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**Summary of the Second E-Rate Modernization Order**

Short Title:

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The Federal Communications Commission (FCC) adopted the *Second E-rate Modernization Order* on December 11, 2014 (<http://www.fcc.gov/document/fcc-continues-e-rate-reboot-meet-nations-digital-learning-needs> [1]). The Order builds on actions taken by the Commission in July to modernize and streamline the schools and libraries universal service support program, known as the E-rate program. In this Order, the Commission aims to ensure that all schools and libraries have access to high-speed connectivity and increases the E-rate program spending cap to adequately support that connectivity. The actions taken in this Order are the critical next step toward meeting the program goals and connectivity targets the Commission adopted in July's *E-rate Modernization Order*.

The *Second E-rate Modernization Order* first addresses the connectivity gap facing many schools and libraries, particularly in rural areas, by maximizing the options available for purchasing affordable high-speed connectivity. Next, the Order extends the category two budget approach adopted in the *E-rate Modernization Order* for five years through funding year 2019. In order to meet the long term connectivity needs for all schools and libraries, the Order also increases the annual E-rate funding cap to $3.9 billion and indexes it to inflation. Lastly, the Order directs the Universal Service Administrative Company (USAC) to establish a performance management system to assess the effectiveness of policy changes and program administration. In the accompanying Order on Reconsideration, the Commission grants, in part, petitions for reconsideration of the E-rate program's definition of "rural," clarifies the proper cost allocation test for individual data plans and the cost effectiveness test for circuits that carry voice and data traffic, and denies petitions for reconsideration of the document retention rule, elimination of E-rate support for telephone service components, voicemail, and email offered as part of an Internet access service, and the application of the rule prohibiting multi-year funding commitments to category two services.

1. **Maximizing Schools' and Libraries' Options for Purchasing Affordable High-Speed Broadband Connectivity (Order ¶¶ 9-76)**

The first section of the Order focuses on providing additional flexibility to schools and libraries seeking to provide affordable high-speed broadband connections. The record in this proceeding demonstrates that the lack of access to broadband infrastructure, particularly in rural areas, and the high recurring costs of high-speed connections in many other areas are two major obstacles to achieving the E-rate program goals. Though E-rate has historically funded all priority one, now category one, requests, a substantial percentage of schools and libraries are not in a position to meet the short and long term connectivity targets adopted in the *E-rate Modernization Order.* The actions taken in this section are designed to help close the rural connectivity gap and increase the affordability of high-speed broadband for all E-rate applicants.

* 1. **Making the Payment Options for Special Construction Charges More Flexible (Order ¶¶ 16-28)**
     1. **Suspending USAC's Multi-Year Amortization Policy for Non-Recurring Construction Costs (Order ¶¶ 17-21)**

The Order directs USAC to suspend for four years its requirement that applicants amortize category one special construction charges in excess of $500,000 over multiple years. This change will incent more vendors to bid on E-rate projects that require special construction and encourage efficient investment since vendors will not pass along financing costs to applicants. The Commission will analyze data collected by USAC on the number and cost of special construction projects funded during suspension of this requirement before deciding whether to permanently suspend the amortization requirement.

* + 1. **Allowing Applicants to Pay the Non-Discounted Portion of Non-Recurring Construction Costs over Multiple Years (Order ¶¶ 22-28)**

In addition, applicants will now be allowed to pay the non-discounted portion of special construction costs in installment plans of no more than four years. This change is designed to assist those applicants that lack the resources to pay the entire non-discounted portion of special construction costs upfront but are able to make installment payments for it. Service providers are under no obligation to offer an installment payment option to applicants.

* 1. **Modifying the Commission's Eligible Services List and Rules to Expand Access to Low Cost Fiber (Order ¶¶ 29-58)**
     1. **Equalizing the Treatment of Lit and Dark Fiber (Order ¶¶ 30-42)**

Beginning in funding year 2016, the Order amends the E-rate program's eligible services list to equalize the treatment of lit and dark fiber. Dark fiber leases permit a customer to purchase capacity on a provider-owned and maintained fiber network without paying for transmission service. The customer pays separately for the modulating electronics required to "light" the fiber (transmit data). Special construction charges beyond the applicant's property line and modulating electronics to light dark fiber will be eligible for category one support. The Order anticipates that funding for dark fiber will be a cost-effective option for many E-rate applicants by increasing the number of competitive options for broadband construction and deployment and lowering recurring costs.

For dark fiber special construction projects, and all other special construction projects, the Order codifies USAC's special construction policies allowing applicants to receive funding for category one infrastructure costs incurred up to six months prior to the funding year provided that the service provider is selected pursuant to a posted FCC Form 470, a category one recurring service depends on the installation of the infrastructure, and the service start date is on or after the start of the funding year. Applicants may also receive extensions of up to one year for unavoidable delays due to weather or other reasons.

The Order adopts safeguards to ensure that applicants properly compare dark fiber with other options and treat price as the primary factor in selecting winning bids. Applicants that seek bids for dark fiber must also seek bids for lit fiber over a comparable time period. Applicants also must include equipment and maintenance costs associated with lighting dark fiber in the same application with the dark fiber lease. Additionally, applicants will not receive support for excess capacity and may only receive special construction support for dark fiber lit in the same funding year.

* + 1. **Permitting Self-Construction of High-Speed Broadband Networks (Order ¶¶ 43-54)**

The Order also permits applicants to seek E-rate support for self-construction of their own high-speed broadband networks, or portions of such networks, beginning in funding year 2016, when self-construction is the most cost-effective solution. Self-construction will enable schools and libraries that do not receive sufficient responses to FCC Form 470 to obtain needed high-speed connectivity.

The Order adopts several safeguards to ensure that the E-rate program only funds self-construction in the limited circumstances when it is demonstrated to be cost effective. Applicants will be required to demonstrate that self-construction is the most cost-effective option by soliciting bids for both service and construction on the same FCC Form 470 and comparing the cost of service to the total cost of ownership over the life of the facility for self-construction. Applicants will only receive support for self-construction of facilities built and used in that funding year and may not resell service. Lastly, as required by E-rate program rules, applicants must secure all resources necessary to make effective use of services purchased.

* + 1. **Additional Discounts When States Match Funds for High-Speed Broadband Construction (Order ¶¶ 55-59)**

Also beginning in funding year 2016, the E-rate program will provide additional category one funding, up to 10 percent, to match state funding for special construction charges for high-speed broadband connections. These matching funds are intended to encourage states to address school and library connectivity gaps. The E-rate program will also match special construction funding for Tribal schools and libraries when a state, Tribal government, or federal agency provides the additional funding.

* 1. **Ensuring Affordable Broadband Service to Schools and Libraries in High-Cost Areas (Order ¶¶ 60-76)**

The Order requires recipients of high-cost universal service support to offer high-speed broadband in response to a posted FCC Form 470 to schools and libraries located in the geographic area where the provider receives high-cost support at rates reasonably comparable to similar services in urban areas. The obligation will apply to all recipients of high-cost support that are subject to broadband performance obligations to serve fixed locations. High-cost recipients must offer schools and libraries high-speed broadband connections sufficient to meet the connectivity targets in the *E-rate Modernization Order*. The Order directs the Wireline Competition Bureau (the Bureau) to establish reasonable comparability benchmarks for rates offered to schools and libraries in urban areas. Those carriers that offer broadband services pursuant to tariffs must offer services at the benchmark rates established by the Bureau.

1. **Adjusting the E-rate Cap to Meet the Program's Connectivity Goals (Order ¶¶ 77-118)**
   1. **Ensuring Certainty for Applicants Seeking Support for Category Two Services (Order ¶¶ 82-100)**

The Order extends the two-year test period adopted in the *E-rate Modernization Order* for category two budgets by three years, through funding year 2019. This action, in conjunction with the increase in the annual E-rate cap, will provide certainty and predictability to applicants and will simplify administration for stakeholders. In doing so, the Order reaffirms that schools seeking support for category two services in funding years 2015 through 2019 will be eligible to request up to $150 per student (pre-discount) over a five-year period. The Order also clarifies that student counts for purposes of schools calculating category two budgets should include part-time students only when doing so regularly increases the maximum number of students on the school premises at the same time during the school day.

For libraries, the Order extends the five-year category two budgets through funding year 2019 and increases the budget to $5.00 per square foot, pre-discount, for libraries located in large and midsize cities, as well as urbanized areas with a population of 250,000 or more (identified by IMLS locale codes 11, 12, and 21) in recognition of the high usage density in urban libraries. All other libraries remain eligible to request discounts on category two services of up to $2.30 per square foot as adopted in the *E-rate Modernization Order*.

The Order concludes that the $1 billion annual target for category two support adopted in the *E-rate Modernization Order* is sufficient to fund the five-year category two budgets for all applicants.

* 1. **Meeting Applicants' Needs for Category One Support (Order ¶¶ 101-113)**

The Order analyzes the factors that will drive future E-rate program funding needs, including the growth in school and library demand for high-speed connectivity both from applicants with insufficient connectivity and applicants without access altogether. Based on the record of the proceeding, the Order anticipates that the increased availability of high-speed connections and robust Wi-Fi networks will contribute to increased demand from schools and libraries. The record also demonstrates that over one-third of schools nationwide and an even higher percentage of libraries lack access to fiber to the building. Closing the gap between schools with and those without access to high-speed connectivity will further increase demand for E-rate support. The Order therefore concludes that the cost of category one services will continue to increase over the next five years, though improved program efficiencies will reduce the overall increase.

* 1. **Adjusting the E-rate Cap to Provide Certainty of Sufficient Available Funding to Achieve Program Goals (Order ¶¶ 114-118)**

To ensure sufficient funding is available over the next five years to meet the program goals, the Order increases the annual E-rate program cap to $3.9 billion in funding year 2015 and indexes it to inflation. The increased cap will allow the E-rate program to meet its target of $1 billion in annual category two support while fully funding the growing demand for category one services. The increased funding cap will provide certainty to the applicant community, allowing local decision-makers to proceed at the pace that best serves their library patrons as they seek to take advantage of the changes to category two funding and to address the high-speed connectivity gap.

1. **Establishing a Performance Management System at USAC to Advance the Goals of the E-rate Program (Order ¶¶ 119-132)**

The Order directs USAC, in consultation with staff from the Office of the Managing Director (OMD) and the Bureau, to develop a robust performance management system to advance the goals adopted in the ­*E-rate Modernization Order* and to analyze, on an ongoing basis, the effectiveness of USAC's administration of the E-rate program.

* 1. **Components of the Performance Management System (Order ¶¶ 120-130)**

The Order directs USAC to incorporate several specific components into the performance management system, including: i) analysis of the impact of changes adopted in the *E-rate Modernization Order*; ii) evaluation of USAC IT upgrades; iii) simplification of the tools available for applicants to calculate discount rates; iv) exploration of the possibility of providing online tools to facilitate competitive bidding and to otherwise expose applicants to more purchasing options; v) improvements to the administrative experience (i.e. applications, appeal, audits) of program participants and applying performance metrics to customer service; vi) analysis of how to maximize the cost effectiveness of program purchases; vii) publicly- accessible data tracking and analysis tools; viii) a general procedural review to identify additional opportunities for data analysis and improved efficiency; and ix) a review and update of financial management practices. The Commission delegates authority to OMD and the Bureau to oversee development and implementation of the performance management system.

* 1. **Expanding Commission Oversight of USAC's Administrative Performance (Order ¶¶ 131-132)**

The Order also delegates authority to OMD and the Bureau to develop the components of an annual USAC performance review and ensure USAC conducts an annual performance review to track progress against program goals and creates a forward-looking strategic plan to expand and sustain performance improvements.

1. **Filing Deadlines for Appeals (Order ¶ 133)**

The Order clarifies that parties have 60 days from the issuance of a decision by USAC to either file an appeal with USAC or request a waiver from the Commission or Bureau. Parties that file a request for review with USAC and receive adverse decision have 60 days from issuance of the decision to file a request for review with the Commission.

1. **Order on Reconsideration (Order ¶¶ 134-163)**
   1. **Urban and Rural Designations (Order ¶¶ 136-143)**

The Order on Reconsideration modifies section 54.505(b)(3) of the Commission's rules, effective in funding year 2015, so that an individual school and library will be designated as "urban" if located in an "Urbanized Area" or "Urban Cluster" with a population of 25,000 or more as determined by the U.S. Census Bureau. Any school or library not designated "urban" will be designated as "rural" and would be eligible to receive an additional discount. This change in the urban/rural designation population threshold grants in part several petitions for reconsideration that argued that the rule adopted in the *E-rate Modernization Order* classified as urban many schools and libraries located in small towns and remote areas that are more expensive to serve. The new rule is consistent with urban/rural definitions in other federal programs and will be simple for USAC to administer. The Order retains the current rule that any school district or library system must have a majority of schools or libraries in a rural area that meets the new urban/rural definition to qualify for the additional rural discount.

* 1. **Document Retention Period (Order ¶¶ 144-147)**

The Order on Reconsideration denies reconsideration of the 10-year document retention requirement adopted in the *E-rate Modernization Order*, concluding that increasing the requirement to 10 years will protect against waste, fraud, and abuse, is consistent with other universal service programs, and will not impose an unreasonable burden on applicants

* 1. **Telephone Service Components, Voicemail, and Email (Order ¶¶ 148-151)**

The Order on Reconsideration denies petitions requesting that E-rate support for telephone service components and voicemail be phased out on the same five-year schedule as support for voice services and that email offered as part of Internet access service remain eligible for support. The Order explains that elimination of support for these services will further focus E-rate program spending on high-speed broadband and will not impose an excessive burden on applicants. The Order on Reconsideration instructs USAC, working with the Bureau, to establish guidelines for cost allocating ineligible telephone service components and voicemail from voice service bills.

* 1. **Conditional or Multi-Year Commitments (Order ¶¶ 152-155)**

The Order on Reconsideration denies a petition requesting that the E-rate program allow multi-year commitments for manage Wi-Fi services. Multi-year funding commitments would be detrimental to program administration and the five year budget for category two services extended in the *Second E-rate Modernization Order* should provide applicants with added certainty. The Order on Reconsideration also denies petitions requesting that the E-rate program provide conditional funding commitments for category two applications. The proposal could create additional uncertainty and administrative complexity. Additionally, many of the concerns underlying the proposal are alleviated by extension of the category two budgets to five funding years.

* 1. **Clarifications (Order ¶¶ 156-163)**

Lastly, the Order on Reconsideration clarifies the proper cost-effectiveness test for data plans and air cards for mobile devices and cost allocation methods for dedicated and shared voice circuits. The *E-rate Modernization Order* stated that the purchase of a fixed broadband connection and wireless local area network (WLAN) equipment is generally more cost effective than the purchase of individual data plans for every student or library patron. However, in limited circumstances where data plans or air cards for mobile devices are shown to be cost effective, the Order on Reconsideration clarifies that applicants should compare the pre-discount cost of data plans or air cards to the pre-discount cost of all components of delivering connectivity through a fixed connection and WLAN. Applicants may not consider the likelihood of receiving category two E-rate support as part of their cost-effectiveness analysis.

Additionally, the Order on Reconsideration clarifies that applicants must cost allocate circuit capacity dedicated to voice service from the cost of data circuits and apply the five-year phase down of support for voice services to charges for dedicated voice capacity. The Order on Reconsideration provides several examples of how to cost allocate voice service charges in different bundled service and shared circuit scenarios.

1. **Delegation to Revise Rules (Order ¶ 165)**

The Order delegates authority to the Bureau to make further rule revisions necessary to ensure the changes adopted in the Order are reflected in Commission rules. The Order also instructs the Bureau and USAC to monitor the program for waste, fraud, and abuse and delegates authority to the Bureau and OMD to specify additional administrative changes and provide implementation guidance to USAC for the purpose of protecting against waste, fraud, and abuse.