

**DISSENTING STATEMENT OF
COMMISSIONER AJIT PAI**

Re: *Modernizing the E-Rate Program for Schools and Libraries*, WC Docket No. 13-184, *Connect America Fund*, WC Docket No. 10-90.

I don't normally claim to be clairvoyant. But last week, at the FCBA Chairman's Dinner, I was compared to Carnac the Magnificent, complete with a photo-shopped picture of me wearing a turban.

At the time, I assumed the Chairman's joke was going to be about the E-Rate order before us today and the intuition I had back in July. That is, I was expecting this clip:

I doubt the recent scramble to claim fiscal responsibility is anything more than a passing fad. . . . [S]everal outside parties have already told me they've been promised a post-election increase in the E-Rate budget. They even told me the specific month it was coming: December. The story was remarkably consistent. So mark my words: Any talk of fiscal responsibility will be short-lived. In five months, maybe six, we'll be back at this table discussing how much to increase Americans' phone bills.¹

What do you know? It's five months later to the day, and lo and behold, we're discussing whether to spend an additional \$1.5 billion each year to pay for the promises made last summer. That's a \$7.5 billion payoff over five years for the entrenched interests that thrive under the bureaucratic yoke of today's E-Rate program. That's a 17.2% telephone tax increase for American families that are still struggling to make ends meet in this lackluster economy. And while those who can afford to live in Georgetown, Manhattan's Upper East Side, or Malibu might scoff at the increased taxes, families in middle America are sick of being nicked and dimed by Washington politicians.

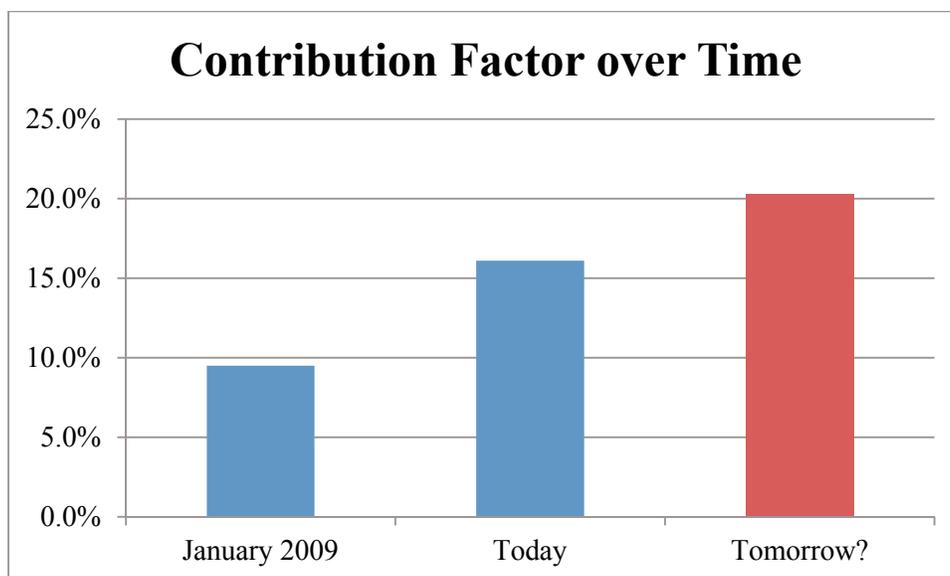
The Commission is well aware of this. It's no accident that a spending increase was promised *before* the election and the tax increase to pay for it is coming *after* the election, the unmistakable message of which was not exactly nationwide yearning for a Beltway bureaucracy's tax hike. As a candid consultant might put it: Back in July, the "lack of transparency [wa]s a huge political advantage. . . . [T]hat was really, really critical to get the thing to pass."²

This tax and spend scheme is nothing new. Universal service contribution rates have jumped 60% under this Administration, from 9.5% to 16.1%. With today's new spending, they'll go up again. The contribution factor could rise as high as 20.3% next year.³ That would be more than double the rate from January 2009, and it would be the first time in history that the factor has cracked the 20% mark.

¹ *Modernizing the E-Rate Program for Schools and Libraries*, WC Docket No. 13-184, Report and Order and Further Notice of Proposed Rulemaking, 29 FCC Rcd 8870, 9042 (2014) (Dissenting Statement of Commissioner Ajit Pai); see also <http://youtu.be/6LDko49R9YM>.

² See Remarks of Jonathan Gruber (Oct. 17, 2013), <https://www.youtube.com/watch?v=G790p0LcgbI>.

³ Specifically, USAC has estimated 1Q 2015 demand to be \$2.18090 billion and the contribution base to be \$15.30530 billion. See USAC, First Quarter 2015 Appendices, <http://www.usac.org/about/tools/fcc/filings/2015/q1.aspx>. Once we hit the new E-Rate cap, the adjusted contribution base would be (\$15.30530 billion – \$2.55590 billion) * 0.99, or \$12.621906 billion; the unadjusted contribution factor would be \$2.55590 billion / \$12.621906 billion, or 0.202497; and the contribution factor would accordingly be 20.3%. See Office of the Managing Director, FCC, Contribution Factor & Quarterly Filings - Universal Service Fund (USF) Management Support, <http://www.fcc.gov/encyclopedia/contribution-factor-quarterly-filings-universal-service-fund-usf-management-support> (describing how the contribution factor is calculated).



A large chunk of the \$7.5 billion in additional spending will go to pay for the Wi-Fi pilot program created last summer. Now, we were told back in July that the math for that program added up, that we wouldn't need to increase taxes to pay for it. We were told that the two-year pilot would cost taxpayers \$2 billion.

Today's *Order* is, in effect, a report card on the Commission's math skills. And we are receiving an "F." How so? Because the costs will be much, much higher. First, the *Order* extends the program to five years, which adds more than \$3 billion to the expected price tag. Second, the *Order* now acknowledges that the "budget" of \$1 billion per year really doesn't exist since "there is pent up demand and . . . applicants may seek a larger portion of the budget early on in the five-year cycle."⁴ In other words, this Wi-Fi pilot might cost one, two, or even three billion dollars in its first year. Consumers' only protection? A baseless "expectation" that requests will be "reasonable."⁵

It's harder to pin down where exactly the other \$4.5 billion in new spending will go. The *Order* claims that this money is needed for "fully funding category one demand" (*i.e.*, broadband connections)⁶—but our staff's own estimates show that's not the case. Their data show that aggregate demand for broadband connections will remain \$35 million to \$326 million *below* the current E-Rate cap for the foreseeable future.⁷ That means we don't need an E-Rate tax increase to pay for the broadband connections that schools and libraries want now or in the next five years.

Others have claimed the money is needed to close the so-called Rural Fiber Gap. Yet the *Order* apparently abandons that concept. None of the new spending is earmarked for it. No money is set aside for rural schools and libraries. Not one safeguard ensures that money is spent where there's a fiber gap.⁸

⁴ *Order* at para. 99; *id.* at para. 114 ("[P]roviding more than the \$1 billion target level in support for internal connections will allow more applicants to close their Wi-Fi gaps sooner and more efficiently.").

⁵ *Order* at para. 99.

⁶ *Order* at para. 113.

⁷ Specifically, staff has estimated that the phase-down of legacy services should reduce category one demand by \$342 million, \$582 million, \$789 million, \$937 million, and \$968 million in fiscal years 2015–2019, so category one demand should be \$2.42 billion, \$2.32 billion, \$2.26 billion, \$2.26 billion, and \$2.39 billion for those same years. Wireline Competition Bureau & Office of Strategic Planning and Policy Staff Report, WC Docket No. 13-184, 29 FCC Rcd 9646, 9663, Fig. 10 (WCB & OSP 2014). During that same period, the cap is expected to adjust with inflation from \$2.46 billion to \$2.63 billion.

⁸ Indeed, the *Order* expressly rejects safeguards like these. *See Order* at para. 52.

The nation's largest urban school districts could easily soak up all the new funding to overbuild existing fiber networks. We've seen this movie before—Eagle-Net, anyone?⁹ The *Order*'s philosophy brings to mind sage words from John Hurt's character in *Contact*: "First rule in government spending: Why build one when you can have two at twice the price?"¹⁰

To be fair, the *Order* does spend a few paragraphs trying to address the differing challenges of connecting rural and urban America. But the *Order* gets even that wrong. You see, rather than sensibly directing money to small schools in small towns or community libraries in the Alaska bush and other remote areas, the *Order* more than doubles the funding for libraries in the nation's largest cities and their suburbs.¹¹ This lopsided carve-out isn't fair to the poor schools and libraries that actually need the funding. And this special-interest giveaway to the nation's best-funded libraries shows just how little Washington, DC actually cares about rural America.

So why does the Commission now think that another \$4.5 billion is needed to meet demand for broadband connectivity? In large part, it is because we are succumbing to a disease that afflicts so many inside the Beltway. We don't *show* that we care about a problem by doing the hard work needed to solve it. No, instead, we *talk about* how much we care about a problem based on the amount of money we are willing to throw at it, a public demonstration of supposed "compassion," "courage," and "vision"—all of which, of course, is easy to do when you are spending other people's money. It has thus become clear that the FCC has given up any pretense of safeguarding the funds that taxpayers have entrusted to us in favor of what my colleague Commissioner O'Rielly rightly called an "E-Rate Spending Spree."¹²

Want to know what *real* compassion, courage, and vision on this issue would look like? One example would be to end the incentives for wasteful spending so that E-Rate dollars are able to stretch farther for more schools and libraries. For more than a decade, the Commission has known that E-Rate's subsidy system—which gives some applicants discounts of up to 90% without limitation—encourages wasteful spending. A 2003 USAC task force found that the high discount rate gave applicants little incentive to spend wisely and recommended applicants receive no more than four E-Rate dollars for every one they spend.¹³ A 2013 independent study showed "that applicants with higher discount rates . . . planned to spend significantly more per-student in pre-discount dollars"—with the highest-discount applicants spending more than twice as much as their peers.¹⁴ It's just common sense. The less of your own money you have to put in, the more of others' money you're going to demand.

That's why our *2013 Notice* recognized that "Applicants receiving substantial (80–90 percent) discounts have greatly reduced incentives to ensure they are receiving the lowest priced services or that they are getting only services they need."¹⁵ And that's why just five months ago, the FCC increased the

⁹ "EAGLE-Net's partnership with Affiniti of Colorado raises questions," *Denver Post* (Oct. 29, 2013), available at http://www.denverpost.com/breakingnews/ci_24413625/eagle-net-deal-affiniti-raises-questions.

¹⁰ S.R. Hadden, *Contact* (Warner Bros. et al. 1997).

¹¹ *Compare Order* at para. 87 (reporting a \$2.30 per square foot pre-discount budget for most libraries), *with id.* at para. 89 (adopting a \$5.00 per square foot pre-discount budget for "the most urban libraries").

¹² Statement of FCC Commissioner O'Rielly: FCC's E-Rate Spending Spree is Flawed, <http://go.usa.gov/FgRx> (Nov. 17, 2014).

¹³ USAC, Recommendations of the Task Force on the Prevention of Waste, Fraud and Abuse, at 3–4 (Sept. 22, 2003) (submitted with letter from Cheryl Parrino, USAC, to Marlene Dortch, Secretary, FCC (filed Nov. 26, 2003)).

¹⁴ *Modernizing the E-Rate Program for Schools and Libraries*, WC Docket No. 13-184, Notice of Proposed Rulemaking, 28 FCC Rcd 11304, 11343, para. 136 (2013) (*2013 Notice*) ("Those seeking 20–59 percent discounts plan \$35.23 per-student in pre-discount purchases of priority one services, while those seeking 60–79 percent discounts plan \$43.02 per-student pre-discount purchases for such services, and those seeking 80–90 percent discounts, \$86.53 per-student pre-discount purchases for such services.").

¹⁵ *Id.* at 11338, para. 122.

matching requirement for internal connections: We said then that “requiring higher matches will lead applicants . . . to pursue lower prices for eligible category two services more aggressively.”¹⁶

In the face of more than a decade of evidence and analysis, what does the Commission do today? Unbelievably, it actually *reduces* the matching requirement.¹⁷ Now, some applicants will have to pay *nothing* out of pocket for new construction—not even the cost of a cup of coffee.¹⁸ In other words, there will be literally no economic incentive for some schools or libraries to choose the most cost-effective option or to avoid gold-plating their networks. Enabling wasteful spending isn’t courageous or compassionate; it’s just crazy.

It gets worse. The *Order* overturns a 14-year-old bipartisan decision designed to limit the amount of funding a wealthy applicant could apply for in a given year.¹⁹ The *Order* next overturns the 9-year-old bipartisan prohibition on E-Rate paying vendors before applicants contribute their matching funds.²⁰ Good luck making sure matching funds are actually paid. The *Order* overturns the 4-year-old bipartisan decision to limit the funding available for dark fiber²¹ and the 17-year-old bipartisan decision that E-Rate would not support wide area networks constructed by applicants.²² So what that these safeguards kept spending in check and deterred overbuilding? In short, the *Order* endorses a free-for-all of vendor-financing and unbounded spending on terms that would make the subprime mortgage industry blush.

The *Order*’s only defense is that it “follow[s] the model the Commission adopted in the *Healthcare Connect [Fund] Order* . . . to ensure that the Fund supports self-construction only when it is the most cost-effective option.”²³ If only that were so. The FCC added six safeguards to the *Healthcare Connect Fund Order* “to ensure that consortia only exercised their option to self-construct when it was absolutely necessary”²⁴: (1) a requirement that USAC carefully evaluate whether “self-construction is demonstrated to be the most cost-effective option after competitive bidding,” (2) a requirement that all applicants “provide a 35 percent contribution to the cost of supported networks and services, which will help ensure prudent investment decisions,” (3) a requirement that the same discount apply regardless of whether applicants purchased service from a provider or constructed their own facilities, (4) an annual cap

¹⁶ *Modernizing the E-rate Program for Schools and Libraries*, WC Docket No. 13-184, Report and Order and Further Notice of Proposed Rulemaking, 29 FCC Rcd 8870, 8901, para. 84 (2014).

¹⁷ *Order* at para. 55.

¹⁸ The *Order* dismisses this concern by claiming that “[t]o the extent that another governmental entity pays a portion of the cost of the E-rate supported service, that entity will have an incentive to ensure that the applicant engages in cost effective purchasing.” *Order* at para. 58. Given that the FCC will now match every state dollar with up to 19 (!) E-Rate dollars, this is cold comfort for anyone familiar with the economic literature or even . . . the history of the E-Rate program. Just Google “E-Rate scandal.”

¹⁹ *Order* at para. 17 (overturning *Request for Review by Brooklyn Public Library, Federal-State Joint Board on Universal Service, Changes to the Board of Directors of the National Exchange Carrier Association, Inc.*, CC Docket Nos. 96-45, 97-21, Order, 15 FCC Rcd 18598 (2000)). The *Brooklyn Order* said applicants had to amortize large, nonrecurring costs over three or more years, in part because of a concern that wealthy applicants could afford large upfront payments whereas poorer applicants could not. Without much ado, the *Order* ends that policy.

²⁰ *Order* at para. 22 (overturning in part *Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Fifth Report and Order, 19 FCC Rcd 15808 (2004)).

²¹ *Order* at para. 30 (overturning in part *Schools and Libraries Universal Service Support Mechanism, A National Broadband Plan for our Future*, CC Docket No. 02-6, GN Docket No. 09-51, Sixth Report and Order, 25 FCC Rcd 18762 (2010)).

²² *Order* at para. 43 (repealing 47 C.F.R. § 54.518 and overturning in part *Federal-State Joint Board on Universal Service et al.*, CC Docket Nos. 96-45, 96-262, 94-1, 91-213, 95-72, 97-21, Fourth Order on Reconsideration and Report and Order, 13 FCC Rcd 5318 (1997) (*Fourth Recon. Order*)).

²³ *Order* at para. 44.

²⁴ *2013 Notice*, 28 FCC Rcd at 11328, para. 81.

on the amount available for new construction spending, (5) a requirement that certain upfront costs be prorated over at least a three year period, and (6) a limitation on “consortia from using revenues from excess capacity as a source of participant contribution.”²⁵ Of these six critical and independent safeguards, only one will apply here.²⁶ To pretend that that *Healthcare Connect Fund Order* is any sort of precedent for today’s action is a bad joke, and the American taxpayer is the punchline.

Lack of fiscal responsibility isn’t the only flaw here; today’s *Order* is also legally deficient on several fronts. The FCC never proposed to remove some of the safeguards it eliminates today, such as reducing the applicant’s contribution to zero percent.²⁷ Nor does the *Order* explain how the public could have reasonably expected 17 paragraphs of new requirements for high-cost recipients, such as new requirements to deploy broadband without additional support, new price regulation of broadband Internet services, and new tariffing obligations. These detailed requirements all stem from a single vague question back in June about the Commission’s “expectation[s],” rather than any proposed rules.²⁸ Nor does the *Order* explain the abrupt reversal of the 1997 decision that “building and purchasing of equipment and facilities [for self-construction] do not meet the statutory definition of ‘telecommunications’” and “do not appear to fall within the narrow provision that allows support for access to the Internet.”²⁹ In other words, the FCC decided in the Clinton Administration that what we’re deciding to do today was unlawful. Not exactly a technicality! But no matter. Legally sustainable decisions have not been much of a priority for the Commission of late.

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Despite today’s *Order*, and despite July’s sad, partisan retreat, I still believe that “E-Rate is a program worth fighting for.”³⁰ When I spoke to villagers in America’s northernmost library, in Barrow, Alaska, I saw how broadband can connect a community that no road reaches. When I visited Los Angeles in the spring, and Chicago in the fall at Mayor Rahm Emanuel’s invitation, I saw the progress that poor children can make when technology is integrated in the classroom. In South Dakota and Kansas, I’ve seen the potential of next-generation technologies to empower small communities and give rural Americans the opportunities found in our nation’s largest cities.

But again, the FCC fails to deliver real reform. This *Order* isn’t profound; it’s prodigal. The Commission shies away from making any hard choices and instead just pours more money into a broken system.

That’s not what the American people want, whatever glowing press releases and gleaming tweets follow this vote. Americans want a student-centered E-Rate program. That means a one-page

²⁵ *Rural Health Care Support Mechanism*, WC Docket No. 02-60, Report and Order, 27 FCC Rcd 16678, 16713, paras. 73–75 (2012) (*Healthcare Connect Fund Order*); *2013 Notice*, 28 FCC Rcd at 11328, n.122.

²⁶ To wit, the first requirement. See *Order* at para. 47. Of course, if this cost-effectiveness review is really just a reiteration of the price-is-the-primary factor rule then it ultimately means nothing but more paperwork for applicants. That rule is itself hopelessly flawed. See *Application for Review of a Decision of the Wireline Competition Bureau by Henrico School District, Richmond, Virginia, File No. SLD-607894, Schools and Libraries Universal Service Support Mechanism*, CC Docket No. 02-6, Order, 29 FCC Rcd 10837, 10843 (2014) (Concurring Statement of Commissioner Ajit Pai).

²⁷ Although the Commission has previously sought comment on matching state funding, it did so in the context of making existing support “conditional on state . . . funds above the otherwise-required school or library 10–80 percent contribution.” See *2013 Notice*, 28 FCC Rcd at 11349, para. 165 (emphasis added).

²⁸ *Compare Order* at paras. 59–75, with *Connect America Fund et al.*, WC Docket No. 10-90 et al., Report and Order, Declaratory Ruling, Order, Memorandum Opinion and Order, Seventh Order on Reconsideration, and Further Notice of Proposed Rulemaking, 29 FCC Rcd 7051, 7107, para. 159 (2014).

²⁹ *Fourth Recon. Order*, 13 FCC Rcd at para. 193.

³⁰ Remarks of Commissioner Ajit Pai, “Connecting the American Classroom: A Student-Centered E-Rate Program,” American Enterprise Institute (July 16, 2013), available at <http://go.usa.gov/jbD3>.

application; a funding commitment process that would last no more than a week; additional funding targeted to rural and remote schools and libraries; an end to the outdated priority system so that local communities can make their own decisions; a dramatic reduction in the amount of money applicants would spend on consultants and the amount of time they'd have to spend on USAC appeals; and an increase in funding by up to \$1 billion each year for next-generation services, all without raising fees one penny. But not one of those things was offered last July to address bipartisan criticism of the first E-Rate proposal, even though each would have drawn broad public support. And not one of those things is contained in today's *Order*.

And so the students and teachers, parents and school boards, librarians and library patrons I've spoken with will have to wait for the bold solutions that could help them. For now, they'll just have to contribute more to the E-Rate program and get less out of it. They'll continue to be trapped in a bureaucracy that makes the IRS look user-friendly. They'll be denied 21st-century digital opportunities for years more. It just won't happen during this Administration.

But in time, I do believe we will achieve real E-Rate reform. And I hope I'm prescient about that, too, because every one of our communities, urban and rural, rich and poor, deserve it.

For all of these reasons, I dissent.