

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

In the Matter of	)	
	)	
Request for Review by	)	CC Docket No. 02-6
Net56, Inc. of Decision of the	)	
Universal Service Administrator	)	
	)	CC Docket No. 96-45
	)	
Schools and Libraries Universal Service	)	Harrison School District 36
Service Support Mechanism	)	2007 Funding Year
	)	FRNs 1531745, 1531757, 1531771,
	)	1531783, 1531795

**REQUEST FOR REVIEW BY NET56, INC. OF DECISION OF THE UNIVERSAL  
SERVICE ADMINISTRATOR**

Net56, Inc. (“Net56”) respectfully requests, pursuant to Sections 54.719 through 54.723 of the Commission’s rules,<sup>1</sup> that the Commission review, and reverse or remand, the Universal Service Administrative Company (“USAC”) Funding Commitment Adjustment Decision for funding year 2007-08 (“COMAD”) issued on May 6, 2011 for the above-referenced FRNs and direct USAC to rescind the related funding recovery action.<sup>2</sup>

**Background**

Net56 is a small, privately-owned technology solutions provider. Net56 began participating in the E-rate program in 2003 in response to local school districts’ interest in more personalized, responsive services that are tailored to their rapidly changing needs. Currently, Net56 provides e-rate and non e-rate services to eight school districts in northern Illinois,

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<sup>1</sup> 47 C.F.R. §§ 54.719-54.723.

<sup>2</sup> See Administrator’s Notification of Commitment Adjustment Letter for Funding Year 2007-08, dated May 6, 2011 attached hereto as Exhibit A (“COMAD ”); *see also* the Notification of Improperly Disbursed Funds Recovery Letter, dated May 6, 2011 (“Funds Recovery Letter”), attached hereto as Exhibit B. The FCC Form 471 Application Number on which the above-referenced FRNs were submitted to USAC is Funding Year 2007 Form 471 Application Number 552545, attached hereto as Exhibit C (the “District’s Form 471”).

including the Harrison School District, the recipient of the services which are the subject of this appeal (the “District”).<sup>3</sup> The District is comprised of a single school with 480 students in the pre-kindergarten through 8<sup>th</sup> grades. More than 30% of the students are eligible for the National School Lunch Program. As a result, the District is eligible to receive services under the E-rate program at the 60% discount level. For the 2007 funding year, the District was eligible to receive E-rate services at the 50% discount level.

On December 6, 2006, the District posted a Form 470 for the 2007 funding year on the USAC website, initiating a 28-day competitive bidding period and seeking bids for Internet access, web and email hosting, firewall, and wide area network services.<sup>4</sup> In response to the Form 470, Net56 proposed a written offer with specific proposed rates for each of these eligible services to the District for the 2007 funding year. The District accepted Net56’s bid and signed the quotation on January 10, 2007, thereby entering into a contract (“2007 E-Rate Contract”).<sup>5</sup> On January 22, 2007, the District filed a Form 471 with USAC, requesting funding for the e-rate services to be provided by Net56 pursuant to this contract, and it identified the January 10, 2007 E-Rate Contract as the applicable contract in its Form 471.<sup>6</sup> USAC reviewed and approved this funding request in full in a Funding Commitment Decision Letter dated December 4, 2007.<sup>7</sup>

In June 2007, subsequent to the execution of the 2007 E-Rate Contract, Net56 and the District decided to establish a broader relationship for non e-rate services. The parties executed a Master Services Agreement (MSA), and at this time the District also entered into a relationship with a leasing company under which its payment to Net56 for e-rate services under the 2007 E-

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<sup>3</sup> Harrison School District 36 is the Billed Entity for the application, and its Billed Entity Number (“BEN”) is 135349.

<sup>4</sup> See FCC Form 470 Application Number 361000000602991 attached hereto as Exhibit D (the “District’s Form 470”).

<sup>5</sup> See Exhibit E.

<sup>6</sup> See Exhibit C.

<sup>7</sup> See USAC Revised Funding Commitment Decision Letter, dated December 4, 2007, attached hereto as Exhibit F.

Rate Contract and non e-rate services under the MSA could be made through the leasing company rather than directly. After the District and the leasing company informed Net56 of the amount of this payment, Net56 provided to the District and the District agreed on a precise allocation of the amounts that would be credited for each specific e-rate service and non e-rate service.<sup>8</sup> The MSA and this payment arrangement in no way changed the rates or terms of the 2007 E-Rate Contract.

In 2008, Net56 and the District entered into a contract for e-rate funding that was substantially similar to the 2007 E-Rate Contract. Several months into the 2008 funding year, USAC advised Net56 and the District that it was conducting a special compliance review of the funding applications filed by school districts served by Net56 and that all funding for these districts would be placed on hold. USAC did not supply Net56 or the District with any information on the reason for the compliance review, despite Net56's numerous attempts to seek out such information before it prepared to place bids for the 2009 funding year. Still in the dark but believing that its contract and service arrangement was compliant based upon USAC's approval of the 2007 funding year, Net56 and the District entered into a third, similar contract for the 2009 funding year.

On February 23, 2010, USAC issued an FCDL denying all funding for the 2008 funding year. On April 13, 2010, USAC issued an FCDL denying all funding for 2009. The primary two bases for these denials were USAC's incorrect assertions that (1) the only relevant contract for e-rate services was the MSA, rather than the E-Rate Contracts, and that the MSA failed to provide a breakdown of the prices for eligible versus ineligible services; and (2) that the District had not actually paid its non-discounted share as required because it paid it to the leasing company for equipment, and not to Net56 for services.

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<sup>8</sup> See Exhibit G.

On May 6, 2011 -- more than four years after Net56 and the District executed the 2007 E-Rate Contract -- USAC's COMAD attempts to try to apply these same two incorrect determinations to the 2007 funding year.

**I. USAC's Decision is Incorrect on the Merits**

**A. The COMAD Erroneously Ignores the Right Contract.**

USAC's first basis for the commitment adjustment is its determination that the District and Net56 supposedly "did not have a contract in place at the time of submission of the Form 471."<sup>9</sup> USAC's assertion is surpassing strange, since Net56 and the District did in fact have a timely written agreement, complete with service description and prices, and this agreement was entered in the Form 471. The COMAD asserts that Net56 was "unable to demonstrate" that it had a contract in place prior to the Form 471, but that is only because USAC did not ask for a copy in the period prior to its release of the COMAD. Instead, USAC's determination appears to be based on its incorrect theory that the MSA was the only contract for e-rate services in 2008 and 2009, and that it therefore assumed the same was true for 2007, and that because the MSA was not signed until June of 2007 that the parties must not have had a timely contract.

As Net56 has previously demonstrated in its appeals of USAC's 2008 and 2009 decisions, USAC's theory that the MSA has been the contract for e-rate services is incorrect. But USAC's error becomes all the more clear when it tries to apply it to 2007. The parties consistently identified the 2007 E-Rate Contract as the relevant contract for 2007 in the Form 471 and thereafter. USAC only obtained the MSA as a result of its due diligence for the 2008-2009 funding years. But USAC nonetheless claims the MSA is the exclusive contract, and that it was signed months too late and failed to properly identify the prices for e-rate services -- a truly

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<sup>9</sup> COMAD at 4.

confounding assertion since the parties did in fact have an agreement that was timely and that expressly identified such prices and services.

As indicated on the District's Form 471, the District and Net56 agreed to and executed a contract on January 10, 2007. That contract, entered into after the bidding period and prior to submission of the Form 471, is the relevant contract between Net56 and the District and clearly allocates and states the price for each e-rate service covered by the District's Form 471. Nothing in the COMAD alleges any flaw in the 2007 E-Rate Contract; instead its decision is based on the supposition that it effectively does not exist. But the record clearly shows that that agreement was the contract executed by the parties at the close of the bidding period and that it reflects the intentions of the parties at that time. It was signed and dated after the bidding period, is the contract referenced on the Form 471, and it is the only document that has a description and 2007-08 rates for the services for which funding has been sought.

At a minimum, the COMAD should be remanded because it fails to explain why it has ignored the E-Rate Contract. However, rather than remand this proceeding, Net56 urges the Commission to reject it instead. USAC's decision may well be based upon the same reasoning it used for the 2008 and 2009 years, when it decided that the MSA was the only contract because the District had in one instance referenced the MSA in responding to a USAC question regarding the applicable contract. That should not be a permissible basis to reach that conclusion for 2007, because the District's response did not pertain to that year. But in any event, nothing in the Commission's rules directs USAC to deny funding on the basis of a minor error in responding to USAC inquiries when in reality the parties complied with program rules. Here, it is obvious from the record that the Parties intended the allocation and rates from the 2007 E-Rate Contract to apply, and that these rates were executed after the end of the 28-day competitive bidding

period. Therefore, the 2007 E-Rate Contract signed on January 10, 2007 is the relevant contract between Net56 and the District and this contract clearly allocates and states the price for each e-rate service covered by the District's Form 471.

Relatedly, USAC also asserts that Net56 improperly provided "free" services to the District such as anti-virus protection, website design, onsite support, and other services.<sup>10</sup> But these services were part of the MSA, not the 2007 E-Rate Contract, which set a specific price for specific, eligible services. The District separately paid for these additional services, as demonstrated in Exhibit G. Because these other services were not part of the E-Rate Contract price, and because, as demonstrated below, the District paid its share separately for the e-rate services and for the other services, no "free" services were provided in violation of program rules.

#### **B. The District Paid for E-Rate Services**

USAC asserts that funding should be recovered because it thought that the District did not pay for eligible services. USAC made that finding because the District's payments for 2007 were delivered to a leasing company in the amount that was originally established by the lease agreement attached to the 2007 MSA. USAC apparently concluded that this payment must be solely attributed to the ineligible equipment described in the lease agreement between the District and the leasing company, and not to the eligible services provided under the parties E-Rate Contract.

It is true that the lease agreement originally described a payment of \$7377.25 without reference to allocation of any part of that payment for Net56 services (eligible or ineligible). However, the District and the leasing company separately agreed in writing (to reflect their original intent) that the equipment was not worth this amount and that a portion of the lease

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<sup>10</sup> COMAD at 4.

payment would be provided by the leasing company to Net56 for services. The District and Net56 also agreed in writing to a service-by-service allocation of these funds to eligible and ineligible services.

USAC's position that the District did not pay should be reversed because it does not comport with reality. *USAC has not disputed that the leasing company did in fact transfer a portion of these funds that it received from the District to Net56.* USAC also did not dispute that that the amount of the District's funds transferred to Net56 were more than enough to pay the District's non-discounted share of eligible services. *If the payments were made solely for equipment owned by the leasing company, then it would not have delivered the funds to Net56.* Instead, the leasing company did pay Net56 on behalf of the District both for eligible and ineligible services, in accordance with the exact allocations specified by Net56 and the District in their 2007 E-Rate Contract. It is incorrect and exceedingly unfair for USAC to ignore these payments, which were actually made, on the sole basis that USAC reads the lease agreement to mean something other than what the parties expressly clarified it to mean. USAC's basis is especially inappropriate given that the lease agreement is not the applicable contract for e-rate services. Ultimately, in assessing whether the District paid for services, it should not really matter what the MSA says or which middlemen may have touched the payments; what matters is that the District did pay, by remitting funds that were ultimately received by the Net56 in the amounts required by the parties' actual E-Rate Contract.

Net56 now recognizes that the District's payment for e-rate services through the leasing company was confusing to USAC, and it has therefore moved away from that model. But the fact is that the District did make payments that cover its non-discounted share, and these payments were received and retained by Net56 as the e-rate services provider, and not by the

leasing company for equipment that it owned. The Administrator was therefore incorrect in concluding in the COMAD that the District had not paid for eligible services.

**C. Rather than Permit a Recovery on Cost-Effectiveness Grounds, the Commission Should Remand Such Proceedings to USAC for Further Consideration, with Additional Guidance.**

In the case of WAN, firewall, email and web hosting services covered under FRNs 1531757, 1531771, 1531783 and 1531795, USAC also requested reimbursement on the basis that these services were not cost-effective.<sup>11</sup>

As an initial matter, the Commission should be particularly wary of USAC demands for reimbursement of four year-old funding on a basis as judgmental as cost-effectiveness. Nothing about the contract prices or the value of the services was hidden from USAC when it approved the funding at the time. Net56 and the District were not provided any warning that their 2007 prices had been reopened, or any opportunity to provide supporting or explanatory information.

Net56 is prepared to demonstrate the cost-effectiveness of its prices to USAC on any remand proceeding, but asks the Commission to reiterate to USAC its prior instruction that even when an applicant violates the cost-effectiveness rule, it is still entitled to funding in the amount associated with the least expensive cost-effective service.<sup>12</sup> In the *Macomb Order*, the school district received identical services from multiple service providers, including the lowest-cost bidder and two providers who offered the service at a higher price. USAC determined that the Macomb district violated the Commission's cost-effectiveness rule by not selecting the lowest-cost bidder to provide all of the services and denied the entire funding request on the basis that more than 30 percent of the request was ineligible. In its decision on appeal, the Commission found that USAC should not have denied all funding even though it agreed with USAC's

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<sup>11</sup> COMAD at 6-12.

<sup>12</sup> See Letter of Appeal to USAC at 4, citing *Request for Review by Macomb Intermediate School District Technology Consortium*, File no. SLD-44190, Order, FCC 07-64 (rel. May 8, 2007) (the "*Macomb Order*").

determination that the school district violated program rules by not selecting the most cost-effective service offering.<sup>13</sup> The Commission recognized that it would be unnecessarily unfair to deprive an applicant or service provider of all funding for an eligible service based upon an all-or-nothing approach.

Net56 understands from USAC staff that its all-or-nothing approach reflects its belief that the Commission does not want to put USAC into the position of having to determine a cost-effective rate to award. However, USAC necessarily must determine at least an estimate of cost-effectiveness in order to apply the *Ysleta* test to find that a service is not cost-effective. The COMAD in fact specifically states that it based its cost-effectiveness test on comparison to a specific market cost that it believes that it would have found to be cost-effective. No greater effort would have been required to provide funding in these amounts. It may well not always be a fair amount, but it would always be fairer than denying funding altogether.

For these reasons, if the Commission permits USAC to re-open an FCDL on cost-effectiveness grounds four years after the fact – which Net56 urges the Commission not to do, as discussed more fully in Section 2 below – then the Commission should remand the proceeding to USAC and direct it to limit any recovery request on cost-effectiveness grounds to the amounts that USAC determined would have exceeded the cost-effective price.

**D. USAC Fails to Provide Any Explanation for its Determination that Some of the Service Prices Include Internal Connections and Ineligible Components**

The COMAD also asserts that funding should be reduced by \$1230 because a DNS/DHCP server used by Net56 “failed the Tennessee Order” requirements and is therefore only eligible for Priority Two funding.<sup>14</sup> Net56 is familiar with the *Tennessee Order*, but USAC failed to provide any explanation or detail to enable Net56 to determine why it believes the FRN

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<sup>13</sup> *Macomb Order* at ¶¶ 6-9.

<sup>14</sup> COMAD at 6.

is ineligible for Priority One funding. The Funds Recovery Letter asserts that the funding for firewall, e-mail, and web hosting services should be reduced by specific amounts because USAC determined that the services included certain ineligible items.<sup>15</sup> The items that USAC purports are ineligible were not listed in the E-Rate Contract and USAC provides no basis for concluding they were included in the funding request. Even if USAC did have reason to conclude they were included, USAC failed to provide any justification for the costs it assigns to these supposedly ineligible components. The Commission should therefore either reject USAC's position or remand these parts of the proceeding back to USAC with direction to provide Net56 with a clear explanation of the alleged violations.

**II. USAC Did Not Afford any Due Process to Net56 and the District or Engage in a Sound Fact-Gathering or Decision-Making Process.**

Net56 is not aware of any questions that USAC asked the District with respect to the alleged deficiencies with respect to the 2007 funding year. Net56 was of course aware of USAC's concerns with the 2008-2009 funding years, but had no knowledge that USAC had reopened consideration of 2007 until the District received the COMAD advising that USAC had decided that all funding must be returned. In some cases, Net56 has no idea how USAC supposedly determined that certain ineligible services were worth the very specific amounts set forth in the COMAD. In reopening an inquiry into the cost-effectiveness of services approved four years ago, USAC should have given the District and Net56 an opportunity to explain and justify the prices. Instead, USAC seems to have prepared the COMAD in a rush and made the sloppy assumption that 2007 was just like 2008. The Commission should remand these issues back to USAC with instruction to engage in appropriate fact-finding procedures in which the applicant and service provider have an opportunity to present evidence. Net56 does not

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<sup>15</sup> See Funds Recovery Letter at 6-8.

necessarily urge that such opportunity must be afforded prior to every FCDL for initial funding, but it would at least be appropriate for a COMAD requesting return of funds already paid.

## **II. It Would be Grossly Inequitable to Deny the Entirety of Three Years of Funding**

Even if the Commission finds that the District and/or Net56 failed to comply with some technical element of program rules, it should give substantial consideration to the inequities that would be imposed on Net56 as a result of USAC's extremely slow decision-making process.

The fact that USAC's demand for a refund was made more than four years after the submission of the Form 471 of course does not necessarily warrant reversal of USAC's decision by itself. Had USAC uncovered evidence of fraud or some other new material fact that Net56 had hidden from it for the past four years, a recovery could be appropriate. But in this case, what Net56 did in 2007 is exactly what it asked USAC if it could do in 2006, and exactly what it fully explained to USAC it was doing over the course of literally dozens of meetings, telephone calls, and emails with USAC since 2008 once the PIA review began. Over and over, and then over and over again, during the PIA Net56 and undersigned counsel asked and then begged USAC personnel to at least give hints as to the nature of their apparent concerns, so that Net56 could address them before it placed bids and entered into contracts for subsequent funding years and at least avoid future denials. But year after year USAC kept Net56 completely in the dark as to whether there was even in fact any concern at all, much less an alleged violation that would result in a complete denial. So Net56 continued to enter into the same type of contract, the contract for which USAC would now condemn Net56 to three years of denial of all funding – not only for serving the Harrison District but also for every district Net56 served.<sup>16</sup>

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<sup>16</sup> As a result of the alleged deficiencies described below, USAC denied 100% of the funding for every single school district served by Net56 for both 2008 and 2009. USAC's demand that Net56 now repay its 2007 funding for the Harrison District suggests that it may now seek the same for all of the other districts as well.

Net56 is a small company and e-rate is a substantial portion of its overall business. If USAC had denied all funding for the 2007 funding year in the first place, the company might have had enough resources and credit available to survive. But a three or four year<sup>17</sup> complete washout of all e-rate funding would result in bankruptcy and dissolution of the company. The CEO's retirement savings have been wiped out and his home is in foreclosure. The employees are on the brink of losing their jobs and health insurance, all because USAC took years to decide what could have been decided in weeks. It would be unconscionable and unjust for the Commission to impose a corporate death penalty on an otherwise vibrant, innovative broadband solutions provider simply because it took USAC four years to develop the opinion that Net56's contracts were not tailored precisely to USAC's liking.

As the Commission has noted, "the timing of the Commission's and USAC's processes may be critical to schools and libraries. Lengthy intervals for processing or reviewing applications could have a disruptive effect on the budget or procurement schedule for schools or libraries."<sup>18</sup> In *Request for Review of Totowa Borough Public Schools*, the Wireline Competition Bureau found that USAC "erred by unreasonably delaying its notification to Totowa of the problems with its Form 470" for eight months.<sup>19</sup> More recently, the Bureau addressed a scenario

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<sup>17</sup> Although Net56 only started to provide service to Harrison in 2007, it used similar contracts with some other Districts in 2006 and Net56 is now concerned that absent Commission direction to the contrary that USAC may seek refunds for the 2006 funding year as well.

<sup>18</sup> *Comprehensive Review of Universal Service Fund Management, Administration, and Oversight*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, WC Docket No. 05-195, 20 FCC Rcd 11308, 11321, ¶ 29 (2005). In the same NPRM/FNPRM, the Commission reiterated that such delays and the resultant impact on mandated budget or procurement schedules "can have a significant negative impact on schools' and libraries' ability to achieve connectivity goals." See *id.* at 11325, ¶ 38.

<sup>19</sup> *Request for Review by Totowa Borough Public Schools, Schools and Libraries Universal Service Support Mechanism*, Order, File No. SLD-265823, CC Docket No. 02-6, DA 04-3898, ¶ 4 and n.14 (Wireline Comp. Bur. 2004) (citing previous instances of unreasonable or excessive delay). See also *Request for Waiver by Lettie W. Jensen Library, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, Order, File No. SLD-267950, CC Docket Nos. 96-45 and 97-21, DA 01-2401, ¶¶ 5-7 (Com. Car. Bur. 2001) (holding that a two-month delay in notification regarding an omitted signature was unreasonable); *Request for Waiver by Council Bluffs Community Schools, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, Order, File No.

in which an applicant's numerous communications with USAC were ignored, as was the case with Net56, ruling in favor of the applicant and pointing to the applicant's "several attempts to follow-up with USAC, and USAC's delay in responding."<sup>20</sup> A common theme in these cases is that dispensation should be provided to applicants when unreasonable delays by USAC would otherwise inflict prejudicial harm.

There is no dispute that Net56 in fact provided valuable, eligible services to the District. As demonstrated below, there is no dispute that Net56 quoted specific rates to the District for each eligible service, and that the District and Net56 signed that proposed contract prior to the District's submission of Form 471. There is also no dispute as to the amounts billed and paid for each eligible service.<sup>21</sup> There is no dispute that the Internet Access services were provided at cost-effective rates. USAC has not raised any suggestion of any competitive bidding violation, and there is no dispute that the District properly sought competitive bids, or that Net56 was the best offer available to the District. USAC's is revoking all funding on the basis that the District and Net56 supposedly failed to clearly allocate prices between eligible and ineligible services, even though they timely executed contract terms that did exactly that, and that the District supposedly failed to pay for e-rate services, even though there is no dispute that the precise amounts due for such services under the contracts were paid to Net56 on the District's behalf by a third party that received the funds from the District. Under all of these circumstances, USAC's belated denial of every cent of requested funding for a three year period would elevate form over substance and unfairly penalize the District and Net56 for USAC's extremely slow process. The

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SLD-E007282, CC Docket Nos. 96-45 and 97-21, DA 00-1909, ¶ 4 (Com. Car. Bur. 2000) (determining that a failure to post applicant's Form 470 for approximately six weeks was excessive).

<sup>20</sup> *Request for Review by Bradford Regional Medical Center; Rural Health Care Universal Service Support Mechanism*, Order, File No. RHCP 14491, WC Docket No. 02-60, 25 FCC Rcd 7221, 7223, ¶ 4 (Wireline Comp. Bur. 2010).

<sup>21</sup> Indeed, USAC's COMAD even references the rate for each separate service in discussing their cost-effectiveness. (Thus, USAC on the one hand cites the exact rates from the 2009-10 E-Rate Contract while on the other hand perplexingly claiming that these rates have not been identified by being separately allocated.)

Commission should therefore grant Net56's appeal and reverse USAC's COMAD and associated demand for reimbursement of 2007 funding.

**Conclusion**

For the foregoing reasons, the Commission should grant Net56's appeal of the COMAD and direct USAC to rescind its request for recovery of the disbursed funds for the above-referenced FRNs.

Respectfully submitted,



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May 23, 2011

**CERTIFICATE OF SERVICE**

I, Cathleen Schultz, hereby certify that a true and correct copy of the foregoing *Request For Review By Net56, Inc. of Decisions of The Universal Service Administrator* was mailed postage prepaid this 23<sup>rd</sup> day of May, 2011 to the following:

Universal Service Administrative Company  
Schools and Libraries Division  
100 South Jefferson Road  
P.O. Box 902  
Whippany, New Jersey 07981

/s/ Cathleen Schultz

Cathleen Schultz