E-Rate Central
2165 Seaford Avenue, Room 217
Seaford, NY 11783-2700
Tel: 516-832-2881 • Fax: 516-334-6697

Before the Federal Communications Commission
in the matter of Schools and Libraries Universal Service Support Mechanism : CC 02-6 : FCC 03-323
State E-Rate Coordinators' Alliance (SECA)
Appendix A : Executive Summary: Analysis of Internal Connection Impact

Impact Analysis of CCSSO E-Rate Recommendation to Reduce Maximum Discount on Priority 2 Services to 70%

Executive Summary

Introduction

In Initial Comments of the Council of Chief State School Officers ("CCSSO") to the FCC's Notice of Proposed Rulemaking in CC Docket No. 02-6 in April 2002, and in subsequent policy briefs, the State E-Rate Coordinators' Alliance ("SECA") recommended that the maximum E-rate discount on Internal Connection ("Priority 2") services be reduced from 90% to 70%.

Under the current discount rate structure, the demand for Internal Connection funding by the 90% and other high discount applicants has been extraordinary. Because of limited E-rate program funds, and an allocation method that channels funding only to the highest discount applicants, no Priority 2 funds have been awarded to applicants at or below 80% since FY 1999.

By reducing the maximum discount funding rate on Priority 2 services to 70%, SECA believes that:

- Scarce Priority 2 funding can be more fairly distributed across a broader range of needy applicants without unduly penalizing those applicants who have already received most of the Internal Connections funds in earlier funding years; and
- Increasing the minimum non-discounted portion of Internal Connection services from 10% to 30% will significantly reduce both applicant and service provider incentives that lead to instances of waste, fraud, and abuse.

Under the SECA recommendation, no changes are proposed to the discount rate structure for Telecommunications or Internet Access ("Priority 1") services. Priority 1 services, with discounts up to 90%, have been fully funded in every program year. The recommended change would affect only Priority 2 funding.

One example of an E-rate discount rate matrix, revised in accordance with this recommendation (and used in this analysis), is shown on the following page.

Revised Discount Rate Matrix

Income	Priority 1 Discounts		Priority 2 Discounts*	
NSLP Eligibility	Urban	Rural	Urban	Rural
Less than 1%	20%	25%	20%	25%
1% to 19%	40%	50%	40%	50%
20% to 34%	50%	60%	50%	60%
35% to 49%	60%	70%	60%	70%
50% to 74%	80%	80%	70%	70%
75% to 100%	90%	90%	70%	70%

* Note: In the event that Priority 2 funds must be allocated at the 70% level, funding would be awarded in accordance with Priority 1 applicant levels (90%, 89%, etc.).

Impact Analysis

In order to estimate the funding impact of a maximum 70% discount rate on Internal Connection services for a broad range of applicants, SECA undertook the analysis summarized below.

- FY 2000 was selected as the base year for estimating the nominal level of funding demand under the current discount matrix. This was the first funding year following FY 1999, the only year in the program's history for which full Priority 2 funding was provided. As such, it was the year least likely to have been affected by applicant expectations of limited Internal Connection funding. It was also the year preceding the explosive new demand for Priority 2 funding at the highest discount levels that may have been fueled more by evolving service provider sales strategies than by real applicant need.

  The initial pre-discount demand for Internal Connection funds in FY 2000 was $4 billion, including 18% by 90% applicants and 36% from 80-89% applicants. Final Priority 2 funding totaling $1.155 billion was awarded to applicants at the 86% discount level and above. Final demand at these levels ranged from 88-92% of the initial demand once ineligible items and/or duplicate applications were eliminated.

- An important assumption in the analysis is that the pre-discount demand for Internal Connection funding by the high discount applicants would decline if the maximum discount level was reduced to 70%, i.e., if the applicants were required to have "more skin in the game." Two levels of revised demand were analyzed.

  <u>Revision 1</u> was based on the initial pre-discount demand levels of FY 2000 as discussed above. Final demand was estimated using the average adjustment factor (90%) that was experienced in funded requests that year.

  <u>Revision 2</u> assumed that Internal Connection demand for the lower income applicants might fall below FY 2000 levels, while demand for higher income applicants might rise

with the prospects that Priority 2 funding would be available at lower discount rates. This "rebalancing" of demand was estimated using "pivot factors" based on FY 2000 Priority 1 demand centered on applicants in the 70-79% discount band. This raised Internal Connection demand slightly below the 70% level, and lowered it at increasing rates from 80% to 90%.

- The availability of funds for Internal Connections was based on the $1.155 billion actually awarded in FY 2000. This figure does not account for additional program funding that may be available now that the SLD has adopted a policy of awarding more than $2.25 billion per year (assuming that all awarded funding will not be used), or that unused funds may be rolled-over into annual funding beginning as early as FY 2004. Conversely, it does not account for the growing demand for Priority 1 funds that has been occurring in recent years. Overall, we view the $1.155 billion figure as modestly conservative.

- The impact of the recommended discount rate revisions on individual applicants depends upon their individual discount rate(s). The impact on single-site applicants (or multi-site applicants with all sites at the same discount rate) is straight-forward. For a given level of pre-discount demand, funding for current 90% applicants would drop to 70%. Assuming that the revision permitted Internal Connection funding down to lower discount rates, many applicants currently at 80% or less would receive funding that has been completely unavailable since FY 1999.

- For multi-site applicants, with a range of discount rates, a more specific analysis is needed. The SECA study analyzed two large city school districts, Norfolk and Seattle, comprised of individual schools with discounts ranging from 20-40% to 90%. For a given level of pre-discount demand per school, the analysis compared the current funding situation, whereby only the 90% schools were funded for Internal Connection services, to projected funding under the two revised cases discussed above whereby funding would be available for lower discount schools, albeit at a maximum of 70%. Two scenarios of individual school demand were examined.

  Scenario 1 assumed equal pre-discount demand ($100,000) for each school.

  Scenario 2 assumed a lower level of demand ($50,000) for any existing 90% school based on the presumption that such schools may have already benefited from Internal Connection funding in recent years and would need less in the future.

Conclusions

The key conclusion of the E-Rate Central analysis is that a revision in the discount matrix to reduce the maximum Internal Connection discount rate to 70% would reduce demand in the higher discount bands to more normal levels and would thereby make Priority 2 funding available to a broader cross-section of E-rate applicants. By reducing monetary incentives for waste, fraud, and abuse, the recommended revision might also permit the SLD to streamline its review process, thus making critical funding available on a more timely basis.

The more quantitative conclusions in the analysis are summarized below.

- Revision 1: Had the revised discount matrix been in place for FY 2000, the 20% reduction in funding for applicants in the 86-90% range would have provided 70% Priority 2 discounts for 81-85% applicants and, on a pro-rated basis (approximately 50%) for 80% applicants.
- Revision 2: If, in addition, pre-discount demand for the higher discount applicants had fallen as estimated, Priority 2 discounts would have been provided for 51-85% applicants and, on a pro-rated basis (35-40%) for 50% applicants. Such a result demonstrates the real potential significance of the recommend revision.
- Large districts, with individual schools at various discount rates, would gain far more from the extension of Priority 2 funding to their lower district schools than they would lose by the 20% reduction of funding for their 90% schools. The analysis for Norfolk and Seattle showed increases in total funding of 35-95% in the Revision 1 case (simply by adding pro-rated funding for 80% schools) and of 130-365% in the Revision 2 case (with funding down to the 50% schools).