Audit No. CR2008CP001), transmitted by letter from Brandon Ruffley, Staff Internal Auditor, to Toni Van Burkleo, Chief Financial Officer, NetworkIP, dated April 29, 2009 (the “Audit Report”) (attached). The transmittal letter indicates that the Audit Report was approved by the USAC Board of Directors on April 23, 2009. Review of the Board’s action is requested pursuant to 47 C.F.R. §§ 54.719(c) and 54.722(a). *See also* 47 C.F.R. §§ 54.723(b), 54.724(b).

<sup>2</sup> Audit Report at 16-36. NetworkIP is not seeking review of the other findings in the Audit Report (including the conclusion in Finding #2 regarding Tandem Revenue), and has amended its Forms 499-A accordingly.

## **I. BACKGROUND**

### **A. NetworkIP and Its Offerings**

NetworkIP is a small, entrepreneurial provider of sophisticated computer software applications and other services offered to carriers that create and sell prepaid calling cards. NetworkIP's universe of potential customers – carriers that provide calling cards – need two fundamental inputs into their service: First, they need the switching and processing capability to manage and provision calling cards. This includes the ability to assign personal identification numbers (“PINs”) to cards and to determine the prices of cards, the number of minutes they will provide, the rate at which value will be decremented, and other operational details such as potential limitations on geographic calling scope.<sup>3</sup> Second, carriers providing calling cards need long distance capacity (wholesale minutes) in order to provide customers with the ability to place calls.

NetworkIP offers its carrier customers both of these inputs for their calling card products. NetworkIP's proprietary platform allows its carrier customers to create their own prepaid card offerings using a web-based interface akin to “cloud computing,” minimizing the carrier's need to invest in physical infrastructure. Using NetworkIP's software platform, NetworkIP's customers can control how their own prepaid card offerings are structured, assign and manage PINs, add value to cards, and otherwise control the prepaid card offerings that they market to their own customers. NetworkIP's platform solution allows prepaid card providers to obtain, by contract through a web-based software solution, the capabilities that previously were available only through the purchase of a switch. Using NetworkIP's platform solution, carrier customers can provision cards by incorporating long distance minutes purchased from NetworkIP or other

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<sup>3</sup> For example, some prepaid cards only allow calling to particular geographic regions.

wholesale carriers, though most customers opt to purchase the platform capability together with wholesale capacity from NetworkIP at an attractive bundled rate. NetworkIP charges carrier customers for usage of the platform – whether they purchase it alone or in conjunction with wholesale long distance capacity – at per-minute rates. NetworkIP bills its carrier customers each week for service provided in the prior week (i.e., the platform service is *not* provided on a prepaid basis).

NetworkIP's carrier customers are all resellers of telecommunications services and thus telecommunications carriers in their own rights.<sup>4</sup> NetworkIP offers no material retail or consumer services.<sup>5</sup> The platform offering is not a finished retail product, but rather a complex interface designed for sophisticated carrier customers.

NetworkIP offers its platform services in a competitive environment. At least one other company besides NetworkIP offers a virtual platform that carriers can use to provision prepaid cards together with wholesale long distance capacity. In addition, at least one other entity offers a virtual platform on a standalone basis, which prepaid card providers can combine with wholesale long distance capacity purchased from other carriers. The market also includes a handful of switching platform vendors that will install the platform capacity to provision prepaid cards on switches or other hardware that prepaid card providers own; prepaid card providers can then combine this capability with wholesale long distance capacity purchased from other

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<sup>4</sup> See 47 U.S.C. §§ 153(43), 153(44), 153(46).

<sup>5</sup> NetworkIP occasionally gives out free calling cards as promotional items at trade shows and other similar venues, and allows people to add value to such promotional cards through NetworkIP's website. This incidental recharging of free promotional cards – which amounts to less than 1% of NetworkIP's revenue – is NetworkIP's only retail service. NetworkIP has reported the nominal amount of revenue it obtains from this incidental end-user service as prepaid card revenue on Line 411.

carriers. According to the Commission's website, none of NetworkIP's platform competitors contributes to universal service.

**B. The USAC Audit**

In 2008, USAC's Internal Audit Division ("IAD") audited NetworkIP's Form 499-A filings for calendar years 2005 and 2006 (due April 1, 2006 and April 1, 2007, respectively). IAD provided its draft conclusions to NetworkIP in November 2008, and NetworkIP submitted a response to IAD on December 22, 2008. The USAC Board approved the final Audit Report, incorporating IAD's original findings, NetworkIP's response, IAD's reply to NetworkIP's response, and USAC Management's response, on April 23, 2009, and delivered it to NetworkIP on April 27, 2009.

The Audit Report is comprised of three Detailed Audit Findings. Of these, NetworkIP requests review of only that portion of Finding #2 which concludes that **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** of NetworkIP's (un-assessable) wholesale revenue must be reclassified as (assessable) end-user revenue because NetworkIP "could not provide the proper documentation for [reseller] classification,"<sup>6</sup> and that **[BEGIN CONFIDENTIAL]** [REDACTED] **[END CONFIDENTIAL]** of that revenue should be reported as "Prepaid Card" revenue on Line 411 (reserved solely for reporting prepaid card revenue).

The classification of the revenue as "Prepaid Card" revenue has two significant consequences: It is treated as assessable end-user revenue, irrespective of the source,<sup>7</sup> and it must be reported at the "face value" of the cards, even though NetworkIP never received that

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<sup>6</sup> Audit Report at I8.

<sup>7</sup> See, e.g., FCC Form 499-A (2006), Instructions at 23 ("All prepaid card revenues are classified as end-user revenues.").

amount of revenue – because it did not sell the cards and indeed does not even know the face value of the cards unless the customer provides this information to NetworkIP.<sup>8</sup>

During the audit, USAC sought information about the “face value” of the cards provisioned over NetworkIP’s platform but NetworkIP has no accurate information on this issue.<sup>9</sup> Just as a wheat farmer has no information on the price of bread ultimately made from his crop, NetworkIP has no visibility into the prices for which its carrier customers sell their cards (unless the carrier customers choose to share such information with NetworkIP). In addition, there is no direct connection between the revenue that NetworkIP’s carrier customers receive when they sell their calling cards and the revenue that NetworkIP receives for its carrier customers’ use of its platform offering. Carrier customers sell cards on a prepaid basis at market-based prices, and receive all of their revenue for a card at the time a card is sold, before the card is ever used. In contrast, NetworkIP bills its carrier customers after the fact on a per-minute basis for usage of the platform capability and (if applicable) long distance capacity.

In the absence of any reliable “face value” information, USAC used an unreliable proxy to calculate a factor to “gross up” NetworkIP’s platform revenues to approximate face value. Specifically, USAC used a report compiling information that NetworkIP’s carrier customers had entered in a field in NetworkIP’s platform that some carrier customers use to track the sale price of cards for their own purposes, but other customers use for other purposes. For example, some carrier customers use this field to track the price they print on the face of prepaid cards, even

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<sup>8</sup> FCC Form 499-A (all years), Line 411 (prepaid card revenue must be “reported at the face value of the card.”). *See also, e.g.*, FCC Form 499-A (2006), Instructions at 23 (prepaid card revenues must reflect “the amounts actually paid by customers and not the amounts paid by distributors or retailers, and should not be reduced or adjusted for discounts provided to distributors or retail establishments.”).

<sup>9</sup> Audit Report at 18 (IAD), 34-35 (USAC Management).

though their marketing strategy involves routinely selling cards to end-user customers for less than this amount.<sup>10</sup> Other carrier customers use NetworkIP's platform to market post-paid calling cards, and use this field to track their end users' credit limits (which customers may never come close to reaching). NetworkIP advised USAC of these flaws, but USAC nevertheless determined that the report represented the "best information" available to estimate face value.<sup>11</sup> Based on this report, USAC calculated a "face value percentage of 52.35%" which it applied to that portion of NetworkIP's revenue that it had determined should be classified as "prepaid card revenue."

The Audit Report thus requires NetworkIP to report the majority of its wholesale revenue as end-user revenue. It further requires NetworkIP to report the majority of its revenue at a value more than half again the amount that NetworkIP actually received and that appears on NetworkIP's general ledger.

As described in detail below, USAC erred with respect to these aspects of Audit Finding #2 because NetworkIP has no revenue that is properly classified as prepaid card revenue, and its reseller certification procedures were compliant.

### **C. Standard of Review**

On review, actions of the USAC Board are entitled to no deference from the Commission; rather, the Commission reviews USAC Board decisions *de novo*.<sup>12</sup> The Commission must resolve requests for review of USAC decisions within 90 days.<sup>13</sup>

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<sup>10</sup> As a result, this "face value" amount would reflect more than "the amounts actually paid by customers." FCC Form 499-A (2006), Instructions at 23.

<sup>11</sup> Audit Report at 34 (USAC Management).

<sup>12</sup> 47 C.F.R. § 54.723.

<sup>13</sup> 47 C.F.R. § 54.724.

**II. NETWORKIP'S PLATFORM SERVICE OFFERING IS NOT PREPAID CARD SERVICE AND NETWORKIP IS NOT A PREPAID CARD PROVIDER**

*None* of NetworkIP's platform service revenue is properly classified as prepaid card revenue on Line 411. NetworkIP does not sell prepaid cards to its carrier customers, and its platform offering is not a prepaid card service.

NetworkIP's platform offering has none of the characteristics of prepaid card service, as described in the Instructions to FCC Form 499-A. The Instructions for reporting prepaid card revenue in the 2005, 2006, and 2007 versions of the form state the following:

This line should include revenues from prepaid calling cards provided either to customers, distributors or to retail establishments.<sup>14</sup>

The 2006 and subsequent versions of the Form further elaborate as follows:

Prepaid card includes prepaid service where the customer utilizes the service provider's switching platform and a personal identification number (PIN) for purposes of verification and billing, even if the customer does not receive a physical card.<sup>15</sup>

NetworkIP has no revenue that fits these definitions. First, NetworkIP does not sell any calling cards.<sup>16</sup> Second, NetworkIP does not sell any services on a "prepaid" basis. As NetworkIP informed the auditors, NetworkIP bills all of its customers after the fact based on the amount of services they use. It is, of course, nonsensical to categorize revenue from a post-paid service as "*prepaid card*" revenue.

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<sup>14</sup> FCC Form 499-A (2007), Instructions at 27; FCC Form 499-A (2006), Instructions at 23.

<sup>15</sup> FCC Form 499-A (2007), Instructions at 27 (internal citation omitted).

<sup>16</sup> *But see supra* note 5 (discussing de minimis prepaid card revenues that NetworkIP receives from incidental recharges of free cards distributed as promotional items).

Third, it is inaccurate to characterize NetworkIP's platform offering as the functional equivalent of a prepaid card through the use of a switching platform and a PIN. NetworkIP's platform offering is not a finished prepaid calling service, but rather an input that carrier customer use in the provision of their own prepaid card offerings. The interface through which NetworkIP's carrier customers access the platform would be useless to a retail consumer. It does not provide the carrier customer with the ability to place calls. Rather, NetworkIP's carrier customers use NetworkIP's platform to create their own prepaid card offerings, and the carrier customers assign PINs which *their customers* use to place calls. NetworkIP's virtual switching platform allows its carrier customers to control and manage the application software, billing and back office support. NetworkIP's customers, in turn, maintain their own relationships with third-party distributors and retailers or end users. Thus, NetworkIP provides services to prepaid card providers, but its platform offering is not service.

Classifying NetworkIP's revenues in the prepaid card category is also incorrect because NetworkIP does not meet the definition of a prepaid card provider. The 2006 Instructions define a prepaid card provider as an entity that:

[P]rovides prepaid calling card services by selling prepaid calling cards to the public, to distributors or to retailers. Prepaid card providers typically resell the toll service of other carriers and determine the price of the service by setting the price of the card and controlling the number of minutes that the card can be used for.<sup>17</sup>

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<sup>17</sup> FCC Form 499-A (2006), Instructions at 13. On October 31, 2006 (just two months before the end of the two-year audit period), the FCC codified definitions of "prepaid calling card" and "prepaid calling card provider" in 47 C.F.R. § 64.5000. *Regulation of Prepaid Calling Card Services*, WC Docket No. 06-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290 (2006) ("*Enhanced Card Order*"), *remanded in part on other grounds, Qwest Services Corp. v. FCC*, 509 F.3d 531 (D.C. Cir. 2007). *See also* 71 Fed. Reg. 43667 (2006) (setting effective date). Because the FCC did not mention the Form Instructions in adopting this rule, modify the Form Instructions in any way in light of it, or submit this rule for OMB approval as required by (continued on next page)

This definition does not describe NetworkIP. As noted above, NetworkIP does not sell calling cards to anyone.<sup>18</sup> NetworkIP's platform offering is not a retail calling card product.<sup>19</sup> Further, NetworkIP does not sell any service on a "prepaid" basis – it bills its customers after the fact. As also discussed above, it is the customers, and *not* NetworkIP, that "determine the price of the service by setting the price of the card and controlling the number of minutes that the card can be used for."<sup>20</sup>

The definition in the 2007 version of the Form is identical to the above but adds the following sentence between the first and second sentences:

Prepaid card providers provide consumers the ability to place long distance calls without presubscribing to an interexchange carrier or using a credit card.<sup>21</sup>

This additional language further demonstrates that NetworkIP is not a prepaid card provider. NetworkIP's platform offering does not provide its carrier customers with the ability to "place long distance calls" at all; rather, it allows those carrier customers to provision their own calling card offerings, which in turn provide the carrier customers' end users with the ability

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44 U.S.C. § 3507, NetworkIP assumes it is irrelevant to contributor revenue reporting. Nevertheless, given that the section 64.5000 definition does not differ materially from the definition in the Instructions, NetworkIP believes for all of the reasons stated herein that its platform offering is inconsistent with this definition as well.

<sup>18</sup> *But see supra* note 5 (discussing de minimis prepaid card revenues that NetworkIP receives from incidental recharges of free cards distributed as promotional items).

<sup>19</sup> *See supra* Section I.A.

<sup>20</sup> *Id.*

<sup>21</sup> FCC Form 499-A (2007), Instructions at 14. The 2007 Instructions were approved by OMB on March 19, 2007, almost 3 months after the conclusion of the audit period. *Wireline Competition Bureau Announces OMB Approval of the 2007 FCC Form 499-A*, Public Notice, 22 FCC Rcd 5356 (WCB 2007). NetworkIP cannot be required to comply with information collection or reporting requirements prior to OMB approval. 44 U.S.C. § 3507.

to place long distance calls. Further, carrier customers that buy NetworkIP's platform services must select an interexchange carrier's service (either NetworkIP's or another long distance carrier's) in order to use NetworkIP's services – thus, the platform offering does not allow customers to make calls “without presubscribing to an interexchange carrier.”<sup>22</sup>

The control that NetworkIP's customers exert over the prepaid card products that they provision using NetworkIP's platform includes assigning the PINs for the cards. The Commission did not spell out the significance of assigning PINs in earlier versions of the Form 499-A Instructions, but staff recently clarified its importance. Specifically, in a Public Notice released in conjunction with the release of the 2009 Form 499-A, the Commission staff described “nonsubstantive clarifications” to the form's instructions.<sup>23</sup> Among the clarifications is an addition to the definition of the category “Prepaid Card provider” which makes clear that *prepaid card providers assign cards' PINs, while entities that do not assign PINs are not prepaid card providers.*<sup>24</sup> Because NetworkIP does not assign PINs its carrier customers, it is not a prepaid card provider, and thus does not have prepaid card revenue.<sup>25</sup> Because the 2009 changes were merely “nonsubstantive clarifications to ensure that all contributors are properly reporting

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<sup>22</sup> In order to develop prepaid card offerings using NetworkIP's suite of services, a customer must have an existing contract to purchase long distance service – either from NetworkIP or from another carrier – in order to bundle that long distance service into its own prepaid offerings. NetworkIP's billing platform will not allow a customer to purchase service without specifying a long distance carrier in advance.

<sup>23</sup> *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”).

<sup>24</sup> 2009 Public Notice at 1. See also FCC Form 499-A (2009), Instructions at 14.

<sup>25</sup> See *supra* note 5.

revenues and are treating similar revenues uniformly,”<sup>26</sup> they should apply with equal force to the earlier periods for which NetworkIP was audited.<sup>27</sup>

NetworkIP raised the arguments above in its response to the initial IAD audit report, but USAC apparently believes that, because NetworkIP’s *carrier customers* were selling prepaid card services, it must be true that *NetworkIP* was selling prepaid card services. Both IAD’s and USAC Management’s responses place great weight on the fact that USAC did not believe that most of NetworkIP’s customers were properly classified as resellers.<sup>28</sup> USAC seems to assume that, if NetworkIP’s customers must be *classified* as end users *on NetworkIP’s Forms 499-A*,<sup>29</sup> then those customers cannot *be* prepaid card providers in their own right – such that no carrier will be responsible for reporting the revenue from the prepaid cards that NetworkIP’s customers sell. But Wireline Competition Bureau (“Bureau”) precedent is to the contrary. Specifically, the Bureau has held that a wholesaler’s obligation to treat a customer as an end-user because of reseller certification deficiencies “does not alter *resellers’* fundamental obligation, under the Act and the Commission’s rules, to report their end-user revenues and contribute to the Fund.”<sup>30</sup> Other cases reach the same result.<sup>31</sup> Thus, NetworkIP’s carrier customers would still be required

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<sup>26</sup> 2009 Public Notice at 1.

<sup>27</sup> If the changes were more than mere “nonsubstantive clarifications,” they are invalid absent prior notice and comment. *See infra* Section V.

<sup>28</sup> *See* Audit Report at 32-33 (IAD response) and 34 (USAC Management response) (“IAD did not reclassify any prepaid card revenue that was sold directly to USF contributors”).

<sup>29</sup> NetworkIP generally disputes the reclassification of its wholesale customers as end users. *See infra* Section III.

<sup>30</sup> *Petition for Review of American Cyber Corp. et al.*, Order, 22 FCC Rcd 4925, 4929-30 ¶ 16 (WCB 2007) (emphasis in original).

<sup>31</sup> *See, e.g., American Telecommunications Systems, Inc.*, Order, 22 FCC Rcd 5009 (WCB 2007).

to contribute as prepaid card providers<sup>32</sup> even if they had to be treated as end users on NetworkIP's Forms 499-A, and this issue should have no bearing on whether NetworkIP's revenue must be classified as prepaid card.

Indeed, this is a logical result. Even if USAC were correct that NetworkIP's reseller certification procedures were inadequate (which it is not<sup>33</sup>), this would not magically transform the nature of NetworkIP's offering into a prepaid card service when it has no characteristics of one. At best, this would justify reporting of the revenue as Ordinary Long Distance (Line 414) or Other Long Distance Services (Line 471).<sup>34</sup>

Further, USAC management acknowledges that NetworkIP's platform allows Network IP's customers to assign card PIN numbers and define the number of minutes on each card, the rate at which incremental usage is debited against the valued of the card, and the price on the card.<sup>35</sup> Nevertheless, USAC management concludes that the "*final end users* of [NetworkIP's]

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<sup>32</sup> There is no serious question that NetworkIP's carrier customers are prepaid card providers: They sell actual and virtual prepaid calling cards, FCC Form 499-A (2007), Instructions at 27, providing consumers with the ability to place long distance calls without presubscribing to an interexchange carrier or using a credit card. FCC Form 499-A (2006), Instructions at 13. They resell the toll service of other carriers and determine the price of the service by setting the price of the card and controlling the number of minutes that the card can be used for. *Id.* They assign the PINs for the cards. *2009 Public Notice* at 2.

<sup>33</sup> NetworkIP also disputes USAC's rejection of NetworkIP's reseller certification procedures. *See infra* Section III.

<sup>34</sup> Such reporting would be in the amount of NetworkIP's actual revenues, not at the "face value" of the cards. *See supra.* NetworkIP reported its platform revenues as telecommunications, even though the platform, which as described above allows its customers to fashion prepaid offerings, is best classified as an information service. However, NetworkIP's pricing model does not readily allow unbundling of the information service component from the prepaid minutes. Thus, pursuant to the safe harbor for reporting revenue for offerings that bundle information service and telecommunications components, NetworkIP reported all of the revenues as telecommunications on Line 311. *See* FCC Form 499-A (2007), Instructions at 29.

<sup>35</sup> Audit Report at 34.

platform are still receiving a prepaid calling card service.”<sup>36</sup> As noted above, however, this is irrelevant to the classification of NetworkIP’s revenues as prepaid card. Just because NetworkIP’s *customers* are controlling and selling prepaid card services does not mean that NetworkIP’s sale of *components* of prepaid card offerings is itself a prepaid card offering.

USAC also relies on the irrelevant fact that NetworkIP’s offerings constitute a telecommunications service.<sup>37</sup> This is not in dispute; NetworkIP reported this revenue on Line 311, a line for reporting telecommunications revenue.<sup>38</sup> The Audit Report, however, would require NetworkIP to report this revenue on Line 411, which is reserved solely for reporting *prepaid card* revenues.<sup>39</sup> The fact that NetworkIP’s offering is a telecommunications service does not make it a prepaid card service. That must be determined based on the nature of NetworkIP’s services – which, as discussed above, is in no way consistent with prepaid card.

In other respects, USAC apparently misapprehends NetworkIP’s platform service offering. Most significantly, USAC Management asserts that NetworkIP’s virtual platform “provides the traditional services of a prepaid calling card provider.”<sup>40</sup> As discussed above, this is simply inaccurate. NetworkIP’s virtual platform solution would be of no use to a consumer wishing to purchase a prepaid card; it is designed solely for sophisticated carrier customers wishing to create their own prepaid card offerings. It is *not* NetworkIP’s customers that access

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<sup>36</sup> Audit Report at 34 (emphasis added).

<sup>37</sup> Audit Report at 33 & n.64 (IAD, quoting the definition of telecommunications); Audit report at 34 n.65 (USAC management, citing the definition of telecommunications).

<sup>38</sup> See *supra* note 34.

<sup>39</sup> Audit Report at 18. It also triggers the Instruction that the revenue be reported at the “face value” of the card – substantially more than NetworkIP actually received. See *supra*.

<sup>40</sup> Audit Report at 34.

telecommunications services via a PIN through NetworkIP's platform<sup>41</sup> – it is NetworkIP's carrier customers' *end users* who do so. USAC also apparently believed that NetworkIP allowed its carrier customers' cards to be recharged on NetworkIP's website,<sup>42</sup> but this is incorrect. NetworkIP provides a link on its website allowing end users to recharge promotional calling cards, which it sometimes gives away for free at trade shows and similar events, but cards provisioned by NetworkIP's carrier customers cannot be recharged there.<sup>43</sup> NetworkIP's carrier customers provide their own means for their end users to recharge the cards that the carrier customers provision using NetworkIP's platform, such as through telephone numbers or websites that the customers themselves provide.<sup>44</sup>

NetworkIP recognizes 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.<sup>45</sup> But the Instructions' solution to this problem is to place the contribution responsibility on the carrier that *controls* the prepaid card.<sup>46</sup> There simply is no support in the

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<sup>41</sup> See Audit Report at 34 (“the customer ... uses a [PIN] for purposes of verification and billing”).

<sup>42</sup> “Calling cards may be recharged on the Carrier’s own website.” Audit Report at 33.

<sup>43</sup> See *supra* note 5. The revenue from these recharges of NetworkIP promotional cards is incidental, amounting to less than 1% of NetworkIP’s total revenue.

<sup>44</sup> NetworkIP provides its carrier customers with an Application Programming Interface (API) for the customers to connect their own websites or other systems to NetworkIP’s system for this purpose.

<sup>45</sup> See, e.g., FCC Form 499-A, Instructions at 23 (“This line should include revenues from prepaid calling cards provided either to customers or to retail establishments. Gross billed revenues should represent the amounts actually paid by customers and not the amounts paid by distributors or retailers.”).

<sup>46</sup> See, e.g., FCC Form 499-A, Instructions at 13 (prepaid card providers “determine the price of the service by setting the price of the card and controlling the number of minutes that the card can be used for.”) See also 2009 Public Notice at 1 (prepaid card providers “assign personal identification numbers (PINs), and providers that do not assign PINs but sell cards created by others are marketing agents that do not file.”)

Instructions (or anywhere else) for the Audit Report's decision to reach *beyond* the provider of the prepaid card, and attempt to impose a contribution obligation on a software platform for prepaid card providers, outside of the card distribution chain altogether.

In sum, USAC's conclusion that NetworkIP's revenue from its prepaid service platform offering must be reported as prepaid card revenue was incorrect and must be reversed.

### **III. NETWORKIP REASONABLY EXPECTED THAT ITS CUSTOMERS WERE RESELLERS**

The Audit Report concluded that NetworkIP did not have adequate procedures to ensure that it reported as revenue from resellers only revenue from customers that "reasonably would be expected to contribute to support universal service."<sup>47</sup> USAC therefore reclassified the bulk of NetworkIP's revenue from the (unassessable) "carrier's carrier" category to the (assessable) "end-user" category.<sup>48</sup> For the reasons discussed below, NetworkIP's reseller certification procedures were more than adequate, and the Audit Report's conclusions must be reversed.

As the Audit Report accurately states, the "risk of revenue reclassification is ... on filers who cannot establish a *reasonable basis* for their expectation that resellers would contribute to support USF."<sup>49</sup> Significantly, the Instructions require that each filer implement "procedures to ensure that it reports as 'revenues from resellers' only revenues from entities that *reasonably would be expected* to contribute to support universal service."<sup>50</sup> As the Bureau has stated, it is

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<sup>47</sup> Audit Report at 17-18 (IAD), 35 (Management), *quoting* FCC Form 499-A (2005), Instructions at 18; FCC Form 499-A (2006), Instructions at 17.

<sup>48</sup> *Id.*

<sup>49</sup> Audit Report at 35 (emphasis added). *See also* FCC Form 499-A (2006), Instructions at 17 ("Each filer should have documented procedures to ensure that it reports as 'revenues from resellers' only revenues from entities that *reasonably would be expected* to contribute to support universal service.") (emphasis added).

<sup>50</sup> FCC Form 499-A (2006), Instructions at 17 (emphasis added).

filers' obligation to "perform due diligence to help ensure that all end-user revenues are captured."<sup>51</sup>

Neither the Commission's rules nor any Commission order has ever discussed how these standards are to be met. In 2002, however, the following language was added to the Instructions to FCC Form 499-A, and this same language appeared in the 2005 and 2006 versions of the forms that were available to NetworkIP throughout the audit period:

Each filer should have documented procedures to ensure that it reports as "revenues from resellers" only revenues from entities that *reasonably would be expected* to contribute to support universal service. The procedures *should* include, but not be limited to, maintaining the following information on resellers: Filer 499 ID; legal name; address; name of a contact person; and phone number of the contact person. Filers shall provide this information to the Commission or the Administrator upon request. The filer *should* verify that each reseller will: 1) resell the filer's services in the form of telecommunications [and not as information services]; and 2) contribute directly to the federal universal service support mechanisms. If the filer does not have independent reason to know that the reseller satisfies these criteria, it should obtain a signed statement certifying that these criteria are met. Current contributors to universal service are identified at <http://gullfoss2.fcc.gov/cib/form499/499a.cfm>. Filers will be responsible for any additional universal service assessments that result if its customers must be reclassified as end users.<sup>52</sup>

During the audit period, NetworkIP had procedures in place that constituted "due diligence" to establish a "reasonable expectation" that most of its carrier customers were resellers, and were consistent with this instruction. Specifically, NetworkIP had obtained signed certifications<sup>53</sup> from most of its carrier customers that included the following:

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<sup>51</sup> *American Cyber Corp.*, 22 FCC Rcd at 4928 ¶ 15 (emphasis added).

<sup>52</sup> FCC Form 499-A (2006), Instructions at 17; FCC Form 499-A (2005), Instructions at 18 (emphasis added).

<sup>53</sup> Like the Form Instructions, NetworkIP's reseller certification forms evolved over time. Due to these changes, the certifications from its active customers during the audit period took 3 different forms. Copies of all 3 forms are attached in Exhibit E. One of the forms includes a line for customers to fill in an effective period for the form, but in all but a small number of cases this line was left blank. In any event, this form goes on to specify that the customer "will continue to  
(continued on next page)

- The customer's legal name, address, and contact telephone number.
- Certification that the customer is either a telecommunications carrier or a private service provider offering telecommunications for a fee and thus "contributes directly to the FUSF pursuant to FCC rules ... or provides the Services only to reseller carriers and Customer has obtained certifications that such reseller carriers comply with FUSF requirements."
- Notice to the customer of the customer's obligation to register and contribute, and that the certification is being requested to determine the customer's eligibility to be treated as a reseller for contribution purposes.
- Certification that the customer has registered with the FCC and filed a Form 499-A with USAC, and that the customer is "entitled to an exemption from NetworkIP billing Customer FUSF charges and related charges for Services that it purchases."
- In most cases, certification that the customer "will continue to file [Form 499] worksheets in the future as required by the FCC," or that the customer "will continue to file [revenue] worksheets or other forms of documentation as required by the FCC from time-to-time" and, in many cases, an obligation that the customer "submit an updated Exemption Certificate to Network IP ... if at any time Customer's certifications as contained herein are no longer accurate."

Samples of NetworkIP's reseller certification form are attached hereto as Exhibit E.

These certifications are more than sufficient to establish a "reasonable expectation" that the customers signing such certifications were contributors.

Nevertheless, USAC concluded that "approximately 85%" of NetworkIP's wholesale customers should be reclassified as end users because of inadequate certifications, though the Audit Report does not explain why.<sup>54</sup> Based on conversations with the auditors, NetworkIP believes that USAC rejected certifications that did not include the customer's Form 499 Filer ID number or were more than one year old, and that USAC also found fault with NetworkIP's failure to check the FCC's website to determine whether its customers were contributors (and retain record of having done so). But neither the Commission nor the Form Instructions has ever

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file [revenue] worksheets or other forms of documentation as required by the FCC from time-to-time"

<sup>54</sup> Audit Report at 18.

required any of these steps. The Instructions state that filers' procedures to verify their customers' reseller status "*should*" include the collection of a variety of information, including the customers' Form 499 Filer IDs.<sup>55</sup> But the use of the permissive "should" instead of the mandatory "must" or "shall" indicates a suggestion rather than a requirement.<sup>56</sup> NetworkIP's certification form required its customers to certify to the information that was central to the requirement – that the customers were themselves USF contributors. There is no basis in the rules or the Form Instructions applicable during the reporting period to deem NetworkIP's certifications invalid solely because some of them did not require customers to provide their Form 499 Filer IDs.

There is similarly no basis to reject certifications that were more than one year old. As noted above, NetworkIP's certification forms required its customers to certify that they "will continue to file [Form 499] worksheets *in the future* as required by the FCC," or that the customer "will continue to file [revenue] worksheets or other forms of documentation as required by the FCC from time-to-time," and in many cases imposed an affirmative duty on customers to notify NetworkIP in the event the information set out on the form changed.<sup>57</sup> Thus, NetworkIP made reasonable efforts to ensure, on a going-forward basis, that its certifications remained accurate. The FCC's rules, orders, and the Form Instructions were utterly silent regarding the frequency with which new certifications had to be obtained throughout the audit period.

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<sup>55</sup> FCC Form 499-A (2006), Instructions at 17; FCC Form 499-A (2005), Instructions at 18.

<sup>56</sup> See, e.g., *Hamlet v. United States*, 63 F.3d 1097, 1104 (Fed. Cir. 1995) (agency document "which stated that an employee's resignation 'should' be by written resignation was precatory and not mandatory"). Cf. *Appalachian Power v. EPA*, 135 F.3d 791, 807 (D.C. Cir. 1998) ("We have noted that when a statute uses the permissive 'may' rather than the mandatory 'shall,' this choice of language suggests that Congress intends to confer some discretion on the agency.").

<sup>57</sup> See *supra* note 53.

NetworkIP recognizes that it had an ongoing obligation to ensure that its certifications remained current, but adequately addressed this issue through the language of its certifications. Thus, there is no basis to impute an annual re-certification requirement for purposes of this audit.

Critically, the Instructions' current language requiring annual re-certification was not in the Instructions during the audit period. The 2007 version of the Form 499-A for the first time affirmatively described the reseller certification requirement as an "annual" obligation and states that new certifications must be obtained "each year."<sup>58</sup> The 2007 revisions also suggest somewhat more strongly that the procedures outlined in the Instruction (including *inter alia* obtaining customers' Form 499 Filer IDs) must be followed by stating for the first time that filers that "do not comply with the above procedures" may have reseller revenue treated as end-user revenue.<sup>59</sup>

Significantly, however, the 2007 version of the Form was not available to filers until March 19, 2007, nearly three months *after* the conclusion of the audit period.<sup>60</sup> This was also the date when OMB approved the 2007 version of the form.<sup>61</sup> NetworkIP cannot be held to an annual re-certification requirement that was not expressed until after the conclusion of the audit period, particularly when NetworkIP's certification program included reasonable alternative procedures to the same end – i.e., certification that customers would continue to file their own revenue reports and, in many cases, an affirmative obligation to notify NetworkIP of any change in the customers' status. NetworkIP also cannot be required to comply with any obligations to

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<sup>58</sup> FCC Form 499-A (2007), Instructions at 18.

<sup>59</sup> *Id.*

<sup>60</sup> *Wireline Competition Bureau Announces OMB Approval of the 2007 FCC Form 499-A*, Public Notice, 22 FCC Rcd 5356 (WCB 2007) (released March 19, 2007).

<sup>61</sup> *Id.*

collect, retain, or report on documents before OMB approval of the information collection.<sup>62</sup> Thus, NetworkIP's reseller certifications during 2005 and 2006 cannot be judged based on any new requirements imposed in the 2007 version of the Form.

During the audit period, the Form Instructions also identified the FCC's website for checking entities' status as contributors, but never stated that filers were under any obligation to check it.<sup>63</sup> Moreover, anyone who has ever attempted to use the website knows that it is frequently inaccurate – for example, entities are not listed as contributors on the website until after they have received *and paid* their first invoice from USAC, which often does not occur until more than six months after they have filed their first Form 499-A. The 2007 Instructions (released after the end of the audit period here) informed filers for the first time that they actually are permitted to rely on the website as part of their procedures to establish a reasonable expectation that their customers are contributors, but still imposed no obligation to check it.<sup>64</sup> Thus, even if NetworkIP's reseller certification procedures could be judged based on the more detailed 2007 Instructions (which they cannot),<sup>65</sup> there would be no basis to find them deficient based on any failure to check whether its customers were listed as contributors on the Commission's website.

Moreover, as NetworkIP explained at length to the auditors, NetworkIP has undertaken significant efforts to ensure that its customers understand their obligations as carriers to file

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<sup>62</sup> 44 U.S.C. § 3507.

<sup>63</sup> FCC Form 499-A (2005), Instructions at 18; FCC Form 499-A (2006), Instructions at 17 (“Current contributors to universal service are identified at <http://gullfoss2.fcc.gov/cib/form499/499a.cfm>.”). In contrast to the instructions regarding the factors discussed above, such as collecting Filer ID numbers, the Instructions did not even say that filers “should” check the website. *Id.*

<sup>64</sup> FCC Form 499-A (2007), Instructions at 19.

<sup>65</sup> *See supra* notes 60-62 and associated text.

revenue reports and contribute to universal service. These efforts, which have cost NetworkIP approximately a half a million dollars over three years, have included presentations at numerous prepaid card industry conferences explaining the legal requirements relevant to prepaid card providers, quarterly customer newsletters, and the production and distribution of information packets and checklists to its own customers and other prepaid card providers. In light of these extraordinary efforts, too, NetworkIP's customers "reasonably would have been expected to contribute" directly to universal service.

In sum, NetworkIP conducted "due diligence" by obtaining detailed certification forms, consistent with the Instructions in place during the audit period, to establish a "reasonable expectation" that its customers were contributors. The audit report was therefore incorrect to reclassify much of NetworkIP's reseller revenue as end-user revenue.

#### **IV. USAC EXCEEDED ITS AUTHORITY IN MAKING THE CONTESTED AUDIT FINDINGS**

USAC's conclusion that NetworkIP's platform service should be treated as prepaid card service inherently involved interpretations that were well beyond USAC's limited ministerial role.

The rules provide that:

USAC may not make policy, interpret unclear provisions of the statute or rules, or interpret the intent of Congress. Where the Act or the Commission's rules are unclear, or do not address a particular situation, USAC shall seek guidance from the Commission.<sup>66</sup>

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<sup>66</sup> 47 C.F.R. § 54.702(c).

The Commission has made clear that USAC “shall not interpret rules or statute,” and its function is “exclusively administrative.”<sup>67</sup>

As demonstrated in Section II, above, there is no way to determine based on the Commission’s rules or orders or the face of the Form Instructions that NetworkIP’s platform offering constitutes prepaid card service. NetworkIP has none of the characteristics of a prepaid card provider, and its platform offering has none of the characteristics of prepaid card service, as defined in the Form 499-A Instructions. Specifically:<sup>68</sup>

- NetworkIP’s platform offering does not involve the sale of calling cards, actual or virtual. Indeed, the platform offering is not a finished retail product at all.
- NetworkIP’s platform offering is not sold on a prepaid basis. All of NetworkIP’s customers pay for services after the fact.
- NetworkIP does not assign PINs.
- NetworkIP does not control the value of the cards.
- NetworkIP does not control the number of minutes on the cards.
- NetworkIP does not control the rate against which incremental usage is debited against the card.
- The platform offering does not permit customers to avoid presubscribing to a long distance carrier.

USAC took note of all of these facts, except the first.<sup>69</sup> USAC also acknowledged that these facts made NetworkIP’s offering inconsistent with the descriptions of prepaid card revenue

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<sup>67</sup> *Changes to the Board of Directors of the National Exchange Carrier Ass’n, Inc.; Federal-State Joint Board on Universal Service*, CC Docket Nos. 97-21 and 96-45, Third Report and Order, Fourth Order on Reconsideration, and Eighth Order on Reconsideration, 13 FCC Rcd 25058, 25067 ¶ 16 (1998) (“NECA Order”).

<sup>68</sup> For a more detailed discussion of each of these factors, *see supra* Section II.

<sup>69</sup> Audit Report at 33 (USAC IAD Response), 34 (USAC Management Response). USAC ignored the post-paid nature of NetworkIP’s service despite the fact that NetworkIP brought it to USAC’s attention. *See* Audit Report at 22 (quoting NetworkIP’s response to IAD’s initial audit report).