

July 31, 2012

Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> St., S.W.  
Washington, DC 20554

Re: CC Docket Nos. 02-6, 96-45, Request for Review by Net56, Inc. of Decisions of the  
Universal Service Administrator for

Harrison School District 36: 2007 Funding Year FRNs 1531745, 1531757, 1531771, 1531783,  
1531795; 2008 Funding Year FRNs 1753187, 1753238, 1753268, 1753317; 2009  
Funding Year FRNs 1852702, 1852749, 1852785, 1852800  
Posen-Robbins School District 143 ½ 2009 Funding Year FRNs 1908586, 1908687  
Country Club Hills School District 2009 Funding Year FRNs 1853415, 1853424, 1853437  
Round Lake Area School District 116, 2009 Funding Year, FRNs 1901504, 1901546, 1901579,  
1901630 and 1901654

Net56, Inc. is providing the attached additional documentation to demonstrate the cost-effectiveness of its wide area network (WAN), web hosting, email hosting, and firewall services in the above-referenced appeals. The cost-effectiveness of these prices is demonstrated in two ways. First, Net56 describes the costs that it incurred in providing the services, which afforded it only a modest profit margin. Second, Net56 has provided evidence that Net56's corporate customers paid at least as much or more for the services (as required by the Commission's lowest corresponding price rule). Corporate customers receive no e-rate subsidy so they are price sensitive and would negotiate for the best possible price.

The contracts with the private companies are not public documents and Net56 may still owe a duty of confidentiality to the customer. In addition, some of Net56's cost information as described herein is commercially sensitive and confidential. Net56 takes all reasonable precautions to avoid public disclosure of this confidential information. Accordingly, Net56 has redacted the names of the companies and certain cost information from the public version of this filing and requests that the confidential version provided to Commission staff be designated by the Commission as confidential and not be made routinely available for public inspection, pursuant to Section 0.459 of the Commission's Rules, 47 C.F.R. § 0.459.

As a preliminary matter, Net56 notes that it is not seeking funding for certain functions that had been included in the contract prices but that USAC held were ineligible.<sup>1</sup> A summary of the adjusted pre-discount prices sought for Commission approval in this proceeding is attached hereto as Exhibit 1. As a second preliminary item, Net56 notes that some of its rates for these districts were reduced in 2010. These reductions do not reflect any admission that prior rates were not cost effective. Instead, the reductions were enabled by the availability of new fiber connectivity options from a new wholesale supplier, and the availability of lower-cost equipment.

### **Cost Justification Based Upon Net56's Actual Costs**

In the attached Exhibit 2, Net56 has provided calculations demonstrating that its rates are cost-effective and did not afford Net56 with any unreasonable margin of profit. Net56 has used formulas previously provided to it by USAC; specifically, Net56 imputed a one-time installation cost of a device as 50% of its purchase price, and annual maintenance costs of another 50% of the purchase price. However, Net56 did not seek to recover all of purchase price or installation costs in the first year of service, even though these services were provided under one-year contracts. Instead, Net56 spread these costs over a projected three-year estimated lifetime of the equipment, a method USAC previously approved.<sup>2</sup> Net56 also added 11.25% to represent its cost of capital; this percentage is based upon the Commission's rules for rate-of-return carriers,<sup>3</sup> which, though not applicable here, can serve as a reasonable proxy. Using these formulas, to reach the adjusted prices sought for approval, Net56 would need to be afforded only approximately 15% of the purchase price to cover all of its other overhead, such as personnel, rent for office and data center space, office expenses, legal fees, electricity and other utilities, insurance, business licenses, taxes, and other expenses.

In theory it may have been possible in some cases for a larger service provider to incur lower costs than Net56 because of access to lower-priced equipment or because of better ability to spread costs over a larger customer base. However, it should be emphasized that, to the best of Net56's knowledge, no such provider offered a lower bid price to any of these districts for any of these services. Given that Net56's prices are reasonably based on its costs and that no other service provider offered these services for a lower price, the Commission could not reasonably conclude that the districts should have chosen a more cost-effective option or that Net56's prices were not cost-effective.

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<sup>1</sup> Net56 does not concede ineligibility of that any part of the services for which funding was sought, but forgoes such argument in this proceeding to expedite the Commission's consideration of the appeals.

<sup>2</sup> USAC approved this formula in multiple appeals in 2010. During the 2010 funding year, USAC initially denied funding for the firewall and WAN services provided to a couple (but not all) of the districts, solely on the basis of cost-effectiveness. Net56 appealed to USAC using formulas described herein, and USAC thereupon granted full funding.

<sup>3</sup> *Rescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, Order, 5 FCC Rcd 7507 (1990). Net56 recognizes that the 11.25% rate set in 1990 may not reflect the current marketplace. However, Net56's actual overhead costs exceed 15%, so the overall calculation demonstrating cost-effectiveness would not materially be undermined by a reasonable reduction of the cost of capital.

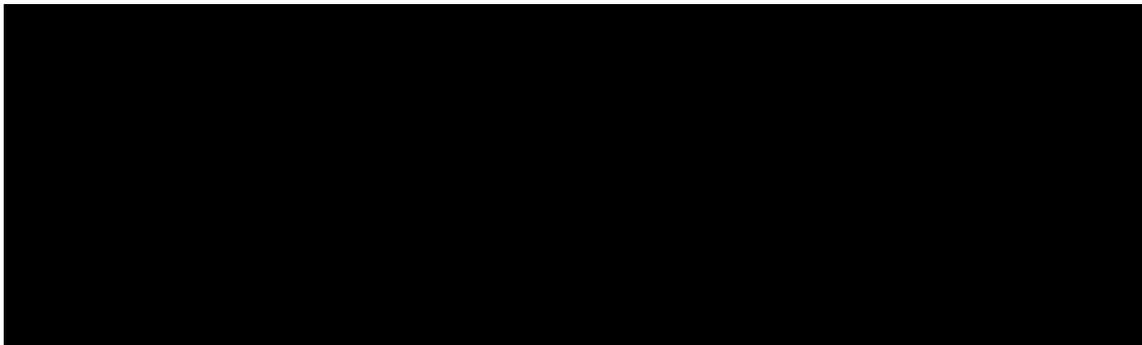
Note Regarding Firewall: Net56 provided substantially the same firewall services to each of these districts, with price varying based upon the size of the customer and its needs. Net56 provided a centralized network-based firewall service using a single, shared architecture for all districts. Net56 used a Cisco Catalyst 6500 Series Switch with High Availability, Supervisor Engine 720 and Application Control Engine (ACE) software. Net56 was able to use this equipment to provide service to multiple districts, and determined that it was more cost effective than providing the schools each with their own Cisco ASA5550-BUN-K9 equipment on each premises. The 6500 series equipment provides a more robust and reliable service.<sup>4</sup> Because a single device could serve multiple districts, Net56 allocated weighted shares (based upon projected usage) of the \$272,250 purchase cost and associated installation and maintenance costs to each district to demonstrate the cost-basis of its rates. For purposes of the firewall calculations in Exhibit 2, Net56 allocated 24% to Round Lake, 15% to Posen Robbins, and 5% each to Country Club Hills and Harrison. The remainder was allocated to districts not covered in these appeals.

Note Regarding WANs: The WAN pricing represents the cost of the Cisco router(s) needed by the district to utilize Net56's Internet Access services and route such services across their wide area networks. Districts such as Round Lake with multiple locations needed one router for each location on their wide area network where they wished to use the Internet Access services. But even a district with one location, such as Harrison, still needed one router to be able to send and receive Internet services.

Harrison had one Cisco 2800 series router, which cost Net56 \$5,525 plus installation and maintenance. Round Lake had twelve Cisco 3560 series, which cost Net56 \$7,094 each. A more expensive router was needed for Round Lake because of higher bandwidth requirements.

Note Regarding Web and Email Pricing: Net56 provided substantially the same email and web hosting services to each of these districts, using a centralized, network-based architecture. A summary of the approximate costs of this implementation is provided below:

**BEGIN REDACTED**



**END REDACTED**

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<sup>4</sup> See [http://www.cisco.com/en/US/prod/collateral/modules/ps2706/ps6906/product\\_data\\_sheet0900aecd8045861b.html](http://www.cisco.com/en/US/prod/collateral/modules/ps2706/ps6906/product_data_sheet0900aecd8045861b.html).



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many fewer end users that were supported by the Harrison service (which supported more than 1000 students, parents, faculty and administrators).

**Company B [REDACTED -- [REDACTED] 6]**

Net56 entered into the confidential agreement attached as Exhibit 4 to provide web hosting and email hosting service at a bundled price of \$15,950/month. Net56's service for this customer included 12 servers, equating to a per server price of approximately \$1,329/month. The hosting services Net56 provided to the Harrison School District involved three email and three web hosting servers, for a total of six servers. Therefore, the \$5,000 total price for Harrison (\$833 per server) is substantially less than what this corporate customer would have paid for similar hosting services utilizing 6 servers.

**Company C [REDACTED -- [REDACTED] ]**

Net56 entered into the confidential agreement attached as Exhibit 5 to provide Internet Gateway service, a branded term that included VPN services, firewall services, and Internet access services at a bundled price of \$20,000/month. Although this bundled price is not broken down, it is evident that the cost for each service is higher than what Net56 charged to the schools. Net56's service for this customer included 11 servers, equating to a per server price of approximately \$1818 per server, compared to \$833 per server at Harrison. The Company C agreement includes some additional services not included in the school's e-rate agreements, such as consulting services, but these services were not core to the agreement and cannot reasonably be viewed as having doubled the bundled price of the contract.

Therefore, the Commission should find that Net56 has not violated the lowest corresponding price rule or the cost-effectiveness requirement in these cases.

Respectfully submitted,



Paul B. Hudson  
Counsel for Net56, Inc.

Attachments

cc: Anita Patankar-Stoll

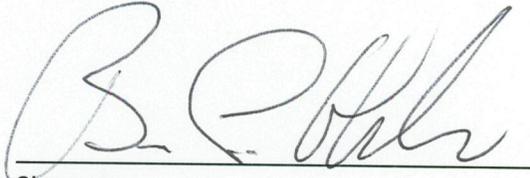
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<sup>6</sup> See Exhibit 4, page 9 of Lease Line Service Agreement; 2001 Web Hosting Agreement.

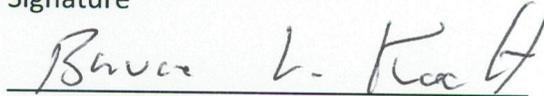
**Affidavit of Net56, Inc.**

I, Bruce L. Koch, do hereby declare under penalty of perjury as follows:

1. I am President and Chief Executive Officer of Net56, Inc. ("Net56"), an Illinois corporation with its principal place of business at 1254 W. Northwest Highway, Suite 740, Palatine, Illinois 60067.
2. I confirm that the agreements attached to this letter are true and complete copies of the originals they purport to be and that Net56 provided the services described therein at the prices set forth therein.
3. I declare under penalty of perjury that the foregoing is true and correct the best of my knowledge.

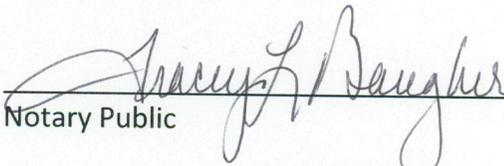


Signature



Printed Name

Sworn and subscribed to before me this 27<sup>th</sup> day of July, 2012.



Notary Public

My Commission expires on: 11/10/13



Exhibits

**CONFIDENTIAL**