Federal Communications Commission
Washington, D.C. 20554

October 24, 2008

Mr. Scott Barash
Acting Chief Executive Officer
Universal Service Administrative Company
2000 L Street, N.W.
Suite 200
Washington, DC 20036

Re: Rural Health Care Pilot Program
WC Docket No. 02-60

Dear Mr. Barash:

This letter responds to questions raised by participants in the Commission's Rural Health Care Pilot Program (Pilot Program) and the Universal Service Administrative Company (USAC) concerning eligible costs, restrictions on resale, and sustainability.

To fully address the questions posed, it is necessary to review some basic principles that were set forth in the *2006 Pilot Program Order* and the *2007 RHC PP Selection Order*.[1]

The Pilot Program supports up to 85 percent of eligible costs of designing, installing, operating and maintaining a broadband health care network, to be used by eligible health care providers.[2] The remaining 15 percent of eligible costs must be paid by the health care providers, from eligible sources of funds.[3] To ensure that the operation of the Pilot Program is consistent with the goals and objectives of the *2006 Pilot Program Order*, the Commission placed limitations on the source of funds from which selected participants may derive their minimum 15 percent contribution. Only funds from an eligible source may be applied towards selected participants' required 15 percent minimum contribution. Eligible sources include the applicant or eligible health care provider participants; state grants, funding, or appropriations; federal funding, grants, loans, or appropriations except for RHC funding; and other grant funding, including private grants. Ineligible sources include in-kind or implied contributions; a local exchange carrier (LEC) or other telecom carrier, utility, contractor, consultant, or other service provider; and for-profit participants.[4] For example, a cost sharing agreement with a for-profit participant, where the for-profit participant would pay an eligible participant's minimum 15 percent contribution, would not be an eligible source of funding.

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[1] *Rural Health Care Support Mechanism*, WC Docket No. 02-60, Order, 21 FCC Rcd 11111 (2006) (*2006 Pilot Program Order*); *Rural Heath Care Support Mechanism*, WC Docket No. 02-60, Order, 22 FCC Rcd 20360 (2007) (*2007 RHC PP Selection Order*).

[2] *See 2006 Pilot Program Order*, 21 FCC Rcd at 11114, para. 10.

[3] *2007 RHC PP Selection Order*, 22 FCC Rcd at 20399, para. 77.

[4] *See id.* at 20399, para. 77.

Any costs associated with a network which relates to the use of the network by for-profit participants (or other ineligible network participants), are deemed ineligible costs, and must be paid with funds other than Pilot Program funds and other than the participant's minimum 15 percent contribution.[5] In their reports to USAC, participants must report both eligible and ineligible network costs. They must identify the eligible source of funds for paying not less than 15 percent of eligible costs (the remainder, up to 85 percent, may be paid for with Pilot Project funds), and they must identify the source of funds for paying 100 percent of ineligible costs.[6]

Section 254(h)(3) of the Communications Act of 1934, as amended,[7] and section 54.617(a) of the Commission's rules[8] restrict the resale of any services purchased pursuant to the rural health care support mechanism. The Commission has determined that, under this resale restriction, a selected participant cannot sell network capacity that was supported by Pilot Program funding, but could share network capacity with an ineligible entity as long as the ineligible entity pays its fair share of network costs attributable to the portion of the network capacity used.[9]

A project that proposes to enter into a sharing arrangement for excess capacity not supported by universal service funds is not disqualified from funding.[10] However, such arrangements must be carefully reviewed on a case by case basis. Participants proposing to sell or lease excess capacity must provide a tangible basis on which eligible and ineligible costs are allocated.[11] At a minimum, the amount identified as the eligible cost (to be funded by the Pilot Program and the participant's minimum 15 percent contribution) should not be more than what the cost would be if the network were designed for eligible use only.[12] In addition, the amount to be contributed by for-profit or other ineligible participants for the network should be a fair share.[13] Participants must be reminded that, to prevent against waste, fraud and abuse, participants must report how for-profit or other ineligible entities paid or will pay for their fair share of network costs.[14] Any participant that intends to construct excess capacity not funded by universal service funds (e.g., dark fiber) to be used by a for-profit entity or other ineligible participant (an ineligible cost), must: (i) allocate the trench costs between eligible and ineligible cost components, on a tangible basis;

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[5] *Id.* at 20399, para. 76.

[6] *Id.*

[7] 47 U.S.C. § 254(h)(3).

[8] 47 C.F.R. § 54.617(a).

[9] *2007 RHC PP Selection Order*, 22 FCC Rcd at 20416, para. 107.

[10] *Id.* at 20416, para. 107 n.347.

[11] *Id.* at 20399, para. 76; *cf.* 47 C.F.R. § 54.504(g) (describing mixed eligibility services in the E-Rate program context).

[12] *Cf.* 47 C.F.R. § 54.504(g).

[13] *2006 Pilot Program Order*, 21 FCC Rcd at 11116-17, para. 17.

[14] *See 2007 RHC PP Selection Order*, 22 FCC Rcd at 20416, para. 108, 20432-20434, Appendix D.

(ii) demonstrate that the amount identified as the eligible cost component is not more than what such amount would be if the trench were being dug for eligible lines only; and (iii) identify how the party paying for the ineligible costs component was assessed a fair share amount and provide proof that such party has paid or will pay such fair share amount.[15]

Although the Commission did not establish a bright line definition for fair share, participants are reminded that they have the obligation to document how fair share was determined, and such documentation remains subject to Pilot Program audits and oversight.[16] To demonstrate fair share, a participant could show that the amount charged to third parties (non-eligible network participants) for use of the network is comparable to market rates and/or was determined pursuant to arms' length and good faith negotiations, and is not disproportionate to the risks and benefits assumed by the third party. In addition, participants should demonstrate that the net eligible costs being paid for by Pilot Project funds, for eligible uses of the network, is not higher than such costs would have been had a non-eligible component for the project not been included.

If there is a mixed use aspect of a network funded by the Pilot Program (i.e., the network will be used by eligible participants and by non-eligible participants), eligible network participants and the ineligible network participants are required to have a formalized agreement that specifies the parties' respective rights and obligations, including access and maintenance. Ineligible participants are also expected to pay a fair share of recurring and non-recurring costs. In their sustainability plans, participants should disclose all sources or potential sources of revenue that relate to the network.[17] Such revenues (including amounts paid by eligible network participants as well as amounts paid by ineligible network participants) should be identified in the participant's sustainability plan, and should be retained by the participant solely for sustaining the network. Such funds should not be diverted for other purposes. The network paid for with Pilot Program funds should not be used as a profit center to fund costs of the participants that are not related to sustaining the network.

In instances where a participant intends to sell or lease excess capacity, the participant must identify such excess capacity in its project description, sustainability plan, and quarterly reports, and should demonstrate how such excess capacity was paid for (or will be paid for) by non-Pilot Program funds, meeting the proper allocation and fair share qualifications identified above. If no such distinctions are made in the applicant's reporting, then the Pilot Program (together with the participant's minimum 15 percent contribution) will be deemed to have funded 100 percent of the network, and no part of it would be deemed excess capacity that could be sold or leased without running afoul of the resale restrictions. If the participant wishes to modify a network to add extra capacity, or to add additional non-eligible participants, this would be a network modification which the Commission discussed in the *2007 RHC PP Selection Order*.[18] In the event of such modifications, the cost to modify the network should be properly

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[15] *See id.* at 20362, para. 6, 20416, para. 108.

[16] *Id.* at 20362, para. 6, 20388-20399, para. 54.

[17] *See id.* at 20432-20434, Appendix D (Pilot Program Participants Quarterly Data Reports). Paragraph 6 of the report requires participants to describe how costs have been apportioned and the sources of the funds to pay such costs, and to identify the source of financial support and anticipated revenues that is paying for costs not covered by the fund and by Pilot Program participants. *Id.* at 20433, Appendix D.

[18] *Id.* at 20401, para. 80.

allocated (meeting the allocation and fair share factors discussed above), the network must not result in a *de minimis* number of rural health care providers participating in the supported network,[19] and, as part of the participant's sustainability plan, net revenues from such modifications should be used to sustain the network and should not be used for other purposes.

Please let me know if you have any questions. I appreciate USAC's continued commitment to ensuring the success of the Pilot Program.

Sincerely,

Dana R. Shaffer
Chief
Wireline Competition Bureau

[19] "Although network modifications may deviate from a selected participant's initial application, to the extent a modification results in a supported network only connecting a *de minimis* number of rural health care providers, the modification may result in adjustment of available support or denial of participation in the Pilot Program for a selected participant." *Id.* at 20401, n. 253.