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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20445

AUG - 6 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)	
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45
)	
Tennessee State Department Of Education)	Applicant ID No. 145698
)	
Application (FCC Form 471) for Approval of Funding)	Universal Service Control No. 144790000000004
To: The Commission		
Administrator, Schools and Libraries Corporation		

**REPLY TO CONSOLIDATED RESPONSE AND RENEWED REQUEST FOR
EXPEDITED DECLARATORY RULING**

Submitted on behalf of:

INTEGRATED SYSTEMS AND
INTERNET SOLUTIONS, INC.

By: Ramsey L. Woodworth
Rudolph J. Geist

WILKES, ARTIS, HEDRICK & LANE,
Chartered
1666 K Street, N.W. Suite 1100
Washington, D.C. 20006
(202) 457-7800

August 6, 1998

Its Attorneys

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**REPLY TO CONSOLIDATED RESPONSE AND RENEWED REQUEST FOR
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This Reply is being submitted by Integrated Systems and Internet Solutions, Inc. ("ISIS 2000") to respond to contentions made in the Consolidated Response filed July 21, 1998 by the Tennessee State Department of Education ("Department"), which are simply not borne out by the factual record, and to renew ISIS 2000's request that the Commission immediately act upon the important issues raised by ISIS 2000 in this proceeding with respect to the above-captioned application.

I. The Department's Claim That Its Contract Award Decision Was Based on the Lowest Pre-Discount Price Is Completely Baseless

Ignoring both its own bid cost evaluation formula set forth in the Request for Proposals ("RFP") and its undisputed analysis of ISIS 2000 and ENA under this formula (ISIS 2000 Objection and Request for Declaratory Ruling, Attachments D & E), the Department nonetheless contends that its selection was based upon the lowest pre-discount price because "the State estimated the "hidden costs" of the ISIS 2000 proposal at \$187 million, or \$113 million more than the ENA proposal." (Consolidated Response, p. 6.) This line of argument, as previously pointed out, is nothing more than a transparent after-the-fact attempt to justify an indefensible position. The record demonstrates unequivocally that an unconditional bid of \$51,275,384 was submitted by ISIS 2000 and that the Department evaluated the bid and made its contract award determination on that basis pursuant to a cost evaluation formula favoring the highest pre-discount price. For example, as stated in the Department's own Report responding to ISIS 2000's initial bid protest:

"ISIS 2000 raises a concern about ENA's costs. The State will pay either proposer the same amount of dollars. ENA demonstrated its understanding of the State's RFP requirements and maximized the opportunity of obtaining FCC E-rate funds..." (Shrago, April 2, 1998 Report, ¶2.9, Attachment 6, Consolidated Response).

The misconception of an alleged higher "hidden" bid cost of \$187 million was not crafted by the Department until after the bid award when the Department was attempting to defend its position. It was initially suggested in the presentation by the Department's representative during the contract award review process before the Review Committee. In her prepared testimony to the Review Committee, the Department representative even acknowledged her awareness of the simple mistake made by ISIS 2000 in a spreadsheet, which resulted in an incorrect number on one six-month cost breakout of the overall 3.5 year cost proposal:

There is a major discrepancy between one-month and six month costs. Even if we assume that they intended for the six month to be the accurate one, it appears unlikely that there is a tariff from BellSouth to support the costs shown for communications lines offered. (Consolidated Response, Attachment 6).

Notwithstanding that ISIS 2000 has demonstrated that this was a mistake on a single spreadsheet in the overall proposal, and that its \$51,275,284 bid is unconditional, the Department continues to raise this issue in an attempt to lead the Commission astray from the USF rule violation issues which go to the heart of the Department's application and this proceeding. The Department Representative's statements in this respect do not represent the findings or conclusions of the Review Committee or any other State agency. Moreover, as the review process was narrow in scope and limited to specific defined issues concerning ENA's

qualifications and eligibility to receive the bid award, they were not even relevant to the bid review proceedings.¹

Following the contract award issued March 20, 1998, ISIS 2000's bid protest raising five issues concerning ENA's qualifications was first considered and denied by the Department of Education on April 2, 1998. Second, a four-person Review Committee composed of a representative from the Department of Education, Department of Finance and Administration, Department of General Services, and the State's Comptroller's office considered the same five specific protest issues raised by ISIS 2000. As characterized by the Chairman of the Review Committee:

"The focus of the panel would be to try to make a determination with respect to the question, did each issue being protested meet the requirements of the RFP? We will try to remain focused on those issues.... The issues raised in the Protest were as follows: whether ENA failed to complete required tests; whether ENA's cost proposal misrepresents E-rate rules and funding; whether the legal status of ENA to participate in the process is questionable; whether ENA lacks the requisite financial responsibility to fulfill its obligations under its proposal and whether ENA failed to submit cost data in a sealed envelope.

(Transcript of Review Committee meeting, April 6, 1998, p. 3-4, attached hereto as Attachment A.)²

¹ Nor is the fact that limited aspects of the Department's bid award to ENA were reviewed by other state agencies relevant to the FCC issues in this matter. Not only was this review very limited in scope, but it does not in any way validate the Department's position with respect to its interpretation of FCC rules. The Department's claim (Consolidated Response, fn. 4) that it was even unable to confirm the cost of a proposed ISIS 2000 subcontractor, Bell South, also has a distinctly hollow ring. The attached letter (Attachment 5 of the Department's pleading) from Bell South says no such thing, noting that the Department's question is "somewhat ambiguous."

Statements of the litigator defending the actions of an administrative agency in an adversarial review process are no substitute for the four corners of the decision. Where the rationale offered by a party in defense of the action goes beyond and is inconsistent with the decision itself, it must be disregarded. See e.g., Richman Communications v. U.S. Sprint, 953 F. 3d. 1431, 1438-1439 (3rd Cir. 1991). Thus, the Department representative's personal conclusions (which are false and were not the conclusions of the State's review process) cannot now be considered in defense of the Department's contract award.

The Department further suggests that its award must have been based on the lower pre-discount price because the contract was awarded to ENA regardless of USF funding. (Consolidated Response, p. 8.) This is an illogical assertion. The nature and extent of the contract awarded to ENA are vastly different depending on whether or not USF funding is obtained. The Department assumed no risk whatsoever of additional costs if USF funding was not obtained, so it is in no position now to claim that it had an incentive to select the lower pre-discount bid. Yet, the Department would have the Commission believe that it was the

⁴ While ISIS 2000 does not desire to overwhelm the Commission with voluminous paper, we feel compelled to file the transcripts of the State's review process in their entirety to give the Commission the opportunity, at its discretion, to review the validity of the Department's characterizations of that process as outlined in the Department's various pleadings. Transcripts from both meetings of the Review Committee on April 3, 1998 and April 6, 1998 are attached hereto as Attachment A.

ISIS 2000 proposal which was suspect because it was contingent on the receipt of USF funding. This turns logic on its head, as the Commission has specifically recommended that schools and libraries make the overall contract contingent on the receipt of E-rate funding so the institution is not left with a financial obligation it cannot afford. See Report & Order, 12 FCC Rcd. 8776, 9057, fn. 1396, 9080, fn. 1496 (1997). As shown in the Consolidated Response, the Department completely misunderstands this simple policy.

Finally, the Department's claim that the ISIS 2000 proposal was not cost-effective because it would be "an inferior, unacceptable piece-meal service" (Consolidated Response, p. 15) must be similarly dismissed as post-decisional defensive rhetoric. Unlike several other bidders whose bids were dismissed for various deficiencies, both ENA and ISIS 2000 were found to have met "mandatory proposal requirements." See ISIS 2000 Objection and Petition for Declaratory Ruling, Attachment E. The Department's ensuing final comparative evaluation under the criteria set forth in the RFP speaks for itself. Both ISIS 2000 and ENA were found to have met the Department's functionality and throughput test standards, the sole objective testing measure specified by the Department for measuring system performance and acceptability. On the basis of the specified scale of 100, the differences in points awarded by each reviewer and in overall average for Technical Approach,

Proposer Experience and Proposer Qualifications show a qualitative difference more along the lines of the difference between a grade of a "B" and a "C" and nothing more. Moreover, if pre-discount price were to be properly evaluated and points awarded on the basis of lowest rather than highest pre-discount price, it is obvious that, by any objective standard, the preference due ISIS 2000 on this factor would have been more than sufficient to offset the differences in points awarded for non-cost factors.

II. The Department's Consolidated Response Raises More Questions Than It Answers With Respect to the So-Called Sale of the ConnectEN Network.

In the Consolidated Response, the Department attempts to explain that the "sale" of the existing ConnectTen network is not a wash transaction which artificially inflates the amount of USF funding made available to the Department, but a real transaction. In support of its argument, the Department claims it has sold the ConnectTen network to ENA for \$7.5 million as of July 1, 1998, and that the sale is "not a right-to-use." Further, in an attempt to support that an actual payment of \$7.5 million has been made for the network, the Department claims that "the State has appropriated \$12.5 million for FY 98-99 from its General Fund," and attaches sections from recent Budget legislation designating \$7.5 million to the Department of Education from sources "other" than State funds. (Consolidated Response, pp. 15-17).

The Department's belated attempt to justify this transaction is transparent on its face. First, the "sale letter" which the Department appears to be referencing but fails to attach to the Consolidated Response makes clear on its face that ENA has obtained only limited "use" rights to all network hardware, with absolutely no passage of title or ownership. This is the letter that ISIS 2000 has already fully discussed in its Second Supplement, which states as follows:

This letter is written pursuant to Section A.11.11 of the Contract between the State of Tennessee, Department of Education and Education Networks of America (ENA). At its meeting on May 26, 1998, the Information Systems Council approved the sale of the State's interest in ConnectEN. That interest includes ENA's exclusive use, but not ownership, of ConnectEN hardware until it is replaced. At that time, the hardware will be returned to the State. We believe this arrangement, which we hereby expressly approve, satisfies the substance of the transfer of ConnectEN that is contemplated in the proposal of ENA.

If the hardware is not included in the sale, what then is left to sell? According to the Consolidated Response, certain unidentified "software" has been sold to ENA. (Consolidated Response, p. 16).

Second, the section of the State's Budget Appropriations legislation does nothing more than detail a \$7.5 million Department line item under an "Other" source of funding category among seemingly hundreds of other appropriations. The State is clearly not the source of this

funding, which supposedly is a payment from ENA. The fact that the Department has reported \$7.5 million in funding under this "Other" category is no more evidence of an actual sale transaction than the previous reported contractual arrangement for the "sale" of the network in return for Internet Access services over the network. The sole purpose of the line item appears to be no more than to allocate the purported proceeds of the sale "from Department revenues" to the Department for spending purposes, a purely paper transaction. The simple fact is - this sham transaction has no net economic effect which the Department or ENA can demonstrate. Courts have historically classified sham transactions as those which lack any economic substance or motive and in which no benefits of ownership pass. See, e.g., Cherin v. Commissioner, 89 T.C. 986-87, 992 (1987).

As ISIS 2000 has demonstrated throughout this proceeding, ENA and the Department have entered into a sham transaction designed to result in nothing more than an artificially inflated amount of USF funding for which the Department would be eligible. A summary of the history of both ENA and the Department's planning of this wash transaction demonstrates that it is entirely devoid of economic merit and results in no passage of ownership to ENA:

- In December, 1997 ENA distributes a business plan which anticipates the wash transaction even before the Department's RFP is written. (See ISIS Supplement to Reply, Attachment X.)

- On February 5, 1998 the Department releases a Request for Proposals ("RFP") which includes a provision entitled "creativity" which, in the context of finding ways to maximize USF funding, encourages proposers to:

consider creative approaches to this situation, including any purchase of existing equipment, resale or salvage of existing equipment.

- On February 25, 1997, ENA submits a Proposal in response to the Department's RFP which proposes to purchase the ConnectTen network for \$7.5 million. Nowhere in the proposal is there any description of how the \$7.5 million figure for the ConnectTen network has been arrived at or what ENA would receive in exchange for the alleged \$7.5 million "credit" to the Department for the network.
- On April 7, 1998, several weeks after the Department has selected ENA as the winning bidder, ENA and the Department enter into a contract which, like the ENA proposal, contains no description whatsoever of how the \$7.5 million figure for the ConnectTen network has been arrived at or what ENA would receive in exchange for the alleged \$7.5 million "credit" to the Department for the network. This contract contains Section A.11.10 which states:

The payment for the ConnectTen network will be received as a credit that will be applied by the State against invoices received from ENA by September 30, 1998 for basic services.

- On April 20, and April 21, 1998, respectively, ENA and the Department file Oppositions' to ISIS 2000's Objection. Neither pleading includes any detailed description regarding how the \$7.5 million figure for the ConnectTen network has been arrived at or what exactly ENA would receive in exchange for the alleged \$7.5 million "credit" to the Department for the network.
- On May 27, 1998 the State Information Systems Council issues a "sale letter" which officially approves "ENA's use, but not ownership of ConnectTen hardware." (see discussion above). The letter provides no other description regarding what the "sale" involves.

- On July 21, 1998, the Department files a Consolidated Response which contains no detailed description regarding how the \$7.5 million figure for the "sale" of ConnectTen has been arrived at or what exactly ENA would receive in exchange for the alleged \$7.5 million "credit" to the Department for the network. The Department does now admit that the "State did not sell or transfer all elements of hardware." The Department admits that the routers in schools are not included in the "sale" but that "software" is included.

The Department's admission in the Consolidated Response that it is not selling the hardware but only software is very puzzling. If ENA is not buying the hardware, then what Department assets are the basis of this transaction, and how does the Department justify the price? The history of ConnectTen demonstrates that the network cost far less than \$7.5 million to implement. According to newspaper accounts contemporaneous with the initial build-out of ConnectTen, the Department spent approximately \$5.5 million up-front for the network hardware for all schools constituting ConnectTen and received software free of charge. The following is an excerpt from an October, 1996 newspaper report describing the costs of the ConnectTen project:

Netscape has donated software, and Cyber Patrol is donating software to block access to controversial areas of the Internet.

The bulk of the project's \$5.5 million cost will come from the state's technology funding for schools. (Attachment B)

Another newspaper account stated the following:

... the Department of Education earmarked \$5.6 million to install and buy the hardware to connect the State information system's county access to every school site. Id.

How the Department and ENA arrived at the \$7.5 million price tag for ConnectTen is beyond comprehension where the Department is not even selling the hardware and appears only to be selling the "use" of software (which the Department did not even pay for).

Further, the \$12 million amount the Department has consistently quoted as the amount of funding necessary to replace ConnectTen is irrelevant as a measure of the current value of the network. (Consolidated Response, p. 14; Department Opposition, p. 13). The Department estimate appears to be based on nothing more than the amount of up-front cost incurred for ConnectTen hardware (\$5.5 million), plus the approximate cost to operate the network from January 1997 through June, 1998 (\$7.5 million).³ The Department's apparent attempt to value the "use" by ENA of ConnectTen "software" by adding all the costs the Department incurred in constructing and operating the network over the past 18 months is preposterous. The only conclusion that can be reached based on the facts is that the Department and ENA have entered into some type of transaction involving

³ The Department has budgeted \$5 million per year to support the ongoing costs of operating ConnectTen, including \$2 million per year for use of the state backbone, \$1.3 million for ISDN lines, \$0.9 million for equipment maintenance, and \$0.9 million for network operations. See ISIS 2000 Objection, at Attachment J.

ENA's "use" of network "software" initially obtained by the Department at no cost in exchange for a credit of \$7.5 million.

Based on this history, ISIS 2000 remains utterly puzzled by what constitutes this alleged "sale" of ConnectTen. At a minimum, the valid transfer of title to \$7.5 million in assets requires a far greater description than what has transpired between ENA and the Department. A typical transaction of this nature with real economic substance would at a minimum contain a line item description of each asset (hardware, software, etc.), detailing the price at which each component is being sold, and would involve the transfer of title. This simply does not exist here. If this is not a sham transaction, then it is clearly the Department's burden to demonstrate the true economic consequences of this "sale" of ConnectTen, provide a line-item description and price of every component involved, and demonstrate the transfer of title.⁴

⁴ The Department is also misguided with respect to its conclusion that ENA will dedicate the network exclusively for the Department's use. (Consolidated Response, p. 20). There is nothing in the Department's contract with ENA or in the ENA proposal that would prevent ENA from providing services over the network to other commercial users. As ISIS 2000 demonstrated in its Supplement to Reply, filed May 1, 1998, ENA plans to offer services to other commercial users over the network.

III. Although Schools in Tennessee May be Eligible for Discounts on ISDN Lines Pursuant to Special Tariff and USF Funding, This Is Inapplicable With Respect to Lines Ordered by ENA for Use in its Alleged Internet Access Service

In light of the further information supplied by the Department with respect to the May 20, 1998 interim order of the Tennessee Regulatory Authority (Consolidated Response, p. 12), ISIS 2000 withdraws that portion of its request for a declaratory ruling concerning the eligibility for USF funding purposes of the purchase by the Department of ISDN network telecommunications services (pp. 24-25 of Objection to Application and Request for Expedited Declaratory Ruling). The question remains, however, whether the acquisition of such telecommunications services for use by the Department (or ENA) could be categorized as an Internet access service for USF funding purposes. The Department is curiously inconsistent on this score.

While it claims it is only purchasing an Internet access service from a commercial service provider, it nonetheless treats this ISDN purchase as the direct purchase of telecommunications services by a qualified educational entity qualifying for the discount. If the service provided by ENA is truly an "Internet service," then ENA would be the entity buying the ISDN lines under end-user business tariffs, and the Department would no longer be eligible to order those lines on behalf of schools at the special school discount. Otherwise, the Department's Form 471 Application

should designate these ISDN lines as telecommunications services, which it does not.⁵

Conclusion

Contrary to the sweeping assertions made in the Consolidated Response, ISIS 2000 does not seek a de novo review of the Department's procurement process and decision. Nor do we seek to limit the Department's discretion to design and implement a technology plan based upon its perceived needs, including the manner in which the management and operation of its existing ConnectTEN network is operated in the future. All we seek is a prompt determination as to whether the "creative" approach followed by the Department in its application now before the SLC complies with the rules and policies of the FCC governing the distribution of USF funds.

Further, contrary to the Department's suggestion, ISIS 2000 does not seek "to effectively delay consideration of the State's application for school funding until Universal Service Fund ('USF') funds are no longer available for the state's K-12 schools." (Consolidated Response, p. 2, fn. 1.) Rather, we have advocated and continue to urge that the

⁵ In the Consolidated Response, the Department also contends that the ENA service involves no internal connections and is a "dedicated" Internet service. (Consolidated Response at pp. 9-11). ISIS 2000 has already demonstrated in this proceeding that the approach by ENA and the Department in classifying all internal connections, telecommunications services, and Internet access service as an "overall Internet service" is contrary to both the Commission's Rules, the Schools and Libraries Corporation's definitions of eligible services, and long-accepted telecommunications and Internet industry-wide practices

Commission act promptly to issue a declaratory ruling in advance of the time frame for SLC funding decisions to permit processing of the Department's application.

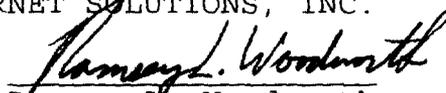
In his letter of July 12, FCC Chairman Kennard has instructed the SLC to withhold a funding commitment for any "high-risk" applications until all questions of funding eligibility and/or necessary interpretations of FCC rules with respect to the issues raised by the application are resolved. Given the substantial issues presented, the Department's application certainly falls into this "high-risk" category.⁶ Moreover, the issues presented transcend simple questions of separating eligible from ineligible services that might be handled by the SLC as part of its routine application processing procedures. They go to the heart of the eligibility for funding of the Department's overall application and involve significant and substantial interpretations of FCC rules. These are questions that only

⁶ Obviously, for this reason, the proposed funding and review procedures set forth in the Common Carrier Bureau's June 15, 1998 Public Notice, DA 98-1336, requesting comment would, if adopted, not be applicable to such high-risk applications. Particularly as the Department has declined all financial responsibility for the payment of any expenditures beyond its fixed payment, there is no way the USF fund could expect to recover funds once advanced in the event of a subsequent reversal of a funding decision.

the Commission is empowered to act upon. Accordingly, ISIS 2000 again requests that its Request for Expedited Declaratory Ruling be promptly granted.

Respectfully submitted,

INTEGRATED SYSTEMS AND
INTERNET SOLUTIONS, INC.

By: 
Ramsey L. Woodworth


Rudolph J. Geist

WILKES, ARTIS, HEDRICK & LANE,
Chartered
1666 K Street, N.W. Suite 1100
Washington, D.C. 20006
(202) 457-7800

August 6, 1998

Its Attorneys

COMMITTEE REVIEW MEETING

#13

Taken on April 3, 1998

APPEARANCE OF THE REVIEW COMMITTEE:

- MS. JANE WALTERS, Department of Education
- MR. DUANE HAWKINS, Chief Operating Officer, Department of Finance and Administration
- MR. ED JONES, Deputy Commissioner, Department of General Services
- MR. ROBERT LEE, Staff Attorney, Comptroller's Office

ALSO PRESENT:

- | | |
|-----------------------|-----------------------|
| Ms. Natasha Metcalf | Mr. Jeffrey Hustad |
| Mr. Paul Ney, Jr. | Mr. Matthew Chelap |
| Ms. Martha Staley | Ms. Amy Bearman |
| Mr. Jeff Roberts | Ms. Jamie Porter |
| Ms. Sadie Rosson | Mr. Charles Harrison |
| Ms. Melinda Parton | Ms. Elaine Williams |
| Mr. Jay Dunlgo | Mr. Phil Evans |
| Ms. Vickie Stanfire | Ms. Tammie Tucker |
| Mr. Albert Ganier III | Ms. Patricia Cottrell |
| Mr. Richard Lodge | Mr. Paul Van Horsa |
| Ms. Jackie Shrago | Ms. Velvet Hunter |
| Mr. Robert Barlow | Ms. Eileen Amaba |

BRIGGS & ASSOCIATES
 LISA A. NIEDZWIECKI, Court Reporter
 501 Union Street, Suite 502
 Nashville, Tennessee 37219

BRIGGS & ASSOCIATES 252-8232

STIPULATIONS

The Committee Review Meeting was taken at the Tennessee Tower, 3rd Floor, Conference Room #2, 312 8th Avenue North, Nashville, Tennessee, on April 3, 1998, for all purposes under the Tennessee Rules of Civil Procedure.

The formalities as to notice, caption, certificate, et cetera, are waived. All objections, except as to the form of the questions, are reserved to the hearing.

It is agreed that Lisa A. Niedzwiecki is a Notary Public and Court Reporter for the State of Tennessee.

(Whereupon, the following Committee Review Meeting began at 8:47 a.m.)

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COMMISSIONER HAWKINS: Good morning, we apologize for the delay. The purpose of the hearing this morning is to hear the reasons for lifting the stay and request for proposal No. 97-2 by the Department of Education.

The order of the proceedings will be, I will introduce the members of the committee here. As you speak, you would identify yourself prior to your presentation. I'm Duane Hawkins and I serve as Chairman of the committee. To my immediate left is Commissioner Walters, the Commissioner of Education. To my immediate right is Robert Lee, who is Staff Attorney for the Comptroller's Office. To his immediate right is Ed Jones, who is the Deputy Commissioner for the Department of General Services.

Ms. Natasha Metcalf is the General Counsel to Finance and Administration. She will present the timeline of events regarding this RFP. Following that timeline, then Commissioner Walters will give her presentation for the Department of Education, followed by the response by ISIS and a response by ENA; is that correct?

MS. METCALF: Yes.

COMMISSIONER HAWKINS: So having given that, I believe we can proceed into the hearing, Ms. Walters.

COMMISSIONER WALTERS: I believe I'm going to do the presentation.

COMMISSIONER HAWKINS: Okay. Jackie Shrago, I

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beg your pardon, is doing the presentation for the Department of Education. My understanding is that we were hearing the issue relating to lifting the stay this morning, that was the only issue that was on the agenda.

MR. NEY: Yes, sir.

COMMISSIONER HAWKINS: Is that correct?

MR. NEY: That is correct.

COMMISSIONER HAWKINS: And as far as the merits of the protest, that we were not prepared to go into those today?

MR. NEY: That's correct.

COMMISSIONER HAWKINS: Okay. Ms. Walters.

COMMISSIONER WALTERS: Jane Walters, Commissioner of Education. The State Department of Education is proud of the efforts that we have made to provide all of the schools in Tennessee with access to the Internet. This task has been accomplished with a great deal of care and attention to detail under a very tight time frame. Both of the companies that responded to RFS 97-2 Amended have worked with us to make this possible. We are grateful to both of them in this effort.

When we issued this RFP, we had several vendors attend our bidders' meetings but when the time for actually responding came, there were only two bidders, ISIS2000 and ENA. I chose the technical readers carefully.

Jackie Shrago, the RFP Coordinator, has been our ConnectEN

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1 project manager. She is a recognized expert on the E-rate
2 Rules established by the FCC. She has served as a consultant
3 to the Chief State School Officers Association on this topic,
4 and she has been a leader among a small group of technology
5 directors from several different states.

6 She has attended meetings in Washington, DC, on the subject
7 of the FCC regulations involving schools and libraries. She
8 has been invited by the SLC to field test the electronic forms
9 used to apply to the SLC for the various discounted services.
10 She has been consulted by members of the SLC concerning the
11 interpretation of the rules and regulations they have
12 established.

13 She also has a long and distinguished background in
14 telecommunications that began in the 1970s when she established
15 her own company, Telco Research, which she later sold to Nynex.
16 She has worked with the schools of Tennessee since her days at
17 Vanderbilt University where she was instrumental in beginning
18 the Virtual School program, which allowed teachers to learn to
19 use E-mail and to become comfortable with the use of technology
20 in the classroom. Her knowledge of telecommunications and her
21 devotion to the schools and teachers of Tennessee is
22 unquestioned.

23 Our second technical evaluator, Louis Kompare, is the
24 Executive Director for the Center for Effective Government. He
25 came to this position from Gaylord Entertainment, where his

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1 protest does not speak to disagreements on the distribution of
2 points on technical issues. Indeed, three of the five issues
3 raised in the protest deal with matters of the legality of ENA
4 as a company, its financial resources, and its delivery of
5 sealed envelopes. We do not consider these matters trivial,
6 but we believe that our investigation explains them adequately.

7 The first issue in the protest deals with required testing
8 of equipment and, again, we feel we have an adequate
9 explanation that includes information that neither party was
10 damaged by the results of the testing. The issue about the
11 E-rate funding has been explained, and I feel we are accurate.
12 We have followed carefully the FCC and SLC rulings since the
13 beginning of the Telecommunications Act of 1996.

14 I have personally attended several sessions in Washington
15 on these matters, and Jackie Shrago is a recognized expert on
16 the Rules. The department has worked with our Attorney
17 General's Office and an attorney in Washington who has
18 extensive experience with the orders of the FCC. I am
19 comfortable that we understand what is acceptable under these
20 rules.

21 We have attempted to be scrupulous in our attention to
22 detail on this RFP because we understand the value of its
23 services to the children of Tennessee. The aspects of this
24 scenario that is unique is the window of opportunity for the
25 State to submit an application for E-rate funding. If this is

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1 responsibilities were in a variety of applications employing
2 telecommunications and technology. He has spent a great deal
3 of his career with Disney where he had the opportunity to use
4 the latest technology and to use his creativity to manage many
5 procurements and to establish applications that were innovative
6 and efficient.

7 The third evaluator, Norris Hoover, has worked with us
8 since the inception of ConnectTEN in his role at the Office of
9 Information Resources of Tennessee State Government. He has
10 been our first line of assistance to the state backbone. He
11 came to the state after a career in the telephone industry, and
12 he has been invaluable in navigating the early days of the
13 ConnectTEN network. He also has had significant experience in
14 procurements, particularly in the State of
15 Tennessee.

16 Our fourth evaluator is James Waldie, our Information
17 Systems Director of the Department of Education. Mr. Waldie is
18 new to the department, joining us from a successful career at
19 Starstruck, a technology company that worked in the
20 entertainment industry. He has impressive qualities in IP
21 networks, client based server applications and systems design.

22 I feel strongly that we should have had highly qualified
23 technical people to evaluate the two proposals we received. I
24 believe they did an excellent job of judging both proposals on
25 their merits. This opinion is supported by the fact that this

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1 not submitted and all documents received by the FCC and SLC
2 within the prescribed 75 day window, the State of Tennessee
3 will not be eligible for first priority funding. This means
4 the loss of \$25 million in 1998. In addition, funding for 1999
5 is jeopardized because it must be submitted by July of '98.

6 We have copies of an urgent notice from the FCC and the SLC
7 urging schools not to wait until the last minute to file.
8 Tennessee is not a rich state, and we have worked tirelessly to
9 be sure that our children have the best chance that we can
10 provide for them to have the access they need to the libraries
11 and databases of the world.

12 It is, therefore, a high priority that we proceed with
13 signing the contract while not overriding any legal processes
14 that the protester has under state law.

15 Executing a contract, and not incurring any cost by the
16 state prior to July 1, 1998, will allow us to proceed with the
17 filing for E-rate funding and protect the rights of the
18 protester. We, therefore, respectfully ask that this stay be
19 lifted under T.C.A. Section 12-4-109 (B) VI on the grounds that
20 the award of this contract without delay is necessary to
21 protect substantial interests of the state.

22 We have considerably more detail on the actual points of
23 this protest. I make no bones about it; this is not my melee.
24 I do not want to be out of line. I do not want to bring up
25 points about the protest that are inappropriate at this

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meeting, but I will be happy to do so if it is considered appropriate by the other members of the committee. Ms. Shrago JAMIE: I'd like to talk about the technical points if you care to hear them.

COMMISSIONER HAWKINS: Do we have any questions for Commissioner Walters?

COMMISSIONER LEE: No.

COMMISSIONER HAWKINS: I apologize, Ms. Metcalf, I went right into Commissioner Walter's presentation and we didn't put the timeline in. Do you want to put that timeline in now?

MS. METCALF: Just briefly. This protest involves an RFS that was issued in December of this year for expansion in network operation of the ConnectTEN Program. The RFS was amended in February of this year. As Commissioner Walters mentioned, the proposals were submitted by ISIS and Education Networks of America. The proposals were evaluated and ENA was determined to be the winning proposer.

The notice of intent to award was sent on March 20th and the protest and request for a stay was filed by ISIS on March 29th. Then on March 31st the Department of Education requested a hearing to lift the stay.

COMMISSIONER HAWKINS: Presenters for ISIS.

MR. NEY: I'm Paul Ney and I'm the attorney for ISIS2000. This is Mr. Matthew Chelap with ISIS and

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which were offered by ISIS2000 that is a 50 percent greater price over the next three and a half years, without asking why, and the question has never really been answered, is not in the State's best interest. \$74 million versus \$51 million that is what we are talking about in terms of the cost proposals between the two.

If the State is not interested in that question, we do believe that the Federal Communication Commission will be interested in that question if only because of the bulk of that \$25 million, to which Commissioner Walters was referring, would be paid next year and is federal money coming from the Universal Service Fund, E-rate Funding Program. I believe, and we believe, that Federal Communication Commission and the federal government is going to be mighty interested in knowing why comparable services are being provided at a cost to the federal government of an extraordinary greater amount, \$25 million.

Also, we don't think it is in the best interest of the State to lift the stay because when the contract is signed and the proposal forms 471, then filed with the FCC, it is going to be subject to the scrutiny of the Federal Communication Commission for abuse or misapplication of those E-rate funds.

We have included in the packet that we have provided with you this morning, a draft copy of the objection and application for declaratory relief that is to be filed with the Federal

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Mr. Jeff Hustad, who is the Chief Technical Officer of ISIS. ISIS, for the benefit of the review committee, is a company which is now under a sole-source contract managing the ConnectTEN Network, which is with respect to this RFS.

That contract was awarded at the recommendation of Commissioner Walters last year in determining that it would be best to award the contract to ISIS to maximize the quality and minimize the cost of this program and administering the system before they got this point of the RFS for the next three and a half years.

I think it is clear that today's focus is not to address the merits of the entire protest, but rather to look to the issue as to whether it is in the state's substantial interest, or to protect the state's substantial interest, to lift the stay which is now in place. We don't think, for several reasons, that lifting the stay protects the state's substantial interest notwithstanding the April 15th deadline, to which Commissioner Walters referred.

We think that by lifting the stay -- knowing as we do that the Department of Education intends to enter the contract immediately based on Commissioner Walters' letter, to my clients last night, we think that it is likely to imperil the ConnectTEN Program rather than to be to the benefit of the State for several reasons. First, to award a contract to ENA when that contract costs \$23 million more for comparable services,

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Communication Commission asking that the Federal Communication Commission rule on those very issues about which we apparently have a disagreement and that is the E-rate funding and how it is supposed to work.

We have laid out the E-rate funding issues in very great detail in that application. We have also laid it out in some measure of detail in the protest letter and to a lesser extent in the letter that you received this morning related to this particular meeting.

If this contract is signed and the State makes a commitment to Education Networks of America to go forward over the next three and a half years only to find that within days or weeks or months, the Federal Communication Commission does agree with us and concludes that the E-rate funding proposal, as set forth in the ENA proposal and consequently the contract, are not allowed under the federal program. That throws the State in a position of jeopardizing the entire ConnectTEN system.

The State may have not paid any money at that time, but the State by that time will have become reliant upon a company who does not have the financial wherewithal to back up the promises made to pay \$7.5 million to the State at the outset of this program and cannot possibly achieve its objectives as presented in the cost proposal without that E-rate funding the entire amount -- and I will say at this point, it is important to note that in the cost proposals provided, and they are attached

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1 probably, in about 14 different places, with all of the
2 material that you have received, but one place I know they are
3 in the material I provided today along with this letter of
4 April 3rd. This cost proposal clearly shows that ENA does not
5 contemplate that any of the money that they are charging for
6 this service and for this equipment is going to be non-eligible
7 for funding. They depend on all of the money coming from the
8 federal government and if the FCC says, no, you were wrong, we
9 have imperiled the ConnectTEN System. We have put it in the
10 hands of the provider that cannot provide.

11 Finally, and maybe most importantly for today's discussion
12 because this is a State Review Committee and you probably are
13 somewhat familiar with these laws, the proposal of ENA is not
14 in the best interest of the State or in the best interest of
15 members of the state departments who proposed to sign off on
16 this contract because it clearly violates the State laws
17 governing the sale of state personal property.

18 It is ENA proposal that they will purchase from the State
19 the ConnectTEN System. The system is comprised of computers,
20 lines, and other tangible property of the State; the State owns
21 that. And under this proposal ENA is to buy that from the
22 State for a proposed price of \$7.5 million. This RFS does not
23 comply by any measure with the State law, which is very
24 specific relating to the sale of State property.

25 Now I want to address that in a little more detail as I run

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1 not talking about them in a comparative way. We are not here
2 to say ISIS should get this and ENA should not, that is not the
3 purpose today. The purpose of today is to say, don't let this
4 contract be executed yet because it imperils the State and it
5 is not in the State's best interest. And the only way you can
6 prevent that from happening, given Commissioner Walters'
7 essential declaration that she intends to sign the contract
8 immediately if the stay is lifted, is not to lift the stay.

9 If you lift the stay, I'm trying to bring to your attention
10 what the consequences could be between now and the resolution
11 of the protest process and the resolution of the FCC proceeding
12 and the resolution of anything relating to how we are going to
13 implement ConnectTEN in this state. So if I may continue, I
14 will try to keep it brief and to the point because I have given
15 it to you in writing and I just want to highlight those points.

16 The State requires proof of financial responsibility and
17 stability and strength. It makes good sense. You don't want
18 to entrust a \$51 million or a \$74 million contract and the
19 entire ConnectTEN System to somebody who can't perform as
20 promised. But ENA does not have the \$7.5 million required to
21 purchase the current ConnectTEN System. That is the key here.
22 Their proposal says that they are going to buy -- if you
23 will look at the cost proposal, which is in the materials that
24 I provided, you can look at it in any of your materials. ENA's
25 cost proposal says, other funds offered by proposer totaling

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1 through my letter, which I have provided so that you sort of
2 have an outline. If I may address each of these issues in a
3 little more detail and refer to the materials that I have
4 provided you.

5 The first issue we address, on Page 2 of my letter, is
6 financial responsibility. The State required proof of the
7 proposer's financial stability and strength --

8 COMMISSIONER HAWKINS: Excuse me, most of what
9 you are responding to are dealing with issues that you have
10 lodged in the protest.

11 MR. NEY: That is correct.

12 COMMISSIONER HAWKINS: I thought we were going
13 to hear the protest later. I'm trying to be as generous as I
14 can, but I have to call that into question.

15 MR. NEY: The State's objective here today is to
16 determine what is in the best interest of the State. You have
17 to make a written finding today that lifting the stay is in the
18 substantial interest of the State. And what we have pulled out
19 of our protest -- we can't divorce this discussion today from
20 our protest, the reason there is a stay is because of the
21 protest, but what we have pulled out are those reasons that we
22 think most strongly impact the determination of the best
23 interest of the stay and this time period that we are looking
24 at while the protest process continues to its resolution.

25 So, yes, we are talking about protest issues, but we are

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1 \$7.5 million is for all right, title and interest the State
2 currently holds in this network called ConnectTEN.

3 The salvage value of the current network is based on ENA's
4 need for its use during the 18 months service level improvement
5 period and ongoing functionality in the event that E-rate
6 funding is never realized. What that means is that the ENA
7 wants to buy from the State the State's property. Now the way
8 this has been structured, the proposal and the contract that
9 would be entered tries to give ENA the opportunity to
10 essentially buy that property on credit, but that is not
11 permissible under state law.

12 The state law and regulations clearly say that possession
13 of state property cannot pass until payment is made by cashiers
14 check, cash or certified check. That means that at the outset
15 of this program, before they can turn on the switch to allow
16 ENA to run this system, ENA has to have paid \$7.5 million in
17 good funds to the State. ENA can't do that. ENA has \$30,000
18 in liquid assets according to the financial statement that was
19 provided to the State.

20 ENA claimed, they made a bold-face statement, that they had
21 a \$5 million line of credit, conditioned only upon getting this
22 contract and documentation. ENA also, however, provided the
23 bank's letter, which made it clearer, that that statement was
24 false and that they had nothing other than the bank's agreement
25 to talk to them and negotiate and discuss a loan in the line of

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1 credit if they did get this contract.

2 ENA by any measure, even including the \$1.5 million
3 personal note by the principals of ENA to SLC, can't pony up
4 with the money. They can't get \$7.5 million to pay the State
5 and if they can't do that, they can't even start the process.

6 The second issue we talked about was that ENA's proposal
7 does not qualify for E-rate funding. Simply put, the federal
8 government will not allow the use of E-rate funds to purchase
9 capital equipment. The provider under the E-rate Program is to
10 capitalize that equipment and then sell the services and recoup
11 its investment through the sales services over time to the
12 State. Again, this is a kink in the plan that ENA has to start
13 this program because ENA doesn't have the \$7.5 million to pay
14 the State. ENA doesn't have the money to buy the system or
15 equipment necessary to provide the service, unless the State
16 will essentially, on credit, give ENA its current system, all
17 of its equipment to use, so that the State can lease it back.
18 That is the problem in a nutshell with the E-rate funding.

19 In addition, there is some other proposals related to
20 E-rate funding eligibility that are simply incorrect and they
21 will be addressed at the FCC level also. Just for the record,
22 it is important to note that the State of Tennessee has had the
23 opportunity to go to the FCC and make a request to the FCC
24 and tell them how this system works and how it ought to work.
25 They haven't done that, and it is unfortunate that they

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1 haven't.

2 Other states have made similar requests not of this nature,
3 but related to the program to find out how does this system
4 work. We want to know before we get rolling. Tennessee should
5 have done that, we think, but unfortunately they haven't but
6 the FCC needs to address this. It is too big a dollar issue
7 for the FCC to disregard and it is a potential embarrassment to
8 the State of Tennessee to be involved in this plan, which
9 provides no greater services for a lot more federal dollars and
10 thereby deprives some school children, somewhere, of these
11 services that the program is supposed to supply. They may be
12 Tennessee school children, we don't know, but they are
13 somebody's school children who aren't going to get that \$15
14 million worth of money.

15 The third issue, the proposed sale of ConnectTEN System,
16 violates State law. This is not a ground for the protest, but
17 it doesn't matter; it is the law of the State of Tennessee. If
18 we didn't raise it, the Attorney General has a duty to raise
19 it. Each officer of the State of Tennessee, including the
20 commissioners of the departments, have a duty to follow this.
21 Your legal counsel ought to be telling you that; I hope they
22 do.

23 The law clearly provides for how state property can be
24 sold. Yesterday when this issue first arose, I sent a letter
25 over to Mr. Jeter and I requested that she provide me with

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1 documents and information relating to the compliance of the
2 Department of Education or the State of Tennessee with the
3 state laws concerning the disposition of personal property.

4 Her response to me was that, the RFS was for the expansion
5 of the network operation of the existing network. The proposal
6 clearly defines this is a network and used by all of Tennessee
7 public schools. And the network is not surplus property by
8 definition and, therefore, the statute of rules don't apply.
9 Candidly, I don't understand that response. Perhaps that is
10 correct and I'm not getting it. But if it is correct the
11 question is this, we all know that each of you who represents
12 the state can't walk down the halfway and sell some of the
13 State's property just because you think it is a good idea.

14 If it doesn't apply -- if these laws that I have cited
15 don't apply, and I believe they do clearly, what do; what laws
16 apply? When can the state engage in the sale of what is valued
17 by ENA as a \$7.5 million network? Don't be confused just
18 because they say network it doesn't mean that it is intangible;
19 it is very tangible. In fact, it only exists by virtue of the
20 equipment that constitutes a network. How do you sell that by
21 just slipping it into a service contract? You cannot do that.
22 I will avoid the comparison but the ISIS proposal, for
23 instance, didn't rely on buying the State's network that way.

24 There has to be some rules and there are, and the rules are
25 very specific. Among them are, there is only two ways to

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1 dispose of this property, public auction and a sealed bid.
2 Some might argue, well, we had sort of a sealed bid but it
3 doesn't work. This process, this RFS process, did not comply
4 with the letter of the law and was in no way the sale or
5 disposition of property through the sealed bid as contemplated
6 by the State.

7 Additionally, we had some problems related to the
8 regulations, which weren't followed. I made the request for
9 documentation to see whether the Commissioner had ever declared
10 that the system, the network and all of that equipment, the
11 routers, hundreds of routers, and all of the other equipment
12 that I'm not really up to describing but Mr. Hustad could, has
13 to declare those surplus. That declaration has not been made.
14 And, indeed, I think it would be tough to make that a
15 declaration because the definition of surplus under the statute
16 is that was which is obsolete, outmoded or no longer useable.

17 Well how can that be when the plan of ENA is to buy this
18 and use it for at least 18 months and use it so that they can
19 sell the services back to the State. Of course, it is not
20 obsolete at that point, not no longer useable and not outmoded,
21 it is, in fact, the very essence of the service that is going
22 to be provided for at least 18 months. And possibly, the
23 service that is going to be provided for the entire life of
24 this contract if there is no E-rate funding.

25 There is a real question about whether the Commissioner

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