
CAMP RUNAMUCK: THE FCC'S TROUBLED E-RATE PROGRAM

Ramsey L. Woodworth[†] and Jared B. Weaver^{*}

I. INTRODUCTION

Since 1998, the Federal Communications Commission's ("FCC's" or "Commission's") E-Rate program has distributed over \$10 billion to schools and libraries for telecommunications improvements, Internet access services, and internal connection equipment.¹ While widely acclaimed for connecting our nation's schools and libraries to the Internet, the program has come under heavy criticism as a haven for wasteful, corrupt, and fraudulent practices. Recent hearings conducted by the House Energy and Commerce Subcommittee on Oversight and Investigations examined the problem in detail, including the scheming of several parties who successfully obtained over \$48 million in E-Rate funding grants in the name of the San Francisco Unified School District without the district's knowledge or authorization.² The conspirators, including a school district custodial supervisor who purported to act for the district, rigged a phony competitive bid procurement to favor the conspiring companies, which more than doubled the already inflated amount of the fraudulent contracts for E-Rate funding purposes.³ The E-Rate program administrator, an

[†] Mr. Woodworth is Of Counsel with Irwin, Campbell & Tannenwald, P.C., Washington, D.C. The views expressed herein are those of the Authors alone and should not be attributed to any other party.

^{*} Mr. Weaver is an Associate with Irwin, Campbell & Tannenwald, P.C., Washington, D.C.

¹ See STAFF OF SUBCOMM. ON OVERSIGHT AND INVESTIGATION OF THE H.R. COMM. ON ENERGY AND COMMERCE, 109TH CONG., REPORT ON WASTE, FRAUD AND ABUSE CONCERNS WITH THE E-RATE PROGRAM 1 (Comm. Print 2005) [hereinafter HOUSE SUBCOMMITTEE REPORT]. Over \$15 billion in funding commitments were issued over this period. The difference between funding commitments and distributions are those commitments that go unused by the school or library, in whole or in part, for a variety of reasons.

² See *id.* at 19–24 (factoring the San Francisco Unified School District's E-Rate experience with service providers into the Subcommittee's overall recommendations).

³ *Id.* at 19–20. According to testimony provided by San Francisco officials and information included in the plea agreement, the companies agreed to circumvent any E-Rate

organization known as the Universal Services Administrative Company (“USAC”), failed to detect the fraud despite subjecting the funding applications to the most intense level of scrutiny provided for under the USAC program integrity review process.⁴ It was only through the whistle-blowing efforts of the school district itself that the criminal conspiracy came to light before funds were actually disbursed.⁵

In addition to the recent congressional hearings, the Government Accountability Office (“GAO”) extensively reviewed the operations of the E-Rate program and found “an astounding degree of managerial neglect.”⁶ The FCC Inspector General, in semi-annual reports to Congress, dated as early as 2002, regularly singled out the E-Rate program as “subject to unacceptably high risk of malfeasance through noncompliance and program weaknesses.”⁷ The FCC itself has tightened program rules four times in the past three years in an attempt to clamp down on fraudulent and wasteful practices.⁸ The Commission is currently undertaking a major review of program management structural issues⁹ and it is hard to miss the reports of criminal indictments and convictions

program competition by “rigging the bidding process, submitting fraudulent bids, and pre-termining who would win,” which grossly inflated the cost of work by \$26 million. *Id.*

⁴ *See id.*

⁵ *Id.* (explaining the school district superintendent’s discovery of the unusual nature of the pending E-Rate program applications and subsequent notification to federal and state authorities).

⁶ *Id.* at 42 (citing *Concerns Regarding the Structure and FCC’s Management of the E-Rate Program: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 109th Cong. (2005) (statement of Mark L. Goldstein, Director, Physical Infrastructure Issues) [hereinafter *Subcommittee Hearing Statements*]).

⁷ FED. COMM’NS COMM’N, OFFICE OF THE INSPECTOR GEN., SEMIANNUAL REPORT TO CONGRESS, APRIL 1, 2002–SEPTEMBER 30, 2002, at 9, <http://www.fcc.gov/oig/sar902.pdf>; *see also* FED. COMM’NS COMM’N, OFFICE OF THE INSPECTOR GENERAL, SEMIANNUAL REPORT TO CONGRESS, OCTOBER 1, 2004–MARCH 31, 2005, at 3, http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-259144A1.pdf.

⁸ *See In re Schools and Libraries Universal Service Support Mechanism, Second Report and Order and Further Notice of Proposed Rulemaking*, 18 F.C.C.R. 9202 (Apr. 30, 2003) (“taking major steps to simplify and streamline the operation” of the universal service mechanism and improving oversight of the support mechanism); *In re Schools and Libraries Universal Service Support Mechanism, Third Report and Order and Second Further Notice of Proposed Rulemaking*, 18 F.C.C.R. 26,912 (Dec. 17, 2003) (adopting rules that limit schools and libraries from engaging in wasteful or fraudulent practices regarding internal connections); *In re Federal-State Board on Universal Service; Changes to the Board of Directors for the National Exchange Carrier Association, Inc.; Schools and Libraries Universal Service Support Mechanism, Order on Reconsideration and Fourth Report and Order*, 19 F.C.C.R. 15,252 (July 23, 2004) (granting various petitions for reconsideration of an order that directed the cancellation of funding commitments made in violation of the 1996 Act); *In re Schools and Libraries Universal Service Support Mechanism, Fifth Report and Order and Order*, 19 F.C.C.R. 15,808 (Aug. 4, 2004) (adopting measures to protect against waste, fraud, and abuse, particularly from audit activities).

⁹ Comprehensive Review of Universal Service Fund Management, Administration and Oversight, 70 Fed. Reg. 41,658 (July 20, 2005) (to be codified at 47 C.F.R. pt. 54).

that periodically appear in the press.¹⁰

Estimates of possible misuse of funds have ranged up to \$180 million annually and this “might just be the tip of an iceberg.”¹¹ It is difficult to pinpoint a more reliable figure. This is in part due to the relatively few funding grants that have been fully audited.¹² Also, program administrators tend to classify a wide variety of situations as violations of program rules constituting the misuse of funds. These violations can range from outright fraudulent schemes to honest misunderstandings of vague or changing program requirements.¹³ But some of the tawdry schemes and devices uncovered to date speak for themselves. They include:

- A large-scale marketing effort by one leading technology company to short-circuit competitive bidding requirements and entice school districts to purchase unneeded equipment at grossly inflated prices.¹⁴ Some believed the pricing would have been indefensible in a public forum and it was probably only the sheer size of the scam—more than \$500 million in requested funding for roughly twenty school districts—that led to its undoing.¹⁵
- The skimming by one service provider of over \$1 million in E-Rate funds for goods and services never provided, most of which were laundered and wired abroad to accounts in Pakistan.¹⁶
- Forgiving or otherwise ignoring through bonus or other arrangements a

¹⁰ See, e.g., *Telecom Notes*, COMM. DAILY, Apr. 7, 2004, at 10 (noting five people were indicted, and four arrested, on conspiracy, mail fraud, and money laundering charges in Milwaukee and Chicago); Matt Richtel & Gary Rivlin, *NEC Unit Admits It Defrauded Schools*, N.Y. TIMES, May 28, 2004, at C1 (reporting that NEC Business Network Solutions, a subsidiary of NEC, Inc., pled guilty to two federal felony counts and agreed to pay over \$20 million in fines and restitution, which is the largest E-Rate program settlement to date); *Telecom Notes*, COMM. DAILY, Apr. 8, 2005, at 10 (noting a San Francisco federal grand jury returned a twenty-two-count indictment); *Telecom Notes*, COMM. DAILY, Feb. 9, 2006, at 16 (reporting Premio, a California company, agreed to plead guilty to charges involving FCC E-Rate programs).

¹¹ HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 8.

¹² See *id.* at 18 (“[A]ccording to hearing testimony and staff interviews, to date no statistically representation audit of the E-rate program has been completed to determine the extent of waste, fraud and abuse.”).

¹³ *Id.* at 12.

¹⁴ See *id.* at 24–31. IBM has participated in the E-Rate program since 1998, and since then has received more the \$832 million. In funding year 2002, IBM requested more than \$1 billion, almost double the previous year’s value, by encouraging school districts to adopt their concept of a “strategic integrator,” which essentially “bundled” millions in ineligible goods and services. *Id.* at 25–26.

¹⁵ *Id.*; *House Committee Holds Third Hearing on E-Rate Abuse*, E-RATE NEWS, Sept. 22, 2004, <http://www.fundsforlearning.com/cgi-bin/NewsList.cgi?world=§ion=&rec=555&cat=E-rate>.

¹⁶ See *United States v. Bokhrati*, 403 F.3d 861, 862–63 (7th Cir. 2005).

school's obligation to pay its cost share.¹⁷

- Kickbacks to a national school organization for promoting E-Rate funded sales to members of the organization.¹⁸

The E-Rate program represents the FCC's first attempt to establish and administer a large-scale multi-billion dollar grant program. Until the implementation of the E-Rate program, the universal service support mechanism administered by the FCC was a more limited program involving far fewer players and simpler fund transfers among a discrete class of telecommunications companies. E-Rate vastly expanded the scope and basic nature of this limited subsidy program to include all public and private Kindergarten–12 schools and libraries nationwide. An unlimited number of potential service providers also joined the group.

One might reasonably have expected the details of the E-Rate program to be less than perfect in the beginning. What actually transpired has been far worse, particularly to the extent in which the program has been open to fraudulent and corrupt schemes—many of which in hindsight appear so obvious that one wonders how they were allowed to progress as far as they did.

This Article examines three aspects of the E-Rate program where the FCC has lacked foresight and management. First, program management has lacked clear lines of responsibility and accountability, particularly between the FCC and USAC. In theory, the FCC establishes the rules and policies and USAC only acts as the passive administrator and disbursing agent. In practice, the role of USAC is far greater. The legalistic “rulemaking” and “appeals” processes by which the FCC purports to supervise USAC are unwieldy, sometimes ineffective, and prone to delay. The program's “management by rule” approach treats USAC as a subservient and integral division of the FCC, although it is a largely independent organization. No clear lines of management responsibility and accountability exist between the FCC and USAC and the actual process by which they interact is largely closed and non-transparent to the outside world.

Second, while competitive bidding requirements—coupled with the school's local co-payment obligation—sought to provide an effective cost control mechanism, the actual requirements adopted by the FCC were at best wishful words that have resulted in a “form over substance” process. Standing alone, they have not led to a true competitive bidding process that imposes a reasonable degree of cost discipline and accountability on applicants and service providers.

¹⁷ *House Committee Holds Third Hearing on E-Rate Abuse*, *supra* note 15.

¹⁸ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 38 (detailing respective roles of the Atlanta Public School Board and E-Rate program vendors involved in the mismanagement of more than \$60 million in funds).

Finally, the FCC initially set forth only vague and open-ended standards as to the nature of equipment and services to be funded, leaving it to USAC—who theoretically only administers the program and has no authority to set policy—to work out the details. As a result, actual decisions as to what would be funded and at what cost have tended to be haphazard, subject to arcane and arbitrary distinctions, and at times downright disingenuous. There is no better example of this than the present USAC policy allowing funding for the construction of wide area networks (“WANs”), even though the FCC’s original prohibition on the use of E-Rate funds for this purpose is still in place.¹⁹

These are by no means the only problems with the administration of the E-Rate program. They are, however, indicative of serious design flaws that need to be candidly addressed if the program is to be ultimately successful in the prudent administration of the substantial funds entrusted to its care.

II. THE ORIGINS AND STRUCTURE OF THE E-RATE PROGRAM

E-Rate is one of the several universal service programs created by the Telecommunications Act of 1996 (“1996 Act”).²⁰ Specifically, § 254(h) of the Act: (1) directs the FCC to establish “competitively neutral rules . . . to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and non-profit elementary and secondary school classrooms, health care providers and libraries;”²¹ and (2) requires telecommunications carriers to provide services eligible for universal service support at discounted rates as determined by the FCC (or the state with respect to intrastate services) as “appropriate and necessary to ensure affordable access to and use of such services by such entities.”²² As summarized in the 1996 Act’s Congressional Conference Report, Congress intended that “elementary and secondary school classrooms, and libraries have affordable access to modern telecommunications services that . . . will help open new worlds of knowledge, learning and education to all Americans—rich

¹⁹ A wide area network is defined as “voice, data, or video network that provides connections from one or more computers or networks within an eligible school or library to one or more computers or networks that are external to such eligible school or library.” Wide Area Network (WAN) Fact Sheet, <http://www.universalservice.org/sl/applicants/step06/wide-area-network-fact-sheet.aspx> (last visited Feb. 2, 2006).

²⁰ See Telecommunications Act of 1996, Pub. L. No. 104-104, § 505, 110 Stat. 56, 136 (codified at 47 U.S.C. §§ 151–170 (2000)).

²¹ 47 U.S.C. § 254(h)(2) (detailing advanced telecommunications services for certain providers).

²² *Id.* § 254(h)(1)(B) (detailing telecommunications services for educational providers and libraries).

and poor, rural and urban.”²³ Congress chose, however, not to accompany these lofty goals with a specific implementing plan. Ultimately, Congress delegated authority to the FCC and a Federal-State Joint Board (“Joint Board”), established by the 1996 Act to advise the FCC, to develop a system to bring these goals to fruition.²⁴ The 1996 Act expressly gives the Commission broad authority to “enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all . . . school class-rooms . . . and libraries.”²⁵

As finally structured by the Joint Board and the FCC, the E-Rate program is administered by USAC, a not-for-profit corporation charged by the Commission to administer all universal service programs.²⁶ USAC is a subsidiary of the National Exchange Carrier Association (“NECA”), also a not-for-profit corporation formed in 1983 by telecommunications carriers, acting under the direction of the FCC. NECA was tasked with administering the access tariff structure developed after the break-up of AT&T.²⁷ Although USAC is technically a NECA subsidiary, by express FCC rule, NECA is prohibited from participating in the functions or management of USAC. Indeed, the only role played by NECA is that of a subcontractor providing various data processing and other services to USAC.²⁸

USAC is charged only with the administration of the program and has no power to establish program rules and policies. These policies are set by the FCC in codified rules, various policy pronouncements, and specific USAC funding actions appealed to the FCC.²⁹ In this respect, the USAC-FCC relationship is structured as though USAC is an integral bureau or division of the

²³ H.R. REP. NO. 104-458, at 132 (1996) (Conf. Rep.); see S. REP. NO. 104-230, at 132 (1996) (Conf. Rep.).

²⁴ 47 U.S.C. § 254(a)(1). The Federal-State Joint Board is comprised of FCC Commissioners, State Utility Commissioners, and a consumer advocate representative. See FCC Universal Service, Federal-State Joint Board on Universal Service, http://www.fcc.gov/wcb/universal_service/JointBoard/welcome.html (last visited Feb. 4, 2006).

²⁵ 47 U.S.C. § 254(h)(2)(A).

²⁶ See *In re* Changes to the Board of Directors of the National Exchange Carrier Association, Inc., *Third Report and Order in CC Docket No. 97-21, Fourth Order on Reconsideration in CC Docket No. 97-21 and Eighth Order on Reconsideration in CC Docket No. 96-45*, 13 F.C.C.R. 25,058, ¶ 2 (Nov. 19, 1998) [hereinafter USAC Third Report and Order].

²⁷ *Id.* ¶ 5; see also NECA—About Us, http://www.neca.org/source/NECA_AboutUs.asp (last visited Dec. 22, 2005).

²⁸ 47 C.F.R. § 54.703(a) (2005). Thus, as discussed hereinafter in more detail, NECA has no role in the appointment of the USAC Board of Directors, which by FCC rule is composed of representatives of the telecommunications industry, and other industries interested in the operation of USAC. See *id.* §§ 54.703(b)–(c).

²⁹ See GEN. ACCOUNTING OFFICE, GREATER INVOLVEMENT NEEDED BY FCC IN THE MANAGEMENT AND OVERSIGHT OF THE E-RATE PROGRAM 5–8 (2005) [hereinafter GAO REPORT], <http://www.gao.gov/new.items/d05151.pdf>.

FCC, although it is a separate non-governmental legal entity. Funding for all universal service programs, including E-Rate, comes from levies paid into the Universal Service Fund (“USF”) by telecommunications carriers. The costs of contributing to these programs are gathered from consumers, usually through monthly phone bill line item charges.³⁰ Universal service funds are not subject to the federal government budgetary process and are held outside of U.S. Department of Treasury standards.³¹

The FCC adopted rules for the E-Rate program in 1997. These rules established three broad categories of Services and equipment eligible for E-Rate support: telecommunications services; Internet access services; and the installation and maintenance of internal connection equipment.³² However, the FCC provided little specific definition as to the precise equipment and services that might be encompassed in these general categories.³³ The rules fix no cap on the funding that applicants may request each year, so long as the equipment and services fall within a “technology plan” approved by a state educational authority.³⁴ Consequently, oversight of cost and reasonableness of an applicant’s “technology plan” is placed in the hands of entities having no responsibility or incentive to control costs.³⁵

With regard to the financial administration, the FCC implemented competitive bidding requirements to maintain fiscal discipline.³⁶ These requirements include a provision requiring applicants to pay a pro rata share of the overall program cost, ranging from 10% to 80% depending on the poverty level of the community served by the school or library.³⁷ In addition to requiring adherence

³⁰ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 6.

³¹ See *id.* at 44. Given the current USAC funds structure, it has been especially difficult to determine what applicable laws and regulations govern the administration of program funds, including the applicability of federal government accounting and investment standards, as opposed to generally accepted business practices. In early fall 2004, the confusion resulted in the loss of approximately \$4.6 million in USAC funds. Due to a last-minute FCC directive to change to federal government accounting and other financial management standards, there arose a need to prematurely liquidate certain investment holdings. *Id.*

³² 47 C.F.R. §§ 54.502–.503.

³³ See *id.* For example, one could discern from the initial rules that the cabling, routers and other equipment necessary to connect school classrooms to the Internet access service drop off point on the outside of the school building would be eligible for funding, whereas asbestos removal within the school to do the cabling would not. In comparison, the FCC now annually promulgates a specific eligible services list, often over sixty pages long. See *id.* § 54.522; Pleading Cycle Established for Eligible Services List for Universal Service Mechanism for Schools and Libraries, *Public Notice*, 19 F.C.C.R. 16,013 (Aug. 13, 2004).

³⁴ An annual cap of \$2.25 billion applies to all requests, but within that the FCC can determine freely how to allocate these resources among the state-approved “technology plans.” See 47 C.F.R. §§ 54.507–.508.

³⁵ See *id.* § 54.508(c).

³⁶ *Id.* § 54.504(a).

³⁷ See *id.* § 54.505.

to whatever local competitive bidding requirements might apply, the FCC established an Internet-based “competitive bidding” process under which the applicant is required to post a description of its service needs on the USAC website and wait twenty-eight days before actually entering into a contract with the service provider.³⁸ The FCC rules require the applicant to “carefully consider” all bids received in response to the web posting and select the “most cost effective” bid, taking actual cost into account as only one of several factors.³⁹ The FCC expressly designed these requirements to give applicants “maximum discretion” to select the proposal best meeting their particular technology needs.

The actual application process is designed to be as automated as possible through the use of electronic filing procedures. While FCC rules originally contemplated that schools would be able to file applications at any time of the year depending on their particular procurement practices, an annual funding cap for the total E-Rate program of \$2.25 billion has in practice resulted in a tight “window” filing requirement each year.⁴⁰ Applications typically must be filed in an approximate ninety-day period from November through January proceeding each funding year, which runs from July 1 through June 30.⁴¹ If requested funding in a year (“demand”) exceeds the annual funding cap (“supply”), the FCC rules ration available funds among successful applicants by restricting funding for internal connection equipment, so-called “Priority Two” services, to the most needy schools.⁴² Typically, this has meant that only schools qualifying for very high subsidies of 80% or higher receive funding for internal connection equipment. These types of subsidies account for the largest number of funding requests.⁴³

Not only was this a completely new and untried structure, but the FCC rules also significantly opened the USF door beyond regulated telecommunication carriers to any potential Internet access service provider or seller of equipment.⁴⁴ In hearing an appeal on this issue, the U.S. Court of Appeals for the

³⁸ See *id.* § 54.511; Universal Service Administrative Company, Open a Competitive Bidding Process (Form 470), <http://www.universalservice.org/sl/applicants/step03> (describing in detail the process and requirements for interested applicants and service providers) (last visited Mar. 15, 2006).

³⁹ 47 C.F.R. § 54.511.

⁴⁰ See *id.* § 54.507.

⁴¹ *E.g.*, Wireline Competition Bureau Announces the Filing Window for Funding Year 2005 FCC Form 471 E-Rate Applications, *Public Notice*, 19 F.C.C.R. 22,085 (Nov. 9, 2004); see HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 6.

⁴² See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 6; 47 C.F.R. § 54.507. “Priority One” services include telecommunications and Internet access fees, while “Priority Two” services account for all other applicant funding requests. See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 6.

⁴³ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 6.

⁴⁴ See *Tex. Office of Pub. Util. Counsel v. FCC*, 183 F.3d 393, 408 (5th Cir. 1999).

Fifth Circuit narrowly sustained the new rules.⁴⁵ The court agreed that “the statute and its legislative history do not support the FCC’s interpretation” that non-telecommunications services and equipment are eligible for support.⁴⁶ Nonetheless, the court deferred to the FCC’s different interpretation because “the language of the statute is ambiguous enough to require deference under *Chevron* step-two.”⁴⁷ The basic mechanics of the USF thus substantially changed from a subsidy mechanism among telecommunications carriers, under which carriers were required to discount their services to certain customers and recoup those discounts through offsetting reductions in their fund contributions, to a new scheme, whereby virtually any entity could draw funds from the USF.

III. A BYZANTINE PROGRAM MANAGEMENT STRUCTURE HINDERS EFFECTIVE PROGRAM MANAGEMENT

In deciding to create a not-for-profit, unaffiliated corporation to administer the E-Rate program, the FCC reasoned that such an organizational structure would “provide for *greater accountability and more efficient administration*” than utilizing a subcontractor.⁴⁸ The original plan required NECA, as the temporary program administrator, to establish under Delaware law a separate non-profit corporation, the Schools and Libraries Corporation (“SLC”), to administer only the E-Rate program.⁴⁹ The FCC intended that the SLC would eventually become “independent of, and unaffiliated with, NECA and USAC.”⁵⁰ This was the Commission’s first organizational misstep.

Critical of the Commission’s authority to create the SLC, Senator Ted Stevens requested that the GAO examine the establishment of the SLC.⁵¹ The GAO concluded that “the Commission lacked authority to direct the [NECA] to create SLC”⁵² In response to the GAO letter, Congress requested that the Commission submit a report and “propose a new structure for the imple-

⁴⁵ *Id.* at 449.

⁴⁶ *Id.* at 440.

⁴⁷ *Id.* One of the members of the three judge panel would have overturned the rules on constitutional grounds, had the issue been raised by the petitioners, as an unconstitutional tax unapproved by Congress. *Id.* at 440 n.86.

⁴⁸ *In re* Changes to the Board of Directors of the National Exchange Carrier Association, Inc. Federal-State Joint Board on Universal Service, *Report and Order and Second Order on Reconsideration*, 12 F.C.C.R. 18,400, ¶ 57 (July 17, 1997) (emphasis added).

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ Report in Response to Senate Bill 1768 and Conference Report on H.R. 3579, *Report to Congress*, 13 F.C.C.R. 11,810, 11,811 n.3 (May 8, 1998).

⁵² *Id.*

mentation of the universal service programs.”⁵³ Congress’s intended to have a single entity administering all of the universal service programs.⁵⁴ As requested by Congress, in 1998, the Commission eliminated the SLC and gave USAC oversight of the E-Rate program, along with all other universal service programs.⁵⁵ In the Commission’s words, this new consolidated structure “may best further the goals of *efficient administration and accountability*” of the E-Rate program.⁵⁶

USAC, while technically a subsidiary of NECA, is governed by a nineteen-member board of directors composed of representatives of the various constituencies interested in the operation of USAC.⁵⁷ Each constituency group is required to “nominate by consensus” their representative or representatives.⁵⁸ The Chairman of the FCC accepts nominations and holds the actual power and responsibility to appoint all board members.⁵⁹ The USAC Board appoints USAC’s Chief Executive Officer (“CEO”).⁶⁰ The FCC Chairman must concur in the appointment. USAC’s CEO holds all management responsibility for program administration. The Commission had originally declined to “divest” USAC from NECA for fear that Congress had not authorized such action. Nevertheless, given the GAO’s legal findings that the FCC did not have the authority to create the SLC, the practical effect of this unusual structural arrangement led to divestiture. Essentially, the FCC divested NECA of any ability to manage USAC and placed the power in different hands. Calling a non-profit corporation like USAC, that has no stock ownership with voting rights or profit-distribution among its owners, a subsidiary of another corporation is a meaningless legal fiction. Rather, the more important consideration is the power to direct the affairs and management of the non-profit corporation—in this case that power shifted, with no clear lines of management control and accountability, to a mostly volunteer board of “stakeholders” representing the various interests involved in the USF transfer process.

While such a “club-like” management structure might have been appropriate for a tightly-knit group with a common interest, it is not the best way to man-

⁵³ *Id.* at 11,810 n.1.

⁵⁴ *Id.* at 11,810 n.2.

⁵⁵ *Id.* ¶ 8.

⁵⁶ *Id.* (emphasis added).

⁵⁷ See 47 C.F.R. § 54.703 (2005). The USAC Board is apportioned among representatives of: incumbent local exchange carriers (3), interexchange carriers (2), commercial mobile radio service providers (1), competitive local exchange carriers (1), cable operators (1), information service providers (1), schools (3), libraries (1), rural health care providers (2), low income consumers (1), state telecommunications regulators (1) state consumer advocates (1), and the USAC CEO. *Id.*

⁵⁸ *Id.*

⁵⁹ See *id.* § 53.703(c)(3).

⁶⁰ See *id.* § 53.704.

age what is, effectively, a massive financial institution doing business with diverging and conflicting interests groups. In this respect, the immense sums collected and disbursed by USAC cannot be overstated. In 2003, USAC collected over \$5.8 billion and dispersed \$5.3 billion to recipients of its various programs.⁶¹ If USAC were a for-profit corporation, its revenues would make it the 314th largest corporation in America, larger than Cox Communications, Inc. and Barnes and Noble, Inc., and slightly smaller than Southwest Airlines Co.⁶²

In requiring the FCC to merge the SLC into USAC, Congress also provided guidance on the appropriate roles of the Commission and USAC.⁶³ Specifically, the Senate bill limited the role of USAC to implementing Commission rules and provided that USAC “may not administer the programs in any manner that requires that entity to interpret the intent of Congress in establishing the programs or interpret any rule promulgated by the Commission in carrying out the programs, without appropriate consultation and guidance from the Commission.”⁶⁴ In other words, Congress intended to limit the role of USAC to the day-to-day administration of the E-Rate program, including such activities as processing funding applications and the disbursement process, and subject to FCC direction as to all policy matters and rule interpretation.⁶⁵

USAC is neither a component branch of the FCC nor a government corporation established by Congress. Although obligated, like any member of the public, to comply with FCC orders and rules, USAC has no other contractual or legally enforceable obligations or standards of performance.⁶⁶ In this respect, according to the GAO, “USAC operates and disburses funds under less explicit federal ties than many other federal programs.”⁶⁷

With no clear lines of control or management or operational responsibility between the FCC and USAC, the net effect has been to rely on the rulemaking and appellate processes as the primary management and oversight mechanism.⁶⁸ Unfortunately, the rulemaking process was not designed as a technique

⁶¹ See UNIVERSAL SERV. ADMIN. CO., 2004 ANNUAL REPORT 17 [hereinafter USAC 2004 ANNUAL REPORT], http://www.universalservice.org/_res/documents/about/pdf/2004-annual-report.pdf (reporting on cash flows from operating activities in 2003).

⁶² See *List of Fortune 500*, USA TODAY, Mar. 22, 2004, http://www.usatoday.com/money/companies/2004-03-22-fortune-500-list_x.htm (reporting on the 2003 revenue of Fortune 500 corporations).

⁶³ See S. 1768, 105th Cong. § 2005(b)(2)(A) (1998); USAC Third Report and Order, *supra* note 26, ¶ 15 (recommending the limitations on USAC’s authority, including the requirement of the submission of an annual report to foster greater accountability).

⁶⁴ S. 1768 § 2005(b)(2)(A).

⁶⁵ See GAO REPORT, *supra* note 29, at 8.

⁶⁶ See *id.* at 12.

⁶⁷ *Id.*

⁶⁸ *Id.*

or method to manage government grant programs involving large fund transfers.⁶⁹ In practice, it has proven to be rather ineffective and incapable of providing the “hands on” day-to-day direction and rapid response to newly arising issues necessary to effective program management.⁷⁰ For example, as one response to the growing fraud problem, in August 2004, the FCC through the rulemaking process formally directed USAC “to submit to the Commission within 45 days from publication in the Federal Register, and annually thereafter, a list summarizing all current USAC administrative procedures . . . that serve to protect against waste, fraud and abuse.”⁷¹ Intended to serve as the basis for further FCC “binding rules” for the recovery of improperly disbursed funds, this matter still remains under review eighteen months later.⁷² Moreover, particularly given the generally vague program rules adopted by the Commission, it was somewhat naïve to think that the division between “policy making and interpretation” and “administration” could be so cleanly divided between two different organizations.⁷³ Without some interpretation on an ongoing basis, USAC could not perform its administrative duties on a day-to-day basis.

This “management by rule” approach might have had some chance of success if it were accompanied by an effective mechanism for the prompt resolution of issues of rule interpretation, matters of dispute on particular funding questions, and the myriad of other unanswered questions that were bound to arise in the administration of the program. This was to be accomplished through an appellate process, as all interested parties hold the right to appeal any USAC action to the FCC and obtain a prompt decision.⁷⁴ Originally, the rules provided for either a decision on any appeal within forty-five days or the automatic granting of the appeal, but subsequent modifications eliminated the automatic grant mechanism to require FCC action within ninety days, extendable to 180 days by specific order of the FCC.⁷⁵

Again, however, the process has not worked as intended. According to the GAO, “the FCC resolves appeals too slowly, and has a very large backlog of

⁶⁹ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 1–2.

⁷⁰ See *id.* at 2 (“The FCC’s three key oversight mechanisms for the E-rate program—rulemaking procedures, beneficiary audits, and reviews of USAC decisions (i.e., appeals decisions)—are not sufficient to manage the program.”).

⁷¹ *In re Schools and Libraries Universal Service Support Mechanism*, *supra* note 8, ¶ 80.

⁷² *In re Comprehensive Review of Universal Service Fund Management, Administration, and Oversight; Federal-State Joint Board on Universal Service; Schools and Libraries Universal Service Support Mechanism; Rural Health Care Support Mechanism; Lifeline and Link-Up; Changes to the Board of Directors for the National Exchange Carrier Association, Inc.*, *Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking*, 20 F.C.C.R. 11,308, ¶ 22 (June 9, 2005).

⁷³ *Subcommittee Hearing Statements*, *supra* note 6, at 1.

⁷⁴ See 47 C.F.R. § 54.719 (2005).

⁷⁵ See *id.* § 54.724.

appeals This adds uncertainty to the program . . . and raises the risk of both wasted funding opportunities and wasteful spending.”⁷⁶ Despite the 180 day deadline for deciding appeals, many have languished at the FCC for years with no action.⁷⁷

The process by which the FCC has avoided the 180-day decision deadline is in itself an interesting commentary on the administrative laxness of the program. Until recently, as required by 47 C.F.R. § 54.724, the Wireline Competition Bureau has carefully issued procedural orders extending the ninety-day period for decision in sixty to thirty day increments up to the ultimate 180-day deadline, but then simply ignores the more fundamental 180 decisional requirement.⁷⁸ Even the issuance of procedural extension orders of the ninety-day requirement seems to have fallen into disuse recently. For USAC, as the entity charged with the ongoing administration of the program, this leaves important questions unanswered and fails to provide needed management direction in an efficient and timely manner. As a result, USAC is often placed in the position of having to craft answers on its own either through administrative policy actions or by its own inaction, both of which contribute to a certain level of institutional paralysis in the program’s responsiveness to changing conditions and developing problems.⁷⁹

The overall result of this rather loose and diffuse management structure is an organization that appears to be largely disconnected from the FCC in terms of the day-to-day “hands on” management and policy oversight necessary for the program’s effective functioning. This leaves USAC in a somewhat “orphan-like” situation, charged on one hand with tremendous responsibilities but on the other hand unable to act decisively on many matters. Hampered from the start by “lingering questions concerning [USAC’s] organization and structure,” the basic program management arrangement fashioned by the FCC does not work as intended, to the detriment of a well-intentioned program.⁸⁰ In the words of the House Subcommittee Report, unfortunately USAC has been

⁷⁶ HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 46 (noting that 527 appeals were pending as of February 2005, although the number is probably greater at this time as relatively few appeals have been resolved since the Subcommittee’s findings).

⁷⁷ *See, e.g., In re* Requests for Review of the Decision of the Universal Service Administrator by Birch Run Area Schools, et al., *Order*, 20 F.C.C.R. 4095, ¶ 2 (Feb. 28, 2005) [hereinafter Birch Run Area Schools Order] (extending time period to take action by an additional sixty days); *In re* Requests for Review of the Decision of the Universal Service Administrator by Anchorage School District, et al., *Order*, 20 F.C.C.R. 4093, ¶ 2 (Feb. 28, 2005) [hereinafter Anchorage School District Order].

⁷⁸ *See, e.g., Birch Run Area Schools Order, supra* note 77, ¶ 2 (extending time period to take action by an additional sixty days); *Anchorage School District Order, supra* note 77, ¶ 2.

⁷⁹ *See* HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 45.

⁸⁰ *See id.* at 42.

“poorly managed” by the FCC, raising substantial questions of “whether control and management of . . . [such a large program] is appropriately delegated to a non-government entity.”⁸¹

IV. E-RATE COMPETITIVE BIDDING REQUIREMENTS HAVE BEEN WISHFUL AND INEFFECTIVE

In order to ensure honesty and prevent excessive price gouging, the E-Rate program utilizes a competitive bidding process coupled with the specific school’s obligation to pay its share of the contract price, which ranges from 10% to 80% depending on the school’s poverty level.⁸² While both requirements sound good in theory, both have proven largely ineffective in preventing abusive and fraudulent practices.⁸³ In addition to whatever local procurement requirements may apply, the FCC established an Internet-based notification process which requires the school to post a description of desired services on the USAC website and wait at least twenty-eight days before contracting with a service provider.⁸⁴ FCC rules do no more than require the school to “carefully consider” any bids received and select the “most cost effective” bid.⁸⁵

These loose and vague requirements have by and large failed to create a true competitive bidding process for E-Rate funded services. The obligation to post services desired online is so loosely defined and enforced that the results are vague and general postings fail to solicit “bids” in any real sense of that term. Even if fairly specific bids do result, schools have substantial freedom to select whichever service provider they want for arbitrary reasons. “Cost effective” has not meant “low price” in the FCC’s scheme of things; rather the FCC’s rules specifically invite the school to give decisive weight to any other factors. While the FCC has recently raised its level of rhetoric and implored schools to show more prudence when considering pricing factors, the “most cost effective” standard still remains far too vague and subjective to be enforceable from a practical standpoint.

The only competitive bid requirement that USAC and the FCC have been able to enforce with some regularity is the required twenty-eight day pre-

⁸¹ *Id.* at 3.

⁸² *See* 47 C.F.R. § 54.505 (2005).

⁸³ *See* HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 10–19 (analyzing the E-Rate program discounts for Puerto Rico Department of Education’s management of its public schools, and the apparent funding and planning problems).

⁸⁴ *See* 47 C.F.R. § 54.511 (stating the selection requirements for providers of eligible services, and deeming the competitive bidding process operational when the Administrator accepts and posts FCC Form 470s for universal use); *Id.* § 54.504(b) (requiring all eligible schools and libraries to submit Form 470, including specific information on the necessary equipment and connections).

⁸⁵ *Id.* § 54.511.

contracting waiting period. Unfortunately, this has further contributed to a process that is largely form over substance. Schools that allow their pre-selected, program-savvy service provider to prepare their funding application probably encounter less actual risk of dismissal than the honest applicant attempting to navigate complex filing requirements on its own who gets a date wrong. Consider the plight of Our Lady of Refuge, an inner-city parochial school in the Bronx, New York.⁸⁶ The FCC ordered the school to return two years of E-Rate funding discounts when, after voluntarily submitting the information in support of a subsequent application, the Commission discovered the school's Internet service contract was dated one day earlier than reflected in the USAC database.⁸⁷

Similarly, adventurous parties have implemented a variety of practices to circumvent the local share payment obligation, ranging from simply ignoring or forgiving the payment obligation to complex schemes designed to create the appearance of a payment.⁸⁸ The school must certify that it will pay its share and the USAC application process examines, sometimes in excruciating detail, the basis for this certification.⁸⁹ However, after granting the E-Rate funding application, no process or procedure apparently exists for conditioning or coordinating the disbursement of E-Rate funds on the actual payment of the local share. Short of a full after-the-fact audit of the completed funding (done in very few cases to date), the actual policing of this important part of the process is sorely lacking.

In 1999, soon after the start of the E-Rate program, the FCC had a chance to strengthen these requirements.⁹⁰ However, rather than impose some cost discipline, the FCC signaled a "hands-off" approach that largely trusted schools and service providers to do the right thing. In a unanimous decision, the FCC overruled a USAC decision to deny E-Rate funding and directed USAC to grant funding to the state of Tennessee to develop a statewide Internet service network.⁹¹

⁸⁶ See *In re* Request for Review of the Decision of the Universal Service Administrator by Our Lady of Refuge School, *Order*, 17 F.C.C.R. 5754, ¶ 7 (Mar. 27, 2002) (denying request for review because contract was signed one day prior to the end of the twenty-eight-day waiting period).

⁸⁷ See *id.*

⁸⁸ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 21, 34 ("NEC, BNS, and VNCI 'waived' the school districts' co-payments, despite clear FCC and USAC guidance that this was prohibited" and proposed inflation of bid costs "so that sufficient margin would be available to cover . . . co-payment" and offer of "interest-free loan to cover . . . co-payment").

⁸⁹ See 47 C.F.R. § 54.507.

⁹⁰ See *In re* Request for Review by the Department of Education of the State of Tennessee of the Decision of the Universal Service Administrator, *Order*, 14 F.C.C.R. 13,734 (Aug. 11, 1999) [hereinafter 1999 Tennessee Order].

⁹¹ See *id.* ¶ 1. Despite the decision being unanimous, then Commissioner Furchgott-

The decision was precipitated by charges filed with the FCC and USAC by a losing bidder who alleged that the contract award and ensuing E-Rate funding request violated both the obligation to select the most cost-effective bid and pay the appropriate local cost share.⁹² In several key respects, the FCC's resolution of these charges set the tone for the subsequent direction of the E-Rate program. Measured by any objective standard, the FCC's decision stretched the definition of cost effectiveness beyond what is reasonable. The winning bid was approximately \$23 million more than the losing bid for essentially the same package of goods and Internet access services over a three-year period.⁹³ The state found that both bidders met the basic qualifications and comparatively evaluated the two parties using a numerical forty-five point system, under which the winning bidder prevailed on the basis of both technical approach (33.375 points versus twenty-six points for the losing bidder) and cost (thirty points versus 20.837 points for the losing bidder).⁹⁴

The preference awarded to the winning bidder for cost efficiency, despite its substantially higher bid price, was particularly novel. Rather than measure price considerations on the basis of overall cost, the state used a formula expressly designed to prefer the bidder who achieved the greatest dollar amount of E-Rate funding, based on a fixed amount of spending by the state.⁹⁵ In other words, so long as the state's cost remained the same, a larger price of the overall contract and a greater cost-bidding would result in preference to the bidder.

Nonetheless, the FCC found that "Tennessee adequately considered price, as well as other factors, in determining the most cost-effective bid."⁹⁶ Placing virtually complete reliance on the expectancy that local and state competitive bidding requirements should be sufficient "to ensure compliance with [FCC] competitive bid requirements," the FCC saw no problem with a competitive bidding approach that, on its face, favored the high price bid: "although the

Roth approved in part, concurred in part, and dissented in part, with a statement to be released at a later date. His promised statement, however, was never released so his specific concerns are unknown.

⁹² See *id.* ¶¶ 4–5. It should be noted that one of the Authors of this article served as counsel to the protesting party before the FCC and USAC, and all information herein is from the public record.

⁹³ See Tennessee State Department of Education Application (FCC Form 471) for Approval of Funding, *Objection to Application and Request for Expedited Declaratory Ruling*, CC Docket No. 96-45, at 6 (Apr. 3, 1998) [hereinafter *ISIS Objection to Application*] (noting the winning bid amounted to \$74,352,941, versus a \$51,275,384 bid from the losing bidder) (available via FCC Electronic Comment Filing System).

⁹⁴ See *In re Request for Review by Integrated Systems and Network Solutions, Inc. of Decision of Universal Service Administrator, Request for Review in Part of Fund Administrator's Explanation for Funding Commitment Decisions*, CC Docket No. 96-45, at 6–7 (Mar. 19, 1999) (available via FCC Electronic Comment Filing System).

⁹⁵ See 1999 Tennessee Order, *supra* note 90, ¶¶ 12–14.

⁹⁶ See *id.* ¶ 6.

formula used to evaluate cost may have awarded the highest points for cost to bids maximizing federal support, this is not prohibited by our rules.”⁹⁷ The FCC thus blessed a competitive bidding approach that rewarded the higher-priced bidder for that reason alone.

This, however, did not end the FCC’s apparent reluctance to examine cost issues and exert a reasonable degree of oversight. Another unusual feature of the winning contract was a transaction involving the transfer to the winning bidder of certain “software and the right to use certain components of the existing WAN owned and used by the schools of Tennessee, the ConnectTEN network[,]” in exchange for Internet access service using the network.⁹⁸ Specifically, the complainant alleged that the transaction violated FCC rules in two distinct ways. First, the complainant argued that funding was being improperly sought for pre-existing WAN facilities.⁹⁹ The second argument maintained that the transaction was essentially a wash that created the appearance of a local share payment.¹⁰⁰ For E-Rate funding purposes, the application used the \$7.5 million due to the state for its existing network rights as part of the state’s payment of its share of the contract price, even though it was apparently offset by the winning bidder’s charges for Internet access service using the equipment.¹⁰¹

This was not a new or novel financial device. For over twenty years, the federal Medicaid program has also struggled with basically the same problem. Medicaid, like E-Rate, is a shared cost program in which the federal government absorbs a certain percentage of each state’s overall program costs.¹⁰² In order to increase the federal share above the set cost percentage, states previously used such devices as “provider donations” or special “provider-specific taxes” that allow a health care provider to donate money or pay a special tax to the state.¹⁰³ This money is then immediately returned to the facility in the form of higher-than-normal payments for Medicaid supported services. The higher-than-normal expense payments are then used as the basis of calculating the federal Medicaid reimbursement amount, thereby increasing the percentage of the state’s actual Medicaid expenses paid by the federal government. According to Gail Wilensky, Administrator for the Health Care Financing Administration, “they are ‘carefully crafted’ finance techniques that allow states to reduce

⁹⁷ *Id.* ¶¶ 10, 14.

⁹⁸ *Id.* ¶ 15.

⁹⁹ *See id.*

¹⁰⁰ *Id.*

¹⁰¹ *See* ISIS Objection to Application, *supra* note 93, at 28–29.

¹⁰² *See* 42 U.S.C. § 1346 (2000) (providing for annual appropriation of funds to qualifying states for medical assistance programs).

¹⁰³ *See* NAT’L HEALTH POLICY FORUM, THE FEDERAL-STATE MEDICAID MATCH: AN ONGOING TUG-OF-WAR OVER PRACTICE AND POLICY, ISSUE BRIEF NO. 760, at 5–6 (2000), http://www.nhpf.org/pdfs_ib/IB760_MedicaidMatch_12-15-00.pdf.

their share of Medicaid costs and force the federal government to pay more.”¹⁰⁴

The FCC, however, apparently limited its inquiry to only the first half of the problem, holding that the charges for Internet access services using the ConnectTEN equipment were ineligible for funding because such “components were part of an ineligible WAN when owned by Tennessee.”¹⁰⁵ The Order was silent as to the second allegation. Because USAC operations are conducted largely off the public record, it is difficult to determine exactly how these issues were subsequently handled by USAC on remand from the FCC. Certain information, however, is ascertainable from the USAC public database. For the first program year, USAC ultimately granted Education Networks of America, inc. (“ENA”) \$22,743,258 in E-Rate funding.¹⁰⁶ The state’s maximum contribution of approximately \$5 million specified in the contract should have resulted in E-Rate funding of \$11 million at the most, assuming the 69% discount rate ultimately allowed.¹⁰⁷ It would thus appear that USAC also failed to examine this aspect of the transaction.

In hindsight, the FCC lost an opportunity to implement effective program cost control requirements. Not only was the winning bid more than 50% higher than the losing bid, it was undisputed that the state’s Request for Proposal and bid evaluation formula was expressly designed to favor the higher priced bid. The state specifically sought “creative approaches” to maximize the amount of E-Rate funding obtainable in return for a fixed expenditure by the state—the higher the overall contract price, the greater the preference to the bidder on cost factors. And in the center of the arrangement was an unusual transaction that allegedly inflated the size of the state’s contribution for E-Rate funding purposes. It is hard to imagine a more target-rich environment.

Since then, the FCC has come to realize that more effective competitive bidding requirements are necessary, but its response still relies more on rhetoric and the “bully pulpit” rather than clear requirements. In 2003, in a series of cases arising out of the same scheme, the FCC affirmed USAC’s denial of

¹⁰⁴ *Id.* at 7 (citing *Financing Medicaid Through Provider Taxes and Intergovernmental Transfers: Hearing Before the Subcomm. On Energy and Commerce*, 102d Cong. 3 (Oct. 16, 1991) (statement of Gail R. Wilensky, Administrator, Health Care Financing Administration)). Congress restricted these practices in the Medicaid Voluntary Contribution and Provider-Specific Tax Amendments of 1991, Pub. L. No. 102-234, 105 Stat. 1793.

¹⁰⁵ 1999 Tennessee Order, *supra* note 90, ¶ 17.

¹⁰⁶ See Universal Service Administrative Company, Schools and Libraries, Funding Request Data Retrieval Tool, <http://www.sl.universalservice.org/funding/opendatasearch/Search1.asp> (last visited Apr. 4, 2006). The search criteria performed to determine USAC’s Committed Amount for ENA included the 1998 Funding Year, State of Tennessee, and BEN number 128260. Additionally, the following data points were selected: Applicant’s Name; Billed Entity Number (BEN); Service Provider Name; and Total Charges under the Discount Funding Request Data. *Id.*

¹⁰⁷ See ISIS Objection to Application, *supra* note 93, at 7–8, attachments F, H.

funding applications from eight school districts requesting approximately \$250 million in total funding for violating program competitive bidding requirements.¹⁰⁸ The Commission, acknowledging that it created some ambiguity in holding that price was “a primary factor” in the Tennessee decision, decreed that price “must be the primary factor in considering bids.”¹⁰⁹ The FCC explained, “For example, if in selecting bids an applicant assigns 10 points for reputation, 10 points to past experience, and 10 points to timing considerations, it must assign at least 11 points to price.”¹¹⁰

While somewhat narrowing the boundary, this still is a loose and largely subjective standard that continues to leave the determination of fair pricing to the vagaries of the USAC application evaluation process. The difficulties recently encountered by the State of Wyoming due to the new standard aptly illustrate the problem.¹¹¹ It was undisputed that Wyoming, through a competitive bidding process mandated by state law, had in fact selected the lowest priced bid, lower by several million dollars according to the record.¹¹² However, because the state’s bid criteria in the initial RFP assigned more weight to the need for system functionality (30%) than to price (20%), Wyoming’s statewide application was denied by USAC on the grounds that this demonstrated price was not the primary factor in the selection process.¹¹³ In so doing, USAC ignored not only the actual pricing in the bids, but the fact that the state’s bid evaluation selected the winning bidder for reason of lowest price and a higher rating on all other factors, including system functionality.¹¹⁴ It was not even a situation where the applicant was contending that another factor should be more important than price.

The FCC overturned the USAC determination and remanded for further consideration, but not due to the USAC’s rather bizarre application of the new standard. Rather, the FCC held the new standard to be inapplicable as the bid-

¹⁰⁸ *In re* Request for Review of the Decision of the Universal Service Administrator for Ysleta Independent School District, et al., *Order*, 18 F.C.C.R. 26,407, ¶¶ 10–81 (Dec. 4, 2003) (concluding that Ysleta and similarly situated applicants violated competitive bidding and pricing requirements, but that waiving FCC filing deadlines to permit an appeal of SLD’s denial of funding was in the public interest).

¹⁰⁹ *Id.* ¶¶ 49–50.

¹¹⁰ *Id.* at 26,429 n.138.

¹¹¹ *In re* Request for Review Wyoming Department of Education Cheyenne, Wyoming, Schools and Libraries Universal Service Support Mechanism, *Order*, CC Docket No. 02-6 (Feb. 28, 2006), http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-06-485A1.pdf [hereinafter Wyoming Order].

¹¹² See Wyoming Department of Education, *Request for Review*, CC Docket No. 02-6, at attachment 6 (Apr. 18, 2005) [hereinafter Wyoming Request for Review] (available via FCC Electronic Filing System).

¹¹³ See Wyoming Order, *supra* note 111, ¶¶ 4, 7.

¹¹⁴ See Wyoming Request for Review, *supra* note 112, at attachments 4–5 (noting the scores and comments for various proposals).

ding process had been conducted before the Commission released the Ysleta decision, and therefore looked “to the *Tennessee Order* for guidance.”¹¹⁵ While the FCC further noted its reliance on the fact the winning bid “represented the lowest cost of the proposals submitted,”¹¹⁶ the decision nonetheless appears to approve USAC’s use of an administrative standard that is difficult to enforce and can produce perverse results. As the House Subcommittee concluded, a more effective bidding structure “is not simply a matter of mandating that price should be considered the primary factor.”¹¹⁷

V. WIDE AREA NETWORKS—THE WINDING ROAD TO ELIGIBILITY

In setting up the E-Rate program, the FCC established three broadly worded categories of services and equipment eligible for funding: telecommunications services; Internet access services; and local area network equipment within the school, called “internal connection” equipment.¹¹⁸ The FCC designed this package to enable schools and libraries to obtain both the basic services and necessary equipment to deliver the services directly to the classroom.¹¹⁹ By express FCC rule, the cost of purchasing or building a wide area network (“WAN”) that extends beyond the premises of the school to provide telecommunications service is ineligible for E-Rate funding.¹²⁰ The rule is cast only in terms of a WAN used to provide telecommunications service; however, the practical scope of the rule is more broad. In adopting the rule, the FCC also cautioned that WAN facilities did “not appear to fall within the narrow provi-

¹¹⁵ *Id.* at ¶ 5.

¹¹⁶ *Id.* at ¶ 10.

¹¹⁷ HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 5. More specifically, the Report recommended that “Congress should consider whether an adequate competitive bidding environment could be better assured by incorporating relevant portions of the Federal Acquisition Regulations (FAR) to the E-rate program’s rules and regulations.” *Id.*

¹¹⁸ See H.R. REP. NO. 104-458, at 132 (1996) (Conf. Rep.); *In re* Federal-State Joint Board on Universal Service, Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charge, *Fourth Order on Reconsideration in CC Docket No. 96-45, Report and Order in CC Docket Nos. 96-45, 96-262, 91-213, 95-72*, 13 F.C.C.R. 5318, ¶ 3 (Dec. 30, 1997) [hereinafter *Fourth Order on Reconsideration*] (“[The Commission established federal universal service support mechanisms to] provide schools and libraries with discounts on all commercially available telecommunications services, Internet access, and internal connections.”).

¹¹⁹ See H.R. REP. NO. 104-458, at 132. For example, a local area network (“LAN”) sufficiently delivers the telecommunications and Internet access services to schools. See *Fourth Order on Reconsideration, supra* note 118, ¶ 210 (ensuring available discounts for internal connections, if the school district office is used as the LAN hub for all the schools in the district connecting through the district office’s internal connections).

¹²⁰ See 47 C.F.R. § 54.518 (2005) (“To the extent that states, schools, or libraries build or purchase a wide area network to provide telecommunications services, the cost of such wide area networks shall not be eligible for universal service discounts . . .”).

sion that allows support for access to the Internet because WANs provide broad-based telecommunications.”¹²¹

While the distinction between local area network equipment and WAN equipment is sometimes vague and the same piece of equipment often can be configured to operate in either context, the principle is clear. Both the FCC and USAC have endeavored to demark with precision the extent to which networking equipment will be considered an eligible internal connection, based both on location and function.¹²²

Furthermore, in response to requests from particular state-sponsored telecommunications networks, the FCC ruled early in the life of the program that such state networks did not qualify as a “telecommunications carrier” eligible to directly receive E-Rate funding for telecommunications services provided to schools because of their limited clientele.¹²³ Rather, the FCC ruled that such state networks were only eligible: (1) to act as a consortia for individual schools in the purchase of telecommunications services from an eligible telecommunications carrier; and (2) to “secure direct reimbursements for their provision of eligible discounted non-telecommunications services (i.e., Internet

¹²¹ *Fourth Order on Reconsideration*, *supra* note 118, ¶ 193. In the first Tennessee case, while declining to place significant weight on this factor “out of concern that a WAN such as this could be used to provide telecommunications service,” the FCC noted that the network will be used by Tennessee only for Internet access services. 1999 Tennessee Order, *supra* note 90, ¶ 30.

¹²² See, e.g., *Fourth Order on Reconsideration*, *supra* note 118; *In re Request for Review of the Decision of the Universal Service Administrator by Arkansas Department of Correction School District*, Order, 17 F.C.C.R. 7100 (Apr. 22, 2002); *In re Request for Review of the Decision of the Universal Service Administrator by Southeast Webster Community Schools*, Order, 17 F.C.C.R. 11,122 (June 14, 2002); see also *Schools and Libraries Support Mechanism for Fund Year 2006, Eligible Services List* (Nov. 22, 2005), http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-197A2.pdf (detailing the services available for E-Rate funding in the 2006 school year).

¹²³ See *Fourth Order on Reconsideration*, *supra* note 118, ¶ 554; *In re Federal-State Joint Board on Universal Service, Memorandum Opinion and Order*, 15 F.C.C.R. 7170 (Sept. 30, 1999) [hereinafter *Washington Petition*] (determining the petition of various Washington state entities that “state telecommunications networks are not eligible to receive discounts directly from the universal service support mechanism”). The Commission’s ruling that Iowa’s state network did not qualify as a “telecommunications carrier” was subsequently reversed and remanded by the U.S. Court of Appeals for the District of Columbia Circuit. *In re Federal-State Joint Board on Universal Service, Declaratory Ruling*, 14 F.C.C.R. 3040 (Jan. 29, 1999); *Iowa v. FCC*, 218 F.3d 756 (D.C. Cir. 2000). On remand, the Commission determined, based on the specific facts presented, that the Iowa state network was a common carrier eligible for direct support. *In re Federal-State Joint Board on Universal Service, Order on Remand*, 16 F.C.C.R. 571 (Dec. 21, 2000) [hereinafter *Federal-State Joint Board on Universal Service Order on Remand*], *aff’d*, *U.S. Telecom Ass’n v. FCC*, 295 F.3d 1326 (D.C. Cir. 2002). In making this determination, the Commission indicated its expectancy that other state networks could be eligible for similar treatment, if the required showing could be made. See *In re Federal-State Joint Board on Universal Service Order on Remand*, *supra*, ¶ 16.

access and internal connections) to schools and libraries.”¹²⁴

However, in actual practice, the situation has proven to be different. Under present USAC policy, E-Rate funding is available for leasing, but not the purchase, of a WAN and equipment—apparently for both telecommunications and Internet access use, because USAC policy makes no distinction.¹²⁵ While the USAC policy is cast in terms of the leasing of services, rather than the purchase of equipment, this is a somewhat legalistic distinction without substantial meaning.

The Tennessee situation illustrates how the USAC policy came about. USAC had initially denied Tennessee’s request for funding, finding that “purchased WAN components are not eligible for support.”¹²⁶ The requested funding involved charges for the construction of network point of presence facilities, also known as “Educational Hub sites,” at various locations throughout the state to be used for routing of Internet access traffic to schools.¹²⁷ More specifically, funding was sought for the entire cost of equipment and other facility construction costs as up-front, non-recurring charges, similar to an initial installation charge for the provision of Internet access service.

Framing the issue as “whether Tennessee essentially requested discounts for the purchase of ineligible facilities or eligible services,” the FCC overruled USAC and directed the grant of funding in a long and somewhat labored discussion.¹²⁸ On one hand, the FCC was “somewhat concerned about the level of the nonrecurring charges” for the purchase of WAN equipment and “troubled” by the effect of a decision to grant funding.¹²⁹ Such funding was not an anticipated component of the program: “[w]hen we started this program, we did not envision providing support to fund significantly the backbone of a provider’s network.”¹³⁰ The FCC also recognized the natural incentive for applicants to call something otherwise ineligible by a different name in order to obtain funding, as well as the difficulties in drawing a “line between end-to-end Internet

¹²⁴ Washington Petition, *supra* note 123, ¶¶ 3–4.

¹²⁵ See Universal Service Administrative Company, Wide Area Network (WAN) Fact Sheet, <http://www.sl.universalservice.org/reference/wan.asp> (last visited Feb. 5, 2005).

¹²⁶ 1999 Tennessee Order, *supra* note 90, ¶ 25. More specifically, because the classification of some of the requested equipment was in dispute, USAC alternatively found that even if viewed as internal connection equipment (i.e., local area network equipment), it could not be funded because Tennessee did not meet the funding cap limit for internal connection equipment. *Id.*

¹²⁷ See *id.*

¹²⁸ See *id.* ¶ 26.

¹²⁹ *Id.* ¶¶ 33, 42.

¹³⁰ *Id.* ¶ 42. It should be noted that the FCC never determined the precise extent to which network equipment and construction costs would be E-Rate funded. While presuming the amount to be substantial for decisional purposes (i.e., the non-recurring up-front charges are greater than the recurring charges), the FCC’s Order notes substantial dispute in the record and does not attempt to resolve the question. *Id.* ¶ 33.

access service and internal connections because Internet service providers configure their networks and services differently.”¹³¹

But, in the end, these concerns failed to carry the day. Rather, the FCC relied on the absence of any evidence showing that the state would have an exclusive right to use the networking equipment or any ownership interest in the equipment.¹³² Even though the cost of statewide WAN facilities would be fully funded up-front and open to use by other parties, the FCC saw no problem with the arrangement. After all, a service provider should be reasonably expected to “include some portion of the cost of facilities . . . within the charges for providing Internet access service”¹³³

The reasoning is superficial and elevates form over substance. While it is an economic truism that a service charge will include the service provider’s costs of providing the service, this does not mean that the E-Rate program may fund the entire cost of construction of WAN facilities under the guise of an Internet access service charge. However, rather than examine the true economic nature of the transaction, the FCC relied upon economic platitudes. It did not even attempt, for example, to ascertain the components of the substantial up-front charges, whether all or only a substantial portion of the cost of the WANs facilities that were being funded.

Similarly, the FCC’s reliance on the absence of a contract-based exclusive right to network facilities and an ownership interest in the facilities both unwisely evaluated only the form, rather than the substance, of the arrangement.¹³⁴ At issue were custom-designed WAN facilities configured to meet the express and unique needs of the state and entirely paid for by the state using E-Rate funding.¹³⁵ The FCC, however, solely relied on the form of the arrangement in making its decision: “even if Tennessee were [Educational Networks of America’s] only customer, that fact alone does not prove that Tennessee has an exclusive right to use the network.”¹³⁶

If truly multiple user network facilities were involved, a different E-Rate funding question should have been raised but was not. Where equipment or facilities are used both for eligible E-Rate and other purposes, the school is required to apportion its application for E-Rate funding and may receive funding only to the extent of eligible E-Rate use.¹³⁷ For example, if networking

¹³¹ *Id.* ¶ 35. In this respect, the FCC actually had two reasons to be concerned, as a funding request for Internet access service could be used to mask funding for either ineligible WAN equipment or ineligible internal connection equipment on school premises.

¹³² *See id.* ¶¶ 37–38.

¹³³ *Id.* ¶ 29.

¹³⁴ *See id.*

¹³⁵ *See id.*

¹³⁶ *Id.* ¶ 32.

¹³⁷ *See* 42 U.S.C. § 254(h)(1) (2000); HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at

equipment is used only 50% of the time for eligible Internet access purposes and 50% for ineligible purposes, only 50% of the cost of the equipment would be eligible for E-Rate funding support.¹³⁸ However, the reasoning used by the FCC went both ways, relying on purported non-exclusive use for one purpose, while assuming exclusive use for the other.

The decision represents a lost opportunity to fashion clear and forthright policies regarding WAN facilities. Rather than face the issue directly, the FCC started down the path of basing fundability on a series of legalistic distinctions that, to a fair degree, are out of touch with the real world. The consequences of this decision are unreasonable given that support will not be provided for schools to build or operate WANs but can be provided to a third party to build the very same network for the school. Even though E-Rate funding paid for the entire cost of the network, the school cannot own the equipment. While the network is custom-designed to serve the needs of one entity, the school or library cannot contract for an exclusive right to use the network. However, the network is not actually required to have other users to qualify for funding.

This is not to argue against E-Rate funding for the operation of WANs. Instead, particularly for large school districts, WANs can be a much needed component within the E-Rate program. Still, rather than force schools into certain service models that sometimes can be quite artificial, schools should have the additional option of direct network ownership and operation. Some schools may prefer a true service arrangement from an established service provider, while others may prefer direct network operation. By allowing no options, the present policy, if anything, serves only to encourage trickery and artful schemes.

If WAN equipment can be leased, is there a valid reason why it may not be purchased? The answer is that there is no good reason. Originally, the FCC held that funding for WANs was outside the pale of the E-Rate program because, from a legal perspective, they were not perceived to meet the statutory definition of services eligible for support. Such networks were neither an eligible telecommunications activity nor eligible internal connection equipment.¹³⁹ Nor were they fundable for just Internet access, given their inherent bandwidth ability to be used for other telecommunications functions.

What the FCC ignored, however, is that "broad authority" exists under § 254(h)(2) to fund equipment and other services necessary to connect classrooms and libraries.¹⁴⁰ At least from the statutory construction standpoint, net-

19–24.

¹³⁸ See Cost Allocation Guidelines for Products and Services, <http://www.universalservice.org/sl/applicants/step06/cost-allocation-guidelines-products-services.aspx> (last visited Feb. 5, 2006) (providing examples of cost allocation methods).

¹³⁹ See *Fourth Order on Reconsideration*, *supra* note 118, ¶ 182.

¹⁴⁰ See *In re Federal-State Joint Board on Universal Service Order on Remand*, *supra*

work equipment is network equipment regardless of whether it is internal to the school or located elsewhere along the chain. Rather than face this question, however, both the FCC and USAC have proceeded to do indirectly what they could not do directly through a continuing series of legal fictions in which only the purchase of Internet access service and lease of equipment are being funded.

VI. SUGGESTIONS FOR THE FUTURE

With escalating stories of fraudulent and wasteful practices, numerous suggestions for program reform have been offered, with some already implemented. Suggested reforms have included such changes as more stringent pre-grant certification requirements, more post-grant audits, on-site inspections, the elimination of funding for internal connection equipment, and an increase in the present 10% minimum local share obligation.¹⁴¹ Relatively minor changes like these may be of some help, but to be truly effective, reform needs to cut deeper. If present certification requirements have not deterred illicit practices, for example, adventurous parties will probably pay no greater attention to more strongly worded language. Audits can no doubt be effective in uncovering fraudulent practices after the fact, as well as providing an essential program integrity component, but they are time-consuming and expensive for such a large program, and the recovery of funds after money is dispersed can be both a difficult and frustrating process. Accordingly, audits should not be viewed as a panacea for effective and prudent program management before funds are disbursed.

In particular, two more fundamental program flaws should take priority status. First and foremost, the program needs an effective “hands on” management structure that combines both policy and administrative matters into an integrated structure with clear lines of responsibility and accountability, an organizational structure that can respond quickly and decisively to issues as they arise. The FCC has recognized the need for more effective management and is now in a comprehensive rulemaking proceeding exploring ways in which the program should be restructured, including the possible replacement of USAC with an outside contractor.¹⁴² This review is a welcome development, but the FCC needs to appreciate that the simple substitution of one outside party for another as program administrator, standing alone, is not likely to solve the problem. Rather, the primary focus needs to be on the underlying management structure and how, as the policy maker, the FCC, can effectively

note 123, at 591.

¹⁴¹ See, e.g., HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 3–5.

¹⁴² See *supra* notes 7–9 and accompanying text.

oversee and manage program administration on a day-to-day basis. Where policy-making ends and administration begins is, at best, a very grey area. Often, in the context of a particular matter, the two are so intertwined as to be inseparable into two organizations with different managers and imperfect lines of responsibility between the two.

This is particularly true given the vagueness of FCC program rules, a rapidly changing technological environment, and the complexity of many technology acquisition projects for which funding is sought. The FCC should not expect that the program may be simply outsourced to an independent body after the program rules are established, but rather must design an integrated management structure that provides effective “hands on” FCC management, including the allocation of sufficient internal staffing to accomplish the job.¹⁴³

Each year, over 40,000 applications for E-Rate funding must be processed over a relatively short time span. To accomplish this, USAC presently outsources much of the actual day-to-day work to electronic data processing companies.¹⁴⁴ The resulting process tends to focus too much on the form of the application rather than the substance of the request. While some of the information technology procurements reviewed by USAC are probably as complicated as a major Pentagon weapons procurement, the present E-Rate application process is more appropriate for the purchase of simple off-the-shelf products that have an established and easily ascertainable price. As a result, an innocent school that places an incorrect address on the application form when requesting a few thousand dollars to pay its telephone bill probably has a greater risk of denial than a multi-million dollar scheme organized by potentially fraudulent parties such as in the San Francisco situation.¹⁴⁵

Again, the ongoing saga of the Tennessee case serves to illustrate the present lack of an effective management structure with clear lines of responsibility and accountability. Since the FCC’s original decision in 1999, the contract award has come under criminal scrutiny by a federal grand jury in Tennes-

¹⁴³ Inadequate staffing resources have bedeviled the E-Rate program from the start. While the program was set up with the laudable goal of keeping administrative costs as low as possible through automated electronic data processing procedures, this must be balanced with the need for effective management of a multi-billion dollar per-year grant program. In this respect, USAC has typically spent from two to three percent of overall E-Rate program costs on program administration, which is probably less than that spent by most charitable organizations managing substantial grant programs. See USAC 2004 ANNUAL REPORT, *supra* note 61, at 22–23. See generally GAO REPORT, *supra* note 29. Also, according to the GAO, FCC staffing levels supporting the program have been low, ranging from 8.8 to 19.5 full-time equivalent positions per fiscal year. *Id.* at app. IV.

¹⁴⁴ See, e.g., UNIVERSAL SERVICE ADMIN. CO., 2001 ANNUAL REPORT, <http://www.universalservice.org/about/governance/annual-reports/2001/pg4.html>.

¹⁴⁵ See HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 22–24.

see.¹⁴⁶ As part of an ongoing investigation into alleged corruption in the awarding of public contracts during this period, the grand jury indicted the founder and CEO of the winning bidder in November 2004 for obstruction of justice. This individual is currently awaiting trial for the alleged destruction of evidence sought by the grand jury.¹⁴⁷ Due to the ongoing grand jury investigation, in late 2002, USAC put a hold on further funding. Thereafter, the state pleaded for relief under the so-called “good samaritan policy.” This policy allows for the designation of a substitute service provider for the sole purpose of receiving funding for disbursement to other entities providing service. In 2003, the FCC directed USAC to “process Tennessee’s Funding Year 2002 application and, if appropriate, disburse funds to the designated Good Samaritan provider” in order to maintain operation of the state’s network.¹⁴⁸ No funds, however, were to be disbursed to ENA, including the payment of salaries of thirty-seven ENA employees responsible for the operation of the network.¹⁴⁹

The implementation of the FCC’s Order proved difficult for USAC. In early 2005, Tennessee again approached the FCC and requested emergency relief, disagreeing with USAC’s implementation of the FCC’s 2003 Order in two respects.¹⁵⁰ First, Tennessee challenged USAC’s determination to disallow funding for equipment and services provided by subcontractors that were ineligible for funding directly, but would be eligible indirectly if included as a component of the overall Internet access service provided by the prime contractor.¹⁵¹ Second, the state disputed USAC’s practice to pay only the portion of the subcontractor’s invoice that was specifically matched to a payment of the state’s

¹⁴⁶ See *Friends in High Places: Agents Raid ENA Offices, Seize Files*, NewsChannel5.com (Dec. 20, 2002), <http://www.newschannel5.com/content/investigates/1036.asp> (reporting on the raid by federal and state agents of the ENA offices in Nashville, possibly in connection with the long-term contracts to continue Internet services with Tennessee schools).

¹⁴⁷ See *Friends in High Places: Sundquist Friend Indicted for Obstruction*, NewsChannel5.com (Nov. 4, 2004), <http://www.newschannel5.com/content/investigates/7737.asp> (reporting on the indictment of ENA founder Al Ganier, and whether his relationship with then Governor Don Sundquist assisted in ENA’s being awarded with millions in state contracts).

¹⁴⁸ *In re* Request for Immediate Relief Filed by the State of Tennessee, *Order*, 18 F.C.C.R. 13,581, ¶ 24 (July 2, 2003) [hereinafter 2003 Tennessee Order].

¹⁴⁹ See *id.* ¶¶ 20–21. As detailed in the Order, 61% of the overall cost of network operation goes to subcontractors providing telecommunications and other supporting services, 18% goes to pay ENA employees responsible for the operation of the state’s network and the remaining 21% goes to ENA for other expenses, costs, and overhead. *Id.* at 13,584 nn. 18–19.

¹⁵⁰ See *In re* Petition for Clarification and Emergency Relief by Department of Education, State of Tennessee; Schools and Libraries Universal Service Support Mechanism, *Order*, 20 F.C.C.R. 10,923 (June 22, 2005) [hereinafter Petition for Clarification]. Tennessee filed a Motion to Withdraw its Petition for Clarification on June 6, 2005, which the FCC granted in the June 22, 2005 Order.

¹⁵¹ See 2003 Tennessee Order, *supra* note 148, at 13,587.

30% share of the overall price to the particular subcontractor.¹⁵² The issues raised illustrate both the illusion of the program—eligibility dependant on the name attached rather than the substance of the transaction—and the difficulty in realistically maintaining a separation between program policy interpretation and administration. Also, the practical effect was substantial. According to the state’s petition, over \$38 million was at stake in the disputed USAC administrative determinations in E-Rate funding for a two-year period.¹⁵³ It further reported that the indicted individual had resigned as an ENA employee, officer, and director.

The FCC never acted upon the state’s petition. Instead, in March and September 2005, USAC granted over \$47 million in funding for program years 2002, 2003, and 2004 to Tennessee for Internet access service provided by the prime contractor ENA.¹⁵⁴ In withdrawing its request for FCC clarification of the July 2003 Order, Tennessee reported in June 2005 that special relief from the FCC was no longer necessary as “USAC has begun to release E-Rate funding again for the state’s schools in its normal course” pursuant to a USAC administrative policy regarding the treatment of entities under investigation that was first released in November 2003.¹⁵⁵

It is unascertainable how this exactly transpired, as USAC operations and decision-making are largely non-transparent to the public. From all outward signs, however, it appears difficult to square the action with both the FCC’s 2003 Order—presumably the highest authority in the matter—and USAC’s own statement of principles which states rather unequivocally that funding will be deferred in cases where “persons associated with the entity under investigation have been arrested or criminal charges have been made”¹⁵⁶ Whatever the answer, these apparent inconsistencies and the convoluted way in which

¹⁵² See Petition for Clarification, *supra* note 150, ¶ 11 (“USAC does not require Service Providers, such as AOL for example, to allocate payments, or even to make payments, in any fashion, or even disclose to competitors how its service is operating and with what suppliers. However, in the current situation, USAC is carrying the Service Provider allocation down to remote levels to sub vendors, for example.”).

¹⁵³ See *id.* ¶ 4.

¹⁵⁴ Universal Service Administrative Company, Funding Commitment Data, <http://www.sl.universalservice.org/ContentInc/funding/previous.asp> (last visited Feb. 22, 2006) (detailing state funding reports and cumulative national data for Funding Years 1998–2005).

¹⁵⁵ See *In re* Petition for Clarification, Department of Education, State of Tennessee; Federal-State Joint Board on Universal Service; Changes in the Board of Directors of the National Exchange Carrier Association, Inc., *Withdrawal of Petition for Clarification and Emergency Relief by Department of Education, State of Tennessee*, CC Docket No. 96-45, at 3 (June 6, 2002) (available via FCC Electronic Comment Filing System); Universal Service Administrative Company, Principles of Treating Entities Under Investigation Relating to their Participation in the Schools and Libraries Universal Service Support Mechanism (2003) [hereinafter USAC PRINCIPLES], <http://sl.universalservice.org/reference/investigation.asp>.

¹⁵⁶ USAC PRINCIPLES, *supra* note 155, ¶ 9b.

the decisions appear to have transpired emphasize the need for greater clarity on who is doing what in the management and administration of the E-Rate program.

Additionally, the artificiality of certain aspects of the funding process must give way to procedures which mirror sound business practices and established procurement procedures that schools would naturally follow if they were spending their own money. Three aspects stand out in particular: (1) where the money actually goes; (2) realistic standards that do not force schools into unusual procurement arrangements just to satisfy the “form” required by the program; and (3) effective competitive bidding requirements.

Under the existing grant distribution process, funding is paid directly to the vendor, rather than flowing to the school. The reason is highly legalistic, resulting largely from the original structure of the universal service program as a discount mechanism among telecommunications carriers under which the carrier “discounted” a service to the favored class of customers and then recovered that discount through an offsetting reduction in its required payment into the USF. The customer originally received only a subsidized service as opposed to a funding grant requiring responsible administration on its part. This antiquated concept does not reflect the realities of the present process in which, except for telecommunications services, funds are now directly paid to the vendor for goods or services provided to the school. It “lessens applicants’ control over work performed and diffuses responsibility and accountability for program integrity”¹⁵⁷ From a practical business standpoint, distributing the funds directly to the school for inclusion in its normal budgeting and accounting procedures, and then holding the school fully accountable for its spending would probably contribute more to overall program integrity than any other single measure.

Similarly, requiring schools to structure procurement transactions in a certain way invites suspect arrangements. There is no better example of this than the present WAN policy that compels the leasing of equipment from a third party, even though the school might otherwise prefer to own and operate the equipment itself.¹⁵⁸ The annual filing window process has also led to an unhealthy “Oklahoma Land Rush” mentality encouraging applicants to stake claims by the close of the filing window. If left to their normal procurement practices, schools and libraries nationwide would utilize a broad variety of procurement practices and project schedules driven by their particular local needs and requirements. By imposing a uniform nationwide filing window for funding each year, the present E-Rate process unwisely encourages the local applicant to ignore its normal way of doing business and usual facilities develop-

¹⁵⁷ HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 3.

¹⁵⁸ See discussion *supra* note 19.

ment process.

Finally, “the program needs a much more robust competitive bidding structure than it currently possesses, in order to ensure that E-rate funds support the highest per-dollar value possible.”¹⁵⁹ Even with the renewed emphasis on lowest price as the primary bidding factor, the process as shown by Wyoming’s difficulties is far from adequate. Simply mandating that schools shall seek competitive bids through a web posting process that often does not really disclose what the school is actually seeking, along with requiring a waiting period of twenty-eight days before entering into a contract does not mean that that competitive bids will actually be received and carefully evaluated, particularly where there are no hard standards or process to follow. Government procurement practices, particularly for complex technology contracts, are far more detailed and complex process and require far more direction and control.

VII. CONCLUSION

Any multi-billion dollar grant program carries with it natural incentives for parties to abuse the system. These incentives are heightened where the program is open-ended as to the dollars that can be obtained, unclear as to exactly what types of equipment and services are eligible for funding, and involve the acquisition and operation of large and extremely complex information technology systems.

This is not to say that the present distributional system has failed in all cases. That seems to be far from the case. Most applicants no doubt have approached the process honestly. A fair number of the growing “violations of program rules” now being noted are really no more than honest mistakes made by parties, such as the Our Lady of Refuge school in the Bronx, caught up in the snares of a cumbersome process that is difficult to navigate.

The recent and widespread public accounts of fraud, corruption, and criminal convictions have probably done more to scare away some potential schemers and clean up blatantly abusive practices than the tightening of regulations to date and the threat of more post-grant audits. To complement this, there needs to be a far greater level of sophistication and business acumen in the overall management of the program and, in particular, the initial grant process. Given the evidence to date of significant criminal activities and other fraudulent schemes within the E-Rate program, more than piecemeal solutions are required at this point to ensure future program viability and integrity.

¹⁵⁹ HOUSE SUBCOMMITTEE REPORT, *supra* note 1, at 5.