Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Comment Sought on Request for Universal Service	)	WC Docket No. 05-337
Policy Guidance Requested by the Universal	)	WC Docket No. 06-122
Service Administrative Company	)	CC Docket No. 96-45
	)	

COMMENTS OF STi PREPAID, LLC

STi Prepaid, LLC ("STi Prepaid"), by its attorneys, respectfully submits these comments in response to the Public Notice issued by the Federal Communications Commission ("Commission" or "FCC") in the above-referenced matters[1] seeking comment on several policy issues raised by the Universal Service Administrative Company ("USAC").[2] Specifically, STi Prepaid responds to USAC's request for guidance on the reporting of prepaid telephone card revenue on the FCC Form 499-A for universal service fund ("USF") contribution purposes.[3] As USAC itself acknowledges,[4] the Instructions accompanying the FCC Form 499-A must be modified and clarified to ensure providers of prepaid telecommunications services via calling cards contribute to the USF on the basis of revenues actually received rather than the current requirement to report on the face value of the calling card sold to the ultimate end user.

The current revenue reporting requirements are not consistent with the way in which prepaid calling cards are offered in the market or with generally accepted accounting principles governing the recognition of revenue. Further, the requirement to report prepaid calling card

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1 *Comment Sought on Request for Universal Service Fund Policy Guidance Requested by the Universal Service Administrative Company*, DA 09-2117 (rel. Sept. 28, 2009).

2 Letter from Richard A. Belden, Chief Operating Officer, USAC, to Julie Veach, Acting Chief, Wireline Competition Bureau, FCC (Aug. 19, 2009) ("USAC Request").

3 USAC Request at 1-2.

4 USAC Request at 1.

revenues based on the face value of the card sold to the ultimate end user ignores the plain language of the Communications Act of 1934, as amended ("Act"), and the Commission's implementing regulations requiring equitable and non-discriminatory contribution obligations based on end user revenues collected by a carrier. As a result, prepaid calling card providers are treated differently than every other provider of telecommunications service in violation of the Act. Accordingly, STi Prepaid urges the Commission to promptly address the clarification requested by USAC and modify the 499-A Instructions to ensure providers of telecommunications services via prepaid calling cards are not disadvantaged vis-à-vis other providers of telecommunications services.

OVERVIEW OF STi PREPAID CALLING CARD DISTRIBUTION METHODS

STi Prepaid is a New York-based telecommunications carrier offering interstate and international services on a prepaid basis. To aid the Commission in understanding why the current requirement to report revenue based on the face value of the card is unworkable, STi Prepaid provides the following information on the four channels it uses to distribute prepaid calling cards to the public.

First, STi Prepaid sells prepaid calling cards on a retail basis directly to the end user making the telephone call. STi Prepaid recognizes the revenue from this type of sale once the end user consumer pays for the calling card. For those cards sold on a retail basis directly to the end user, face value is an appropriate measure of revenues because, when prepaid cards are sold at retail without any intermediate entities, STi Prepaid actually receives revenue reflecting the full face value of the prepaid card.

Second, STi Prepaid sells large batches of prepaid cards to distributors at a price less than the face value of the card. In turn, the distributor sells the card to either sub-distributors, retailers, or end users at varying prices reflecting the distributor's gross margin. For example, STi Prepaid may sell a prepaid card to a distributor for $7, which the end user consumer ultimately purchases for $10. For accounting purposes, STi Prepaid recognizes the revenue from this type of sale when the card is activated, meaning that the prepaid card is placed on the store shelf and is ready for sale to the end user customer. As required under the current 499-A Instructions, STi Prepaid reports $10 in revenue (the face value of the card) even though it only actually receives $7 in revenue for that sale.

Third, STi Prepaid sells large batches of prepaid cards to a retailer, such as Wal-Mart or Sam's Club at a price less than the face value of the card. After the cards are sold by Wal-Mart to consumers, STi Prepaid sends a bill to Wal-Mart for the aggregate number of cards sold. The bill is based on the number of cards sold multiplied by the face value of the cards less the amount Wal-Mart receives for distributing the card. Thus, if ten (10) $10 cards are sold by Wal-Mart (totaling $100), STi Prepaid would receive $70 in revenue from Wal-Mart, which reflects the $30 in revenue Wal-Mart retains for distributing the prepaid cards. Under the current 499-A Instructions, however, STi Prepaid is required to report $100 in revenue (based on the face value of the cards sold) although it only actually receives $70 in revenue for that transaction.

Fourth, many of the calling cards sold to STi Prepaid's distributors and retailers are "rechargeable" meaning that end user consumers can add additional minutes to an existing card. If a consumer recharges a card that was purchased from one of STi Prepaid's retailers, the retailer receives a portion of the revenue for each sale of the recharged card. For example, a consumer may seek to add $10 to its existing prepaid calling card that the consumer previously purchased at Wal-Mart. Wal-Mart earns $3 for that recharge and STi Prepaid actually receives $7 from the sale of the recharged minutes to the consumer. Under the 499-A Instructions, however, STi Prepaid is required to report $10 in revenue rather than the $7 it actually receives.

ARGUMENT

As the above scenarios demonstrate,[5] the 499-A Instructions' requirement to report revenues based on face value of the prepaid calling card is not an accurate determinate of the revenue a carrier typically receives for its prepaid products. The universal service reporting requirements should therefore reflect the significant distinction between revenues received via retail provision of prepaid calling cards and revenues received from the wholesale provision of cards. Simply requiring all telecommunications services offered via prepaid calling cards to be reported at the face value of the card sold to the ultimate end user customer does not correspond to the ways in which carriers realize revenues for these services.

I. REVENUE REPORTING SHOULD BE BASED ON REVENUES ACTUALLY RECEIVED FOR THE PROVISION OF TELECOMMUNICATIONS SERVICES

The longstanding regulatory basis for assessment of USF contributions is each carrier's "*collected* end-user interstate and international telecommunications revenues."[6] In most cases, however, the telecommunications carrier providing the prepaid service will never "collect" the face value of the prepaid card - only the final retailer does. In no case other than telecommunications services provided via prepaid calling cards are carriers required to report revenues greater than those they actually collect. In fact, if other telecommunications carriers

[5] Several other carriers employ similar distribution methods. *See, e.g.*, *IDT Corporation and IDT Telecom Request for Review of Decision of the Universal Service Administrator*, WC Docket No. 06-122, at 3 (filed June 30, 2008) ("Typically, the card is sold by IDT to a distributor for a wholesale price (*i.e.*, a price less than that listed on the face of the card). That distributor, in turn, may sell the card to one or more "sub-distributors" before ultimately selling the cards to a retail store, typically an independent ethnic market, but also to large drug stores and supermarkets. These stores ultimately set the price of the cards (which are often, but not always, at the stated face value of the card) and sell the cards to the public."); *Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Reply Comments of Sprint Nextel Corporation to Petitions for Reconsideration and/or Clarification, at n.21 (filed Oct. 23, 2006) ("Most prepaid calling cards are sold through retailers, who sell the cards at face value but purchase them at discounts of up to 50%.").

[6] 47 C.F.R. § 54.706(b) (emphasis added); *see also Federal-State Joint Board on Universal Service*, 17 FCC Rcd 24952 (2002) ("*2002 USF Contribution Order*").

find they are unable to actually collect the amount that they bill customers, they are allowed to deduct that uncollectible amount from their reported revenues.[7] By requiring the carrier offering the prepaid calling card to report more revenue than it actually "collects," the 499-A Instructions conflict with the Commission rule that contributions are to be assessed on "collected" revenues.

From the inception of the current USF, the Commission recognized the importance of ensuring that contributions be based solely on end user revenues. The Commission found that using end user revenues would be "both competitively neutral and relatively easy to administer."[8] Further, "[b]asing contributions on end user telecommunications revenues eliminates this potential economic distortion because contributions will be assessed at the end user level, not at the wholesale and end user level . . . regardless of how the services are provided, their contributions will be assessed only on revenue derived from end users."[9]

The face value reporting requirement distorts the meaning of "end user" in the context of telecommunications services provided via prepaid calling cards. The requirement to report revenues based on the face value of the prepaid card does not account for the various links that may exist in the distribution chain between the telecommunications provider and the ultimate user of the telecommunications service, a chain that the Commission has previously recognized[10] and is acknowledged in the 499-A Instructions.[11] Even USAC appears to recognize the "seemingly conflicting" position of telecommunications carriers offering prepaid calling cards

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7 FCC Form 499-A at Lines 421 and 422.

8 *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, ¶ 844 (1997) ("*USF First Report and Order*").

9 *USF First Report and Order* ¶ 850.

10 *AT&T Corp., Complainant v. BellSouth Corporation, and its Carrier Subsidiaries and Affiliates, including (but not limited to) BellSouth Long Distance, Inc. and BellSouth Telecommunications, Inc., Defendant*, 14 FCC Rcd 8515 (1999) ("*BellSouth Calling Card Order*") (recognizing that BellSouth was acting as the issuer of a prepaid card while another carrier actually provided the underlying telecommunications service).

11 FCC Form 499-A Instructions at 27 (recognizing that prepaid calling cards are often include "discounts provided to distributors or retail establishments").

given that the carrier may not know "the amount the customer paid" for a card or the amount may be less then the face value of the card due to the distribution method used.[12]

The face value reporting requirement also violates the basic principles of GAAP[13] accounting, which prohibit recognition of unearned revenue, *i.e.*, revenue that was not actually received may not be recorded under GAAP.[14] By requiring prepaid calling card revenues to be reported at face value, the 499-A Instructions put providers of prepaid telecommunications services in a precarious position by requiring them to report the same revenue in two different ways - one way for 499-A purposes (including revenues not actually received) and another way for GAAP purposes (including only those revenues actually earned). The Commission is subject to GAAP and similar universal accounting methodologies, and imposes the same requirements on USAC.[15] Yet the 499-A Instructions require carriers offering prepaid telecommunications services to violate one of the basic tenants of generally accepted accounting principles.

As USAC's Request recognizes, the 499-A Instructions offer no clear guidance on when revenue should be recognized for universal service reporting purposes.[16] Changes must therefore be made to acknowledge the requirements imposed by GAAP and similar accounting methodologies to ensure carriers are not forced to recognize and report revenues in a manner contrary to normal accounting standards. The Commission has routinely incorporated GAAP

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12 USAC Request at 1-2.

13 According to the Commission, GAAP encompasses the conventions, rules, and procedures necessary to define accepted practice in the preparation of financial statements in the United States. *See 2002 USF Contribution Order* at n.97.

14 *See, e.g., SEC v. Lucent Techs., Inc.*, 363 F. Supp. 2d 708, 712 (D.N.J. 2005) ("Under GAAP as summarized by FASB Concepts Statement No. 5 ("CON 5"), before Lucent can recognize revenue in a given transaction, the revenue must be both realized and earned.").

15 *See generally Application of Generally Accepted Accounting Principles for Federal Agencies and Generally Accepted Government Auditing Standards to the Universal Service Fund, et al.*, 18 FCC Rcd 19911 (2003).

16 USAC Request at 2.

principles into its rulemaking and permitted carriers to rely on GAAP for financial reporting purposes.[17] In fact, the Commission specifically requires that other revenue reported on the FCC Form 499-A, such as a carrier's uncollectibles, be calculated in accordance with GAAP.[18] There is no reason why telecommunications carriers offering prepaid calling card services should not be permitted to utilize GAAP and similar accounting methods when reporting their prepaid calling card revenues on the FCC Form 499-A.

The face value reporting requirement is also inconsistent with ordinary tax law. There is no comparable arena under which the reporting of income of a wholesaler is based upon the increase in income earned by the retailer. Under the Internal Revenue Code, taxes are based on a corporation's gross taxable income - not an artificial calculation based upon others' earnings. For example, corporations are taxed based upon their "taxable income,"[19] which is defined as gross income minus deductions.[20] In turn, "gross income" is defined as "all income from whatever source derived."[21] Thus, the federal tax scheme is governed by the premise that taxes should be rendered on actual monies earned. There is no provision that allows for an increased reporting of income based upon the relationship between a wholesaler and a retailer. But the 499-A Instructions' face value reporting requirement does just that.

Accordingly, the Commission should modify the 499-A Instructions to ensure telecommunications carriers offering prepaid services are reporting those revenues actually collected as mandated by the Commission's rules. In the alternative, the Commission should

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17 *See, e.g.*, 47 C.F.R. § 26.4 (defining terms based on GAAP principles); 47 C.F.R. § 76.924 (requiring cable operators to utilize GAAP in certain instances); 47 C.F.R. § 64.604 (requiring the telecommunications relay service fund to be kept in accordance with GAAP);

18 *2002 USF Contribution Order* ¶ 32.

19 26 U.S.C. § 11.

20 26 U.S.C. § 63.

21 26 U.S.C. § 61.

permit prepaid providers to deduct the difference between the face value of the prepaid card and the revenues actually received as "uncollectible" revenue on Lines 421 and 422 of the FCC Form 499-A.

II. THE FACE VALUE REPORTING REQUIREMENT DISCRIMINATES AGAINST CARRIERS CHOOSING TO SELL TELECOMMUNICATIONS SERVICES VIA PREPAID CALLING CARDS

The Act requires the Commission to establish rules that assess USF contributions on an "equitable and nondiscriminatory basis."[22] The face value reporting requirement violates the Act's mandates by singling out telecommunications carriers offering prepaid calling card services and requiring them to contribute based on revenues they do not actually receive.[23] No other class of telecommunications carriers is subject to such a requirement, and there is no reasonable or rational basis for discriminating against prepaid calling card providers in this manner.[24]

Uniformly assessing USF contributions on the face value of the prepaid card, without taking other factors into consideration, is inequitable and places carriers offering telecommunications services via prepaid platforms at a disadvantage vis-à-vis other telecommunications carriers. The Commission has expressed a long-standing interest in ensuring a "level playing field" between carriers and promoting equal treatment of like services in order to increase competition and protect the interests of consumers.[25] This requires the equal

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[22] 47 U.S.C. § 254(d).

[23] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 434 (5th Cir. 1999) (finding it would violate "the equitable language in the statute" to have a carrier "pay more universal service contributions than it can generate in interstate revenues").

[24] *Cf. Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd 5880 (1991) (setting forth permissible reasons for treating similarly situated entities differently).

[25] *See, e.g., Applicable Regulatory Treatment for Broadband Access to the Internet over Wireless Networks,* 22 FCC Rcd 5901, ¶¶ 53, 55-56 (2007) (noting the importance of "ensuring regulatory parity" to achieving the "overarching goal of fostering competition by providing a level playing field in the market and removing unnecessary regulatory impediments"); *Promoting Efficient Use of Spectrum Through Elimination of Barriers to the*

treatment of all participants in a particular market by applying rules and regulations in an equitable fashion.[26] The Commission has also routinely allowed providers to experiment with technologies and business models by ensuring regulation did not dictate or favor a particular business model.[27] However, despite these deep-routed principles, the face value reporting requirement treats prepaid telecommunications providers inequitably in comparison to all other providers of telecommunications services.

Indeed, it is important to note that the effect of the face value reporting requirement goes beyond USF contributions. The revenues reported on the FCC Form 499-A are used as the basis for telecommunications carriers' contributions to all federal funds as well as the payment of regulatory fees. Thus, not only are prepaid providers contributing more to USF than they otherwise should, they are also contributing in excess to support the telecommunications relay service ("TRS") fund, North American Numbering Plan Administration ("NANPA"), Local Number Portability Administration ("LNPA"), and FCC regulatory fees. The Commission should therefore promptly amend the 499-A Instructions to ensure this inequitable treatment of prepaid providers does not continue.

Development of Secondary Markets, 15 FCC Rcd 24203, ¶ 93 (finding that harmonization of rules "provides regulatory neutrality to help establish a level playing field across technologies and thereby foster more effective competition") (citing *Principles For Reallocation of Spectrum to Encourage the Development of Technologies for the Telecommunications New Millennium*, 14 FCC Rcd 19868, ¶ 9 (1999)).

[26] *See, e.g., IP-Enabled Services*, 19 FCC Rcd 4863 (2004) (determining that creating "a level playing field [] minimizes arbitrages and maximizes the opportunities for new technologies to flourish") (concurring statement of Commissioner Copps)); *Remarks by FCC Chairman Kevin J. Martin "Balancing Deregulation and Consumer Protection*," 2009 WL 56765, *2 (Jan. 8, 2009) (explaining the importance of "a regulatory environment that promotes investment and competition, setting the rules of the road so that players can compete on a level playing-field").

[27] *See, e.g.*, *Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, 17 FCC Rcd 2844, ¶ 133 (2002) (favoring "competition, not regulation"); GN Docket No. 09-191, *Preserving the Open Internet; Broadband Industry Practices*, FCC 09-93, Notice of Proposed Rulemaking, ¶ 9 (rel. Oct. 22, 2009) (noting Commission's policy of "preserving and protecting" the ability of providers "to experiment with technologies and business models").

CONCLUSION

For the reasons described above, the Commission should act promptly to modify and clarify the 499-A Instructions to ensure that carriers using prepaid calling cards to provide telecommunications services are not required to report and contribute to the USF and other federal funds on the basis of revenues they do not actually receive.

Respectfully submitted,

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