

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)
)
Federal-State Joint Board on Universal Service) CC Docket No. 02-6

William F. Caton
Office of the Secretary
Federal Communications Commission
445 12th Street SW
Washington, DC 20554

**RE: Comments on the Notice of Proposed Rule Making and Order,
Adopted January 16, 2002, Submitted by Funds For Learning, LLC**

Funds For Learning, LLC is an educational technology consulting firm that has focused its practice on the E-rate program since the program's inception in 1997. We work with schools and libraries, providing a wide range of services, including assistance with application preparation, the processing of payment-related paperwork, and support through the post-commitment auditing process. In addition, we provide a variety of consulting services to help companies understand the program's rules and requirements and communicate them within their organizations and to their customers. Our school and library clients include applicants of all sizes, both urban and rural. Our vendor clients include both Fortune 500 companies and start-up companies.

Thus, we believe we have a valuable and unique perspective on ways in which the program could be improved, while still ensuring that funds are distributed equitably and that appropriate safeguards are in place to guard against waste, fraud and abuse. Further, we hope to provide an honest appraisal of how the program's real-world operations sometimes fall short of its goals.

Our comments will focus both on the specific issues raised by the Commission's Notice of Proposed Rule-Making, as well as other areas of potential improvement. Four overarching themes will recur throughout our comments. They are:

- The biggest improvement that could be made in the program would be to make its regulations as clear and explicit as possible and to enforce those rules uniformly—and with clear consequences when the rules are willfully violated.

- Resources should be redeployed to focus on the big issues, rather than issues that appear to be “nit-picky” to many program stakeholders.

- The most effective way to fight waste, fraud and abuse is to be clear about what constitutes waste and fraud, make clear the consequences that will result when it occurs, publicize it when it occurs, and follow through quickly to address it.

- We believe applicants and service providers alike would endorse devoting additional resources to program administration—even at the expense of the available discounts—if it meant the program would operate more smoothly. Every time a funding commitment is unreasonably delayed, it means more steps are required, more things can go wrong, and the greater the likelihood that the funding, once approved, will ultimately not be used.

I. Application Process

A. Eligible Services

We believe that the definition of eligible services is at the heart of the E-rate program, and that by devoting additional resources in this area, the Universal Service Administrative Company (USAC) could achieve major improvements at all stages of the process.

From the outset of the schools and libraries program, the Commission and USAC have had the difficult challenge of translating a few paragraphs of legislative and regulatory language into a constantly evolving list of eligible and ineligible products and services. Further complicating the process is the fact that most products’ eligibility ultimately rests on how they are used and/or by whom—a determination that can be difficult to review and audit.

Currently, there is no formal, publicized process for getting the eligibility of products reviewed. Consequently, service providers with innovative products either have been forced to keep their fingers crossed that their customers’ applications would pass muster when they were reviewed, or salespeople confidently assured schools and libraries that the products were, in fact, eligible for support when that determination had never been made. Further, because the eligibility standards continued to evolve, applicants frequently found that a product or service that was approved one year would get rejected the next when a new standard was applied. Applicants who were aggressive about pursuing appeals or knew who to contact at the Schools and Libraries Division (SLD) sometimes succeeded in getting products added to the list. But, more frequently,

the SLD began applying some “new” standard, such as the job titles of those using cellular phones, without advising applicants of the standard they should use. The result: the rejection of funding requests from applicants who could have done their applications correctly if they had only known what standard the SLD intended to apply.

The SLD apparently has been reluctant to make available information about how it evaluates applications for fear it would point the way to opportunities to abuse the system. **We submit that the opposite is true: that the vast majority of applicants and service providers want to follow the rules—if they only understood what they were. We believe that this is the most important message that the Commission could take away from this rule-making proceeding.**

We believe that publicizing the SLD’s existing, detailed list of products that have been deemed eligible and ineligible would dramatically improve *all* aspects of the application process. What could be worse for an applicant who has invested months in technology planning, contracting and application preparation than to have its application rejected on the eve of the anticipated project start date because it misunderstood how the SLD would apply eligibility rules. (Even worse is for the eligibility of a particular product to be questioned at the invoice processing stage after it has already been installed.)

We understand from the Commission’s response to Freedom of Information Act requests that the program’s administrators have had some concerns about the potentially anti-competitive effects of publicly detailing the eligibility of particular parts and products. However, we believe vendors would have a powerful incentive to submit their product lists for review, if the SLD were to make such a list public. It seems to us that applicants will be far more likely to choose a particular product if its eligibility has been formally reviewed and if they can count on the SLD to maintain that position at least throughout that particular application cycle. Once those product lists were reviewed, applicants, all levels of the education technology sales and supply chain—and even SLD application reviewers—would be presented with a common set of rules. The publication of such a list would be anti-competitive only if some vendors were denied the opportunity to submit their products for a formal, fair and timely review. Thus, we believe the SLD should create formal procedures and timetables under which vendors can get their products reviewed and—equally important—devote both the financial and human resources necessary to accomplish this objective.

We acknowledge that in areas of “conditional” eligibility, this will present more of a challenge. However, we believe that by illustrating this detailed eligibility list with the same kind of real-world examples that the SLD presumably uses to train its own application reviewers,

everyone will better understand “the rules of the game.” Further, it will give program stakeholders a more formal opportunity to make their case when they believe the rules are being applied inappropriately—as was done, for instance, in the case of remote access routers and servers earlier in the program’s history.¹

We are less confident that this list could be incorporated into the online application itself. We believe that the current combination of online filing and additional Description of Services backup provides a good solution that lets the applicant supply additional context for its application. We believe an online product checkoff presumes a uniformity to school technology plans and choices that simply does not exist in the real world. Further, we believe that this approach would probably lead to more fraud and abuse if items that were checked off were subject to no further review by the Program Integrity Assurance staff. Last but not least, we believe applicants would tend to choose products on the online application, rather than the product that best suited their needs, if they knew it would free them up from additional reviews. We believe that such a list would grow too long to incorporate easily into the online application. In addition, we believe it would be difficult for the SLD to maintain such a list in a timely way if it is incorporated into its online filing mechanism, as opposed to simply being posted as a reference on the SLD’s web site.

We believe that creation of a publicly available, product-specific, regularly updated eligibility list should begin—and begin immediately. Many service providers use the late summer months to prepare their sales staffs for the fourth quarter E-rate filing window and their ability to train their sales channels will be hindered the longer the process is delayed. Equally important, the SLD should create a clear process—and provide adequate staff—to conduct these product reviews because they are so central to the application process, not to mention the prevention of fraud and abuse. Further, it’s possible vendors would be willing to pay a small fee to support this process if it meant their products would get an expedited approval. It does no one any good for the SLD to release an updated eligible services list just as applicants are issuing RFPs—or signing contracts—to purchase products that are suddenly deemed ineligible for support. Similarly, when this review is delayed, it means that applicants may have decided not to pursue solutions that would, in fact be eligible, because those solutions had previously failed to pass muster with the SLD.²

¹ The Commission’s position on DHCP servers was changed as a result of an appeal brought by the School District of Philadelphia, one of our clients, a process that took nearly two years before the district was able to proceed with its purchase.

² In 2001, the updated eligible services list was released on October 19, approximately two weeks before the start of the filing window for the Form 471 application. In 2000, the updated list was released on

We believe that in practice, eligibility reviews are likely to be desired by both applicants and vendors. The program's application rules assume that an applicant can turn to its vendor for an accurate representation of eligible and ineligible components, but that presumes a sales person both understands the rules and is not trying to stretch them to make a sale. We believe creating a formal product review process would clarify eligibility and help applicants submit requests that don't inadvertently include ineligible products. That, in turn, should make it easier for the SLD to review applications, keeping administrative costs down and providing a better check against waste, fraud and abuse.

B. Determination of Eligibility of WANs, Wireless Service and Voice Mail

1) WANS. We believe that in all eligibility determinations the Commission should be governed not only by Section 254 but by what makes sense for school districts and libraries. How one feels about the eligibility of wide area networks probably largely depends on the applicant's relative discount rate or what business a vendor is engaged in. Our observation is only that as long as the Commission retains a two-priority division between telecommunications services and Internet access on the one hand, and internal connections on the other, applicants with discount rates below 90 percent may be pushed to lease a network, rather than build their own, even if their preference would be to own their own network. Thus "cost-effectiveness" may be distorted by the current system of priorities.

2) Wireless Service. We believe that the SLD has taken an approach to reviewing cellular phone services in school districts that is too narrow, is not technologically neutral, takes up too much of the SLD's administrative time, and results in school districts having to waste valuable time breaking down their cellular phone bills by job titles. The SLD currently applies a very narrow standard (that, once again, is less than 100 percent clear and seems to shift from year to year), supporting cellular service to individuals with a classroom connection, primarily teachers and principals. If, on the other hand, one assumes that cellular service is provided to individuals who support the educational process, whatever their job title, we believe the case can be made that the eligibility standard should be broadened. We note that the SLD has, for instance, rejected cellular service to technical support persons whose job it is to help keep E-rate-supported

October 16, again just weeks before applicants could begin submitting their Form 471 applications. Further revisions were posted on December 20, 2000, less than a month before the filing window closed for the year. For Funding Year 3, the revisions were posted on December 6, 1999, just over a month before the application window closed for that year. Because applicants are required to post their Form 470 applications at least 28 days before they file the pertinent Form 471 application, an applicant might have missed out on an opportunity to request proposals for a product or service that had just been determined to be eligible.

equipment functioning for teachers. (Should this treatment be any different from the eligibility afforded maintenance on eligible internal connections?) Further, many individuals whose telephone usage would be supported if they had a fixed office space in a school building are denied support when they use a cellular phone to help them cover multiple buildings across a school district.

Through December 31, 2001, USAC reported that it had disbursed only \$27.2 million worth of support to cellular telephone companies, out of a total of \$4.5 billion disbursed in the program's first four years. As a result, we believe that the SLD and applicants are being asked to devote a disproportionate amount of resources to make a determination that, we believe, cannot be justified by either law or practice. We suspect that this relatively new fascination with cellular telephone bills may have grown out of the General Accounting Office's review of the SLD's eligibility determinations. If that is the case, we believe that there are other areas that are more worthy of additional auditing attention than this one.

On this point, we note that the SLD has *never* provided *any* guidance on how a school district and its telephone company should manage the application of discounts to a traditional telephone bill. For instance, is it adequate to review a monthly bill immediately prior to the application filing window to deduct an estimate of the percentage of ineligible services (or a fixed amount) that were included in the bill? Is it adequate to apply that figure to the bills for the subsequent funding year? Should a school district be prepared to report how many phone lines it has? Should its vendor?

The SLD's Web site indicates that a school should, for instance, determine whether a PBX will support a phone line to a Pre-K classroom so that some of the cost could be allocated out as ineligible. What if the classroom is used for another purpose in the next school year? What if a state defines Pre-K students as eligible "elementary school" students? What if the amount of money is insignificant compared to the amount of time it would take the applicant and its vendor to make this determination? What level of auditing resources would be required to review this? Does it really matter when it's all part of a school's total telecommunications package, the so-called "shared network of services?"

Without addressing questions like these and detailing its expectations, it will be hard for USAC to impose sanctions on a school district that tries to make a reasonable estimate of ineligible charges when it submits a funding request or request for reimbursement, but has not taken the time to analyze every line of a monthly phone bill that may run hundreds of pages.

In terms of other evolving wireless technologies, we believe that the SLD has generally treated wireless and wireline networks in a competitively neutral way. Nevertheless, we believe

the SLD could provide better guidance on the treatment of Network Interface Cards that include a wireless antenna. In addition, the agency should be prepared to adapt its policies as these components become increasingly integrated into laptop computers and other devices to provide schools with greater flexibility in accessing the Internet.

3) Voice Mail. We agree with those who argue that if E-mail services are eligible for support, voice mail services should be, too. Voice mail applications provide schools and libraries with a valuable tool in bridging a “communications divide” that can exist with parents and patrons who do not yet have access to the Internet. In many cases, these are precisely the households that struggling schools need most to engage in their students’ education. Relaxing the rules on voice mail eligibility would enable schools and libraries to take advantage of homework hotlines and other innovative voice-response-type products. As more and more schools install telephones in the classroom, voice mailboxes provide the mechanism to enable parents and administrators to communicate with teachers without interrupting the classroom with a ringing phone. Again, the need to segregate charges associated with voice mailboxes has required applicants to waste time tallying up minimal charges on phone bills, or breaking them out of PBX installations, if they were to be in full compliance with the letter of the law. Thus, on balance, it makes sense to make voice mail services eligible for support as it would be in keeping with the goals of the program and reduce the administrative burden on all parties.

4) Other products and services. In addition to the products cited in the Commission’s Notice of Proposed Rule Making, we believe there are several other products whose eligibility should be reviewed. (The fact that the Commission has asked for comments on only these three kinds of products underscores the fact that there is no formal process available to raise these eligibility issues with the Commission, short of an application rejection and appeal or stakeholder lobbying.)

Perhaps the most obvious example is the determination that caching and proxy servers are ineligible for support. These products are a widely accepted approach for delivering rich media to the classroom while conserving bandwidth and securing the network. Caching is particularly suited to schools, where students may be directed to access particular Web sites over and over as part of their classroom assignments. As long as proxy and caching servers, and certain caching devices, are not eligible for support, the Commission will be providing a disincentive for applicants to manage their bandwidth needs in a cost-effective manner and to build secure networks.

In addition, as we noted in comments we filed as part of the Commission’s rule-making regarding the Children’s Internet Protection Act, we believe that the Commission’s rules

regarding filtering are not applied in a competitively neutral way. An applicant whose Internet service provider offers filtering as part of its standard bundle of services can, in fact, get its filtering supported by the program while a school district wishing to exercise closer control over what it filters by installing software on its servers, cannot.

C. 30 Percent Threshold

We believe that the 30-percent threshold is a reasonable mechanism to encourage applicants to request only eligible services—as long as the SLD provides better, more specific guidance on how particular products will be reviewed. The problem occurs with the application of the rule, not with the rule itself.

In our own consulting practice, we know of at least two cases in which school districts were forced to appeal—ultimately successfully—because the SLD reviewers did not do the math correctly in determining that a particular component represented more than 30 percent of a funding request. In another case, the applicant was, in effect, penalized for breaking down a contract into smaller, site-specific components. If a single funding request had been submitted, the components found to be ineligible would have simply been trimmed, rather than triggering the rejection, because they did not represent more than 30 percent of the contract’s total cost.³

We believe it would be reasonable for a Program Integrity Assurance reviewer to inform an applicant that a request was about to be rejected under the 30-percent rule, and give the applicant an opportunity to show cause why that determination was not correct. Alternatively, the SLD should consider “fast-tracking” its review of appeals that involve these kinds of issues because otherwise applicants may be denied funds they deserve for a significant length of time.

D. Consortia Issues

We wish to bring to the Commission’s attention two issues regarding consortia applications. First, we believe that the way in which discount rates have been calculated since the Form 471 was revised in Year 3 can unfairly distort the discount rates of consortia. Unlike school districts, consortia are not required to use a weighted average of their entities. This actually could lead to a situation in which applicants with low-discount rates could go “partner-shopping” for partners with higher discount rates, with no regard to their relative size.⁴

³ Because the applicant was a library system in a single school district, the same discount rate applied, no matter how the contract was divided.

⁴ For example, a school district with 100,000 students, a district-wide discount rate of 40 percent and a \$1 million phone bill could form a consortium with a private religious school with 100 students, a 90 percent discount rate and a \$1,000 phone bill. Together, they can qualify for a discount rate of 65 percent,

We also believe that the SLD needs to clarify the requirements of consortium membership. We are aware of cases in which state and regional consortia planned to apply for services on behalf of districts that had not yet confirmed that they would ultimately purchase or use the services in question. Now that the Commission has rejected several appeals involving consortium applications in which consortium managers did not take their roles seriously, and with the new reporting requirements mandated by the Children’s Internet Protection Act, this issue may not be as much of a problem as it once was. However, we still believe that the program could benefit from a clear statement of the Commission’s expectations for consortium membership and management. For instance, the Form 479 could be modified to include a certification that the school district or library had authorized the consortium manager to procure services on its behalf and that it intended to purchase them.

II. Post-Commitment Management Issues

The administration of payments after commitments are made has, from the outset, been characterized by at least two flawed assumptions:

- That vendors would be willing to do what their customers wanted;
- That vendors were, by nature, more honest than applicants.

We believe one of the major inherent weaknesses of the program—a loophole that provides an opportunity to those intent on committing fraud—is the fact that service providers are free to submit invoices to the SLD for payment with no additional review by their customers. Since the early days of the program, this has been identified as a major weakness, particularly in terms of progress payments for internal connections contracts, which are typical for some of the most costly projects that the E-rate program supports. Once an applicant files a Form 486, it has no leverage to assure that work is being performed according to its demands—short of paying the full cost of the job itself and seeking reimbursement through the Billed Entity Applicant Reimbursement (BEAR) process.

We find it peculiar that an applicant is required to obtain a vendor’s signature before submitting a BEAR form (indicating that the applicant did, in fact, already pay for the services), but that a service provider is not required to obtain the signature of an applicant (confirming that the service provider did, in fact, provide the services that are being invoiced). Without such a

no matter what their relative size is. When that 65 percent discount is applied to the school district’s \$1 million phone bill, the \$650,000 in savings that the district would achieve is more than adequate to make up what the higher-discount participant would lose (\$350) and could even pay for a consortium manager, too, if necessary. While we know of no applicant that has actually made use of this approach, it

simple check, a service provider is free to collect up to 90 percent of the cost of a project on the day it begins—and without the knowledge of its customer!

Requiring this simple check would also provide a very good way for schools and libraries to confirm their support for the particular billing method chosen by their vendor. Under the current procedures, once a vendor has submitted a service provider invoice form for a particular funding request, the applicant is committed to that payment method for the rest of the year. If the vendor were required to obtain a signature, it would help ensure that the vendor and applicant had at least had a conversation about the preferred payment method.

Applicants have very good reasons for preferring one method over another. Some school districts are forced to rely on discounted invoices because they are not able to come up with the full price themselves. Other districts prefer the BEAR method because it is currently their only way of assuring that the vendor performs its work to their satisfaction. In addition, some technology directors have found that the BEAR method makes it easier for them to recapture the use of E-rate savings for their technology budgets, either through the creation of a separate account for their reimbursements or by taking credits against future purchases.

We acknowledge that the SLD may oppose this change because of the work it has already done to implement the online filing of invoices. However, we believe it would be relatively easy to modify this procedure to let applicants certify online that the submitted bill is accurate, or to permit applicants to approve the invoice through a paper certification. Although we are reluctant to suggest the creation of any new procedure requiring additional paperwork and review, we believe that this particular one is so essential to the orderly management of the program, and such a powerful deterrent to waste, fraud and abuse, that it could easily be justified.

This process would further address the concerns raised by the GAO and the SLD's outside auditors concerning weaknesses in the invoice payment process. We recognize that the SLD now requires some vendors to solicit certifications from their customers before it will process their invoices. We believe it would be a stronger guard against waste and fraud—and actually streamline the process—to *require this certification of everyone upfront*, rather than having to contact certain vendors to have them contact certain customers to receive approval of certain invoices after the invoice has been submitted. For a fuller discussion of this issue, we direct the Commission to the separate comments filed in this proceeding by our client, the School District of Philadelphia.

would seem to be permissible under the current rules. The large school district could potentially qualify for an additional \$250,000 in discounts because its size is not factored into the calculation of discount rates.

We also believe that the Commission should move immediately to impose penalties on companies that fail to remit BEAR payments on a timely basis. First, however, we believe USAC should take steps to provide vendors with better information to make it easier to identify which of their customers should receive a BEAR payment and for what amount of money. Disbursement checks should be accompanied by much better information to help service providers get these checks to the right customers.

While a 20-day turnaround certainly seems reasonable from the applicant's standpoint, we anticipate that it may be opposed by some service providers. Consequently, we advocate a slightly more relaxed standard, coupled with well-publicized, tough sanctions on those vendors who refuse to respond to a request that an approved BEAR payment be remitted to the applicant. Stronger enforcement here is much more important than establishing a new deadline that is never enforced.

Among our own applicant clients, we know of an instance in which a systems integrator has withheld an approved Year 1 BEAR payment, totaling just over \$160,000, for more than two and a half years. The vendor has failed to respond, even to a letter from the USAC general counsel, pointing out that it is in violation of program rules and certifications that it made on the BEAR form. Because of the lack of sanctions, the school district has had no choice but to pursue this matter through the courts, a process involving further delays and expense. In the meantime, the vendor has collected another \$417,000 in support from the Universal Service Fund.

In a case involving another school district client, an internal connections supplier submitted a service provider invoice to the SLD at approximately the same time it signed a BEAR form for the school district, which had already paid for the same services. When the SLD denied payment on the BEAR form (having already paid the vendor), the school district asked the vendor for the \$122,400 reimbursement it deserved. After more than 12 months of phone calls and e-mails, the vendor finally repaid the school district. (This episode also underscores why a vendor should be required to get the signature of its customer before it can bill the SLD.)

We know of additional cases in which applicants' BEAR payments have gotten caught up in corporate bankruptcy proceedings. Indeed, school officials in the first cited example are fearful that the company involved may go bankrupt before it gets relief through the court system.

While we recognize that the Commission may have a tougher time imposing penalties on companies that are not required to contribute to the Universal Service Fund, we believe that, at a minimum, disbursements to such companies should be held up until these matters are resolved. In addition, we believe that the SLD should publicize a list of vendors who have failed to respond appropriately when the USAC general counsel has sought to retrieve the dollars that are owed to

an applicant so that other schools and libraries can take that into account when they choose the companies with whom they want to do business.

We believe that publicizing the names of these “bad actor” vendors will not only serve as a powerful deterrent but also help protect other school districts from becoming victims of the same questionable business practices. The model of the Better Business Bureau is a useful one here.

The financial challenges now facing the telecommunications and technology businesses create an ever greater need for the Commission and USAC to make clear their policies and expectations in these areas. As long as there is no penalty involved, many companies will continue to place a low priority on managing these payments for their customers, particularly when the project involved is a one-time installation that is now complete.

A. Transferability of Equipment

We recognize that applicants may have many valid reasons for wanting to transfer equipment from the building at which it was first installed. On the other hand, we believe that the Commission never intended school districts to use their high-discount school buildings, in effect, as a “funnel” to bring E-rate-supported equipment into their district, only to move it to a low-discount school the next year and reapply for the original building.

We believe that the three-year limit proposed for transferring networking equipment, and 10 years for *transferring* cabling are sensible proposals. (We believe that applicants should not be required to wait 10 years to *upgrade* their cabling, if that was the intent of the Commission’s proposal.) We offer these other suggestions to facilitate the proposed approach on equipment transferability:

- That applicants with a legitimate reason for moving equipment be permitted to seek approval in writing from the SLD to do so;

- That applicants be advised of what kinds of records they need to keep when equipment is moved after three years, so that they will be protected if their installations are reviewed by auditors within the five years currently specified for retention of E-rate-related records;

- That the SLD explicitly make clear that, under the current priority rules, it is a violation of program rules to move equipment within three years without prior approval of the SLD because of the appearance that the applicant is trying to “game” the system. The fact that this issue has been raised suggests that the Commission knows that this practice is going on, or that there is a strong perception that it is—and may be one reason why demand for internal connections for applicants with a 90 percent discount rate has skyrocketed in Year 5;

- That when a school district has applied for discounts on hardware for a group of schools that all have the same discount rate, that any new policy would permit the district to transfer the equipment among that group of schools, as long as it kept good records showing where the E-rate-supported equipment was now located.

B. Qualifying for Internal Connections Discounts

Implicit in the Notice of Proposed Rule-making issued by the Commission in spring 2001 was a concern, shared by many stakeholders, that the E-rate program was never intended to build better and better networks for the neediest schools, while schools and libraries that are nearly as needy are forced to go without because of the lack of adequate funding. Nevertheless, as we and others argued at the time⁵, we believe that proposals that would deny funding to entities solely based on whether they received money in a previous funding year are short-sighted and would have unintended consequences.

If the Commission is not prepared to increase the size of the schools and libraries program beyond \$2.25 billion, we believe that making undisbursed funds available in future funding years and/or committing funds substantially above the \$2.25 billion threshold in recognition that applicants historically have failed to use as much as 30 percent of approved commitments, would help stretch the available dollars further.

We believe that one of the greatest problems now facing the program is its unpredictability. As a result, three things are happening. More and more schools and libraries that fall below the 90 percent threshold are giving up in discouragement. Applicants are beginning to shift solutions to the telecommunications and Internet access category, via so-called “managed services,” whether or not it makes long-term sense to do so. In addition, many internal connections vendors now choose to focus their sales efforts on the neediest applicants, knowing they are the only ones likely to qualify for Priority Two support.

We believe that the program’s goals would ultimately be served by a system in which applicants could do their technology planning with greater assurance that some level of funding would actually be available, and that within that amount, they would have the flexibility to choose which eligible services best met their needs and their budgets, without regard to whether it was, in fact, a telecommunications service.

⁵ FFL was part of the Coalition for Predictable E-rate Priorities, which filed comments in response to the Commission’s April 26, 2001 Notice of Proposed Rule-Making. In separate reply comments, FFL provided an analysis of applicants that would have been barred from receiving funding for internal connections in Year 4, under the Commission’s proposal.

We see several ways this problem could be addressed, although each has its own set of complications:

- The Commission could impose a per-student or per-patron cap on what an applicant can receive over a year, or a period of time, that would factor in its applicable discount rate. In return, applicants should be given the flexibility to use the money to support whatever kinds of E-rate eligible services they choose, regardless of whether they are currently classified Priority One or Priority Two. Under this approach, applicants could certify at the start of the application season that they intended to seek discounts and provide the appropriate documentation to demonstrate the number of students or patrons they represented. This would enable the Commission to ration the available funds among all the applicants it wanted to support. At the same time, it would probably force some applicants to use funds more carefully than they did in the past, when there were few market-driven limits imposed.

We note, for instance, that, according to the SLD's funding commitment reports, just two school districts, and their easily identifiable subunits, together accounted for more than 17 percent of the *total* funding commitments awarded in Years 3 and 4. Further, in Year 5, projected requests for internal connections support from applicants claiming a 90-percent discount rate increased 68 percent over the projected requests from that group the year before. Meanwhile, the approved commitments for internal connections for that group nearly tripled in value between the first and fourth years of the program. Surely there must be a way to find some reasonable middle ground that will continue to let low-income applicants receive reasonable support for the needs that they define, while facilitating the wiring of the approximately 20 percent of public school classrooms that are still not connected to the Internet.

- The Commission could decide to allocate the available dollars among different categories—providing, for example, a certain percentage for telecommunications services, a certain percentage for Internet access, and a certain percentage for internal connections requests from different discount bands. If any dollars remained after commitments were filled, they could be applied to unfunded requests, based on the current priority system.

For instance, in Funding Years 3, 4 and 5, the SLD projected that Priority One services represented roughly 30, 33 and 32 percent, respectively, of its total projected demand. To ensure that the neediest schools continue to receive funding for whatever services they wish to purchase, the Commission could make a decision to limit the amount that would be available for each category of funding, either in advance or based on the relative share of overall demand it represented.

- The Commission could adjust the discount matrix to require applicants to pay a larger share of the costs of their E-rate eligible projects and services. Although this would undoubtedly impose new financial challenges on many districts, it might force some to use their available funds more carefully and deter those “bad-actor” vendors that have assured their customers that they don’t have to pay their 10 percent share of the product’s cost. Such a change should be phased in at the start of an application cycle so that applicants could plan accordingly.

- The Commission could specify the maximum network capabilities it is willing to support to spread the available money farther. (However, we do not believe that the Commission or the SLD wants to get into the business of reviewing applicants’ network configurations and making this kind of determination.)

- Because the internal connections category covers such a wide range of products (from servers to routers to PBXes to cabling to network maintenance), any move to bar an applicant that received internal connections discounts in one year from receiving them the next should take into account these distinctions. As argued last year by the Coalition for Predictable E-rate Priorities⁶, it does not make sense for the schools and libraries program to support the installation of a network in a 90-percent-discount school one year and not be willing to provide *any* support for network maintenance for that network the next year. Further, should a school district that installs a new PBX one year be barred from installing a data network the next?

Any effort to limit applications based on what was sought in the previous year should be announced two years before it will take effect so that applicants can structure their applications in the first year with an eye to how the rules will apply in the second. We would expect that districts would be much more careful in how they make use of so-called shared services if it means that every entity cited in the group would be barred from receiving internal connections support in the coming year. Further, districts would need to know in advance what the impact would be on their own applications if they were cited as part of a statewide or regional consortium that received support for internal connections, whether or not they actually directly benefited from that support.

Processing Appeals

We believe that the Commission should make permanent its temporary extension to 60 days of the deadline for filing appeals of decisions by the fund administrator. Even before mail delivery was disrupted in the aftermath of September 11, 2001, many applicants were hard pressed to respond in the permissible time period because of school vacations, the heavy demands

⁶ See comments submitted by the Coalition for Predictable E-rate Priorities on the Commission’s April 26, 2001, rule-making.

on the time of school district IT personnel, staff turnover and the SLD's own delays in processing pre-dated letters. We believe that the record shows that as many as half of the appeals to the Commission were dismissed either because they were not filed on a timely basis with the Commission or the SLD.

Nevertheless, we are concerned about the impact this change could have on the ability of both SLD and Commission staff to respond to appeals on a timely basis. Increasing the number of timely appeals may simply worsen the existing backlog of unresolved appeals. Even when an appeal seeks only to correct a processing error on the part of the SLD staff, it can take a torturous amount of time for it to be reviewed and a funding commitment granted. To cite three examples from our own consulting practice:

- The SLD failed to data-enter a page worth of funding requests, totaling close to \$1 million, on a school district's Year 2, "out-of-window" application, filed in March 2000. Despite attempts to get the matter corrected at the Receipt Acknowledgement Letter stage and throughout the Program Integrity Assurance review, the funding commitment letter that was issued in April 2001 still did not include these requests. As a result of an appeal, the SLD agreed in September 2001 that the items should be data-entered. As of March 31, 2002, a full *two years* after the original application was *correctly* filed, the funding commitments still have not been approved. Repeated inquiries to the SLD have provided no guidance on when the commitments may be forthcoming.

- In January 2000, another client submitted a Form 471 application that included a request for DHCP servers. The SLD rejected the request in July 2000, and the school district appealed to the Commission on August 25, 2000. On April 30, 2001, the Commission agreed with the school district that the SLD had failed to justify its rejection and ordered the SLD to review the funding request. It was not until October 2001 that the SLD acknowledged that the item should be approved and issued a funding commitment—again, nearly two years after the school district first applied for what turned out to be an eligible service. (DHCP servers were added to the formal eligible services list in the same month.)

- In January 2000, yet another client submitted a Form 471 application that included a request for a variety of internal connections. In July, some of the funding requests were rejected. In one instance, the SLD had not applied the 30-per-cent ineligibility rule correctly. The applicant filed an appeal with the SLD in August 2000. In September 2001, the SLD agreed that it had made a mistake in its math. Yet it did not issue the funding commitment letter until January 2002—again a full two years after the application was originally submitted. The applicant continues to pursue its remaining issues before the Commission.

When appeals involve recurring expenses, these delays are even more problematic. A school district that cannot afford to purchase the recurring services without E-rate support will ultimately be denied the benefit of the discounts because they cannot be used once a funding year has ended. In this context, the phrase “justice delayed is justice denied” is not a cliché, it’s fact.

We believe that the SLD should be instructed to make these specific improvements in how it processes appeals:

- The processing of funding commitments for meritorious appeals involving previous funding years should not be put in line behind application processing for the current funding year. The SLD should have dedicated staff to expedite these funding commitments as quickly as possible, because the applicant has already been subjected to significant delays as demonstrated in the examples above.

- The SLD should “fast-track” the review—and funding—of appeals that involve its own clerical or mathematical errors, rather than further penalizing the applicants that have already had their rightful commitments delayed.

- The SLD should not penalize applicants for errors that are clearly “clerical” in nature. A Form 471 application is not a typing test. Negligence or rules violations should not be tolerated, but some mistakes inevitably occur. Nevertheless, a system has been created in which it appears that more applicants are tripped up for a failure to meet an inconsequential Minimum Processing Standard than bad-actor vendors are flagged for filing unauthorized Form 470 applications or withholding BEAR payments. Appeals involving these kinds of clerical issues should also be fast-tracked for quick review.

- The SLD’s funding commitment decision letters, and even its decisions on appeals, supply very limited information or explanation of the reasoning behind a decision, making appeals more likely and more difficult for all, including, ultimately, the Commission. We believe that this is particularly the case in the area of review of eligible services, a problem that could be addressed in part by providing greater specificity on the eligibility of particular products.

- The SLD should be instructed to change its systems so that applicants can update their contact information. When a funding commitment is issued on an appeal that involves an earlier funding year, it is possible that the applicant’s address or contact person has changed. The SLD apparently has had difficulty updating its databases so that the current E-rate contact for the applicant is notified when previous year’s funding commitments are approved, or an appeal decided.⁷

⁷ In the case of one our clients, the U.S. Postal Service will no longer deliver its mail to the street address that was provided on its application in case the SLD needed to contact it by express mail service. Thus, the

For many applicants, the appeals process represents an exercise in futility. By the time their funding commitment is ultimately distributed, it may be two school budget cycles beyond when they had first hoped to use the money. Because of the E-rate program's requirement that every project must be supported, at least in part, with some of the applicant's own funds, this may mean that the project is now out of reach because of applicants' inability to "bank" funds at the end of a school budget year.

We believe that this situation could be improved with a small expenditure of funds to support either additional staff (an attorney to specifically manage appeals at the SLD level) or the hiring of experienced outside contractors to help manage the flow of appeals. While we appreciate that the Commission and USAC have attempted to limit, as much as possible, the amount of money that is spent administering these programs, we believe that in this instance they have been penny-wise and pound-foolish. We believe that most applicants would gladly sacrifice the amount it would take to expand the available staffing if it meant this process would be conducted more efficiently and with greater accuracy. Alternatively, we submit that some small part of the interest that USAC has been able to earn on unspent monies in the school and libraries program (\$11.589 million in interest is projected for second quarter of 2002 alone⁸) could easily be designated for improvements in this area. We believe it makes sense to address this issue because the longer that appeals go unresolved, the greater the likelihood an applicant will not be able to use its approved funds.

Funding of Appeals

We believe that concerns about the depletion of the so-called "appeals reserve" are misplaced. Appeals should not be evaluated differently than the first round of funding requests because that would unfairly penalize applicants who were forced to appeal because the SLD incorrectly rejected their requests in the first place. While we can appreciate that the SLD must build into its calculations some amount in anticipation of appeals, the volume of unspent money in the schools and libraries fund is such that we believe there is no *real* problem involved with USAC being able to cover approved appeals. (The problem occurs only when USAC is instructed to use undisbursed dollars to lower the level of carrier contributions—and then discovers that the pot has been depleted by the time the appeals have been decided.)

school district has been forced to try to anticipate when the SLD will be sending it something and go hunting for its returned mail.

⁸ See "Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2002," submitted January 31, 2002.

We understand that at the beginning of February 2002, the SLD was holding up issuing funding commitments for successful Year 4 appeals involving internal connections until it could determine that its appeal reserve would not be depleted. When will all Year 4 appeals ultimately be resolved—three years from now? With the Commission’s acknowledgment that more than \$900 million went unspent in Years 1 and 2, and possibly as much as \$600 million in Year 3,⁹ we fail to understand the cause of concern. Further delays, as noted above, will only help assure that the money ultimately goes unspent, and further widen the commitment-disbursement gap that is already the subject of this NPRM.

III. Enforcement Issues

We believe that the best enforcement mechanisms that the SLD has available are ones that cost nary a penny more: it should make its rules as clear as possible, enforce them in a consistent manner, and publicize instances in which vendors and applicants are found to be willfully violating them.

The E-rate program’s rules have evolved over time, and the SLD’s own understanding of the rules has evolved along with that of applicants. At the start of the program, the SLD adopted an approach of being the applicant’s friendly adviser, working with the applicant to make sure its application was submitted correctly. Over time, that attitude has, out of necessity, evolved—the agency simply does not have the resources available to serve as nursemaid for 30,000-plus applications.

It seems reasonable to us to take the position that with \$2.25 billion worth of telecommunications companies’ revenues involved, applicants are expected to follow the rules and prepare their applications accurately because there are more than enough applicants lined up, eager to claim the money. That said, it has seemed to us, and we believe to many applicants, that much of the SLD’s energies are devoted to reviews that amount to bureaucratic nit-picking, rather than focusing limited resources on potential problems of a much greater magnitude.

SLD reviewers have, in the past, asked our clients to fax back Block 5 pages indicating a “Billing Account Number” was “N/A” and certifying that a funding request should be rounded to the next penny when the SLD’s computers calculated it differently. Or they required a fax to certify that an application field should contain a zero rather than be left blank or marked with a dash. When the SLD reviewers have that kind of time available, do they not have time to engage

⁹ According to the latest USAC quarterly report, through December 31, 2001, USAC had committed \$2.08 billion for Year 3 and disbursed \$1.421 billion. This estimate of available funding does not include the \$170 million that was presumably held in reserve from the \$2.25 billion that could have been committed in the first place.

in a short conversation when they are about to trim or reject a funding request to make sure they are interpreting the provided information correctly? With one phone call, a mistake could be avoided—along with the processing of the subsequent appeal—and the approved funding put to use in the year for which it was sought.

Schools and libraries lost out on millions of dollars for using a Year 3 application form in Year 4, when the new form was unveiled only days before the start of the application window and announced only on the SLD's Web site—not in the SLD's mailed communication to schools and libraries announcing the start of the application season. (In this case, the substantive differences between the two forms, including the certification statements, were minor, and in terms of data collection, did not affect school districts applying for contracted services.)

Further, schools and libraries' requests have been rejected when they made even small clerical errors, while the program apparently paid substantial amounts to vendors who were found, in subsequent years, to be willfully violating the program's rules. We believe that in the case of clearly clerical errors, the SLD should be instructed to revise individual funding requests upward, even before a funding commitment letter is issued, if the applicant can demonstrate that the higher figure was detailed correctly elsewhere in its application, that its application was otherwise substantially complete and accurate, that it had met all of the program's *substantive* rules and that it had notified the SLD of the error as quickly as possible—and certainly no later than the deadline for a Receipt Acknowledgement Letter review. With the current volume of undisbursed dollars that are available, there is no sensible reason why an applicant that makes this kind of clerical error—and brings it to the SLD's attention on a timely basis—should lose out on its deserved funding.

We recognize that in some cases, outside auditors have decreed that the SLD should focus on issues such as discount rates, believing they represented areas with the greatest potential for fraud. In other cases, we believe that the SLD reviewers' questions amount to the kinds of inquiries that relatively low-level employees can be asked to make, rather than those, for example, that might require legal expertise. If the SLD believes that it must continue to rely on these reviewers as its major defense against waste and fraud, then it should give applicants and service providers the option of providing much more detailed back-up with their applications from the outset. For instance, what level of detail does the SLD want to see in the "Description of Services?" What certifications should be attached if a district knows that the discount rates it is reporting are different from the ones it reported last year? If a district has properly exercised a contract extension option, should it go ahead and include a copy of the contracts?

We suggest that USAC and the Commission should consider whether the level of review that can be provided by its current application review staff is the most cost-effective way to address substantial forms of waste, fraud and abuse or whether resources could be deployed more effectively by hiring persons with more formal legal and auditing training.

It is possible, of course, that the SLD is tackling more difficult issues. If so, the only way the applicant community will ever find out—and the only way “bad apples” will be deterred—is if the vendor or applicant in question decides to pursue the matter to the Commission, and a decision is ultimately granted. For instance:

- Who are the vendors that have posted unauthorized Form 470 applications?

- Who are the companies that the SLD says have improperly advertised themselves as “SLD-certified” consultants?

- Who are the vendors that have told school districts they aren’t required to pay the undiscounted portion of a product’s price?

- Who are the vendors that have posed as SLD auditors?

- Has a public school district ever tried to create a fictitious new school building for the purposes of applying for discounts it did not deserve? If so, the name of the culprit should be publicized and the district sanctioned. If not, then why do SLD reviewers require districts to produce additional documentation to back up an application that certifies they are seeking discounts for a new school?

The SLD has failed to publicize the fact—much less the name—of the large urban school district whose multi-million-dollar Year 3 application request failed an Item 25 review. Only those who carefully monitor the Commission’s appeals decisions, or attend the quarterly meetings of the Schools and Libraries Committee, would learn of situations like these—which should be powerful deterrents to applicants who fail to take the program’s rules and requirements seriously.

In Year 3, we reported to the SLD, on behalf of one of our school-district clients, that a vendor was filing applications on behalf of individual, high-discount schools in that district—without the district’s authorization. Among other things, district-level officials were concerned that the vendor may have been misinforming the schools that they were not required to pay

anything to acquire technology through the E-rate program. The SLD rejected the Form 471 that the vendor filed, but the vendor kept its case alive through a due-process technicality. Through all of this, the school district was never updated on the status of the case.

It was recently brought to the district's attention—two years later—that the vendor is *still* filing unauthorized applications, this time on behalf of 47 schools within the district. This underscores the need to strengthen USAC's ability to respond quickly to situations such as these, to investigate them carefully and thoroughly and, when the facts warrant it, to take meaningful and decisive action—publicly. What good is having systems and mechanisms in place to detect waste, fraud and abuse, if USAC is lacking the tools to eliminate it once it finds it?

In our own consulting practice, we have always attempted to communicate to clients and potential clients our current understanding of the program's rules and the likely consequences of not following them. Sometimes, this approach has meant we lost potential business when potential clients apparently did not like the honest answers we tried to provide. On at least two occasions, we were gratified when Commission appeals decisions backed up the interpretation of the rules that we had provided. But, in general, very little information is distributed about enforcement activities and how the SLD interprets and applies Commission policies.

Instead, the SLD's review staff pummels applicants for whom there has been no suggestion of wrongdoing with questions that arise when the up-to-date information that an applicant has certified on its application does not match the out-of-date information that the SLD has in its databases or on an out-of-date state Web site. Or, year after year, the staff will ask a library to certify that the library's discount rate information is correct when the source of the data is always the local school district, over which the library has no control.

If discount rates are *that* important, then the SLD should explain the specific standard by which they will be judged and reviewed and the sanctions that will be imposed if the data is found to be substantially inaccurate. If a standard is enunciated, applicants can make sure that they meet it. The SLD can devote its resources to reviewing those cases where it appears the numbers have no basis in reality, rather than calling on school districts to re-certify that figures they have already certified are, in fact, correct.

While we believe, as noted above, that additional attention should be paid to the process by which invoices are paid, we are distressed that the SLD is now reviewing invoices with the kind of analysis that we believe should correctly be applied before a funding commitment is approved. What could be worse for a school district than to have the SLD refuse to pay an invoice for a funding commitment that it was told had already passed muster?

As noted above, the applicant itself can serve as a useful check on vendors seeking payment from USAC before the work is actually performed. Further, because a vendor may not have seen the documentation that was submitted with an application or be aware of all the discussions that led the SLD to trim an applicant's funding request, the vendor may not know exactly how the invoice should be adjusted unless it has discussed the situation with its customer. But questions about what can legitimately be supported should have been resolved before the funding commitment is issued.

A. Independent Audits

We support requiring service providers and recipients to reimburse USAC for the cost of independent audits only in cases where serious problems, specifically willful violations of program rules, have been uncovered. Thus it may be more appropriate to recoup these costs through fines imposed on these violators.

The Commission's proposal calls for requiring an applicant to underwrite the cost of an audit "where the Administrator has reason to believe that potentially serious problems exist." How will the administrator make that determination? What if the administrator is wrong? Would this review be initiated by a phone call to the "Code 9" whistleblower hotline, and, if so, how would an applicant or vendor be protected against calls initiated by, say, a losing bidder in a bid competition that was conducted under the rules of the program?

If such a policy is implemented, it will be incumbent on the program's administrators to clearly detail what a "potentially serious problem" would be, and what kind of event would trigger this sort of review. Where, for instance, will the line be drawn between willful and criminal falsification of information and an honest mistake by a harried school administrator? That's why we believe it makes more sense for USAC to seek reimbursement for its audit costs after the investigation is closed rather than at the outset. In any case, any change in Commission enforcement policy will need to be clearly communicated to both applicants and vendors alike so that they can put the appropriate internal controls in place, if necessary.

The Auditing Experience

Through the luck of the draw and, we suppose, the size of the funding commitments awarded to some of our larger applicant clients, we have experienced three post-commitment beneficiary audits, two by Arthur Andersen and one by the Commission's own auditing staff. Although the results of these audits have not yet been released, we wish to offer our perspective that this is not a very cost-effective way to guard against waste, fraud and abuse in the program.

Both sets of auditors had a limited understanding of the program's rules, because, as they both acknowledged, they had had very limited training and experience with the program. At one point, one auditor commented that it was extremely difficult to do an audit because the rules were "so vague"—particularly compared to the usual audits that that individual performed. How can an applicant be expected to follow the rules if the enforcers don't understand them?

The auditors also devoted what appeared to be an excessive amount of attention to what, on the surface, would appear to be relatively insignificant issues—such as asking one district to detail which cell phones were assigned to which personnel—a funding commitment that amounted to only \$3,072 out of \$2.108 million worth of discounts that that district received in Year 2.

In another instance, an auditor asked an applicant to specify what percentage of a server was devoted to "administrative" purposes and what percentage to "instructional." However, the Commission has never specified that server functionality needed to be divided that way, nor given any guidance on how a district would make that evaluation. For instance, if a server is used to transmit grade reports from the classroom to a centralized office, is that an administrative function or an instructional one? If a teacher orders books or classroom supplies by connecting to an online store through a server, is that an administrative purpose or an instructional one? Does this distinction matter?

The blurring of distinctions like these will continue to increase as technology is increasingly integrated into all school district operations. Implicit in the recently passed No Child Left Behind Act, the reauthorization of the Elementary and Secondary Education Act, is a recognition that technology will increasingly be used as a standard tool in school districts to promote accountability, do assessments, communicate to parents—and deliver instructional materials to the classroom. *Doesn't it make more sense to assume that everything a school district does ultimately supports the education of our children, and stop splitting hairs over defining "educational purposes"?* If some limit has to be imposed because, of course, the available funds are not limitless, establish a limit on the funding available to an applicant and then let it decide how to prioritize the available discounts among the kinds of generally eligible products and services it wishes to purchase. With the new law's requirements that schools demonstrate that they are, in fact, "educating" children, requiring schools to ration their E-rate dollars themselves among eligible services, it seems to us, would be one way of assuring that E-rate funds are being used to support "educational purposes."

After four years of experience with the program, we believe that the SLD staff—and program participants—know best the places where program fraud is likely to occur, not

congressional auditors nor auditors brought in for short-term assignments. The Commission should convene a task force, much like the one that revamped the Year 3 application forms, to discuss strategies for addressing program fraud when and if it occurs. Participants should identify the areas that are most prone to fraud and strategies for combating it. We believe enforcement efforts should be directed primarily to areas where large-scale savings could be achieved or where bad actors are deliberately trying to rip off the program. For starters, we submit that these areas would probably be worth reviewing:

- Instances, which we know exist, where language submitted on Form 470 applications is duplicated across multiple states and applicants, suggesting someone other than school district personnel is defining technology needs and making a mockery of the program’s competitive bidding requirements;¹⁰

- Instances where districts have taken advantage of high district-wide discount rates, but may not have supplied services to all of the schools that were cited to produce that high discount rate;

- Instances in which vendors that installed non-recurring services received *all* of their payments from multiple customers in the form of service provider invoices;

- Unusually high funding requests (e.g., more than \$10 million) in a single line item for applicants at the 90 percent discount level.

Further, we submit that if the Commission and SLD are concerned that applicants are, in fact, *not* conducting competitive bids in which cost is the primary factor, they should provide additional guidance on their policies related to specifying brands, relying on vendors that have worked with the district in the past, what level of response is required, if any, when a vendor wants to propose a solution other than the one specified on a Form 470 application, and other real-world issues. Administrators might consider, for instance, creating a worksheet that an applicant would be required to maintain during the 28-day bidding period and then submit, if requested by the SLD, if questions had been raised by a losing bidder or another party. It appears to us that in some cases, well-meaning and largely innocent school administrators have, in fact, been caught by “gotcha”-type questioning by SLD reviewers when they did not produce the “right” answer to a question related to their bidding processes. Virtually all of the guidance the SLD *does* provide on appropriate vendor relations is provided only in its service provider manual, a document that most applicants are unlikely to review.

¹⁰ If the SLD is not able to conduct this kind of comparative review itself, we can make available the information that was compiled by our E-rate Market Analyst tool.

B. Barring Wrongdoers from Program Participation

We believe that vendors, applicants and consultants who are found to be willfully violating program rules should be barred from participating in the program for a period of time. We also believe that individuals should be barred so that they cannot simply open up shop under another name. In certain cases, where there is no other “good Samaritan” vendor available to step in to serve an applicant, it might be appropriate to put a vendor “on probation” so that the applicant could still receive its services. Fines are another possible deterrent.

However, if the Commission decides to take this approach, it must ensure that the situations that are subject to these sanctions represent a determined effort to circumvent the program’s rules, that the violated rules are substantial ones and that the potential penalties have been made clear in advance.

C. Unused Funds

In our own experience, we believe that the problem of unused funds is caused by several factors, some of which are probably beyond the Commission’s control:

- E-rate applications must be submitted well before applicants complete their budgeting for the funding year in question.

- Delays associated with issuing funding commitments and approving meritorious appeals mean that in some cases, the applicant no longer can come up with its portion of the price once the discounts are finally approved.

- In the case of appeals involving recurring services, the applicant may not be able to use the approved funding request because either part or all of the funding year has already passed, and it was unable to purchase the service by itself.

- Delays in funding commitments lead applicants to request funds in more than one funding year when they don’t know whether they will succeed the first time they asked. For instance, Year 5 applications had to be submitted before applicants who had sought internal connections discounts at a discount rate of 87-85 percent had learned whether they would receive support in Year 4.

- There is a public relations value in getting a large funding request approved. Because USAC never details how much of their approved funding individual applicants actually *used*, there is no negative publicity associated with mismanaging planned projects or locking up funds that could have been put to use by another applicant. Instead, applicants may be encouraged to seek approval for larger and larger amounts. A funding commitment, rather than a project’s successful completion, becomes the *de facto* standard by which “success” is measured.

- The current—and still somewhat restrictive—limits on service substitutions, coupled with rapid advancements in technology, may lead some applicants to decide not to use their approved discounts because, in the meantime, they have decided to pursue a different technological path. In addition, because the SLD has no formal timetable for handling these substitution requests, vendors and applicants that make a good-faith effort to notify the SLD of these changes can sometimes be left in limbo.

We believe that the following steps, which could be taken immediately, would help address the problem of undisbursed commitments:

- Publicize data showing the extent to which applicants have actually used the commitments that they have received. We believe that the resulting publicity and peer pressure would discourage some applicants from “biting off more than they can chew” and locking up funding that others could use.

An analysis of the Arthur Andersen audit of Year 1 beneficiaries—which, as far as we can determine, was never publicly posted on the web sites of the SLD, USAC or the Commission—reveals that a number the applicants who were audited had failed to use substantial amounts of the funding that had been approved for them. For instance, according to figures supplied by the report, the Puerto Rico Department of Education used only 47 percent of the \$46.2 million in approved commitments that the auditors reviewed; the Los Angeles Unified School District was able to use only 54 percent of the \$8.7 million in approved commitments that the auditors reviewed; and the Chicago Public Schools were able to use only 58 percent of the \$15.9 million in commitments that the auditors. By contrast, the School District of Philadelphia made use of 99.6 percent of the discounts that were approved for its use that year—a record that it has maintained since the program’s start.

This information presumably is in the SLD’s database, even if USAC is not currently required to report it. As funding requests have grown over the life of the program, stakeholders should be able to determine which applicants are, in effect, “wasting” money by not putting it to use. We believe that shining a light on this practice would help to curb it.

- Permit applicants to substitute products—even if they cost more or have a higher percentage of ineligible costs. It makes no sense to prohibit an applicant from using its own money to purchase a better product, as long as the substitution is permissible under its state and local procurement rules and it is from the same “bucket” of E-rate eligible services as the one that was originally approved. If the Commission is not willing to provide this flexibility to all applicants, it should consider modifying the substitution policy for those applicants whose

funding commitments have been delayed for a significant amount of time through appeals, service provider changes and the like.

- Require applicants to alert the SLD at the time of their application that they have submitted the same funding request in more than one funding year. If the request is, in fact, a duplicate, the SLD might require such applicants to commit to one year or another by a certain date. (This, of course, presumes that the SLD can move nimbly enough to make the funds available to another applicant.)

- Provide applicants with a full year after the date of their funding commitment letter is received to complete an internal connections project. Although the Commission has addressed this issue through its permanent extension of the installation deadline, that provides no relief to applicants who, for instance, received their Year 4 internal connections funding commitments in mid-February 2002. Because these funding commitments were held up precisely because the amounts were large and on the cusp of the funding threshold, many of them undoubtedly involved large urban districts who will be hard-pressed to complete major wiring projects by the September 30, 2002 deadline.

We believe that while the intent of the Form 500 was laudable, the SLD has so far not demonstrated that it can make funds that are “returned” to the program available to any other applicant on a timely basis. Further, an applicant is given absolutely no incentive, either through rewards or sanctions, to take the time to submit a Form 500. If the Commission wishes to encourage the use of the Form 500, it should consider these steps:

- Provide a more direct incentive for entities to submit the form. For instance, we believe state E-rate coordinators would be more inclined to encourage their applicants to return unspent money if the savings could be designated for the use of applicants within their states who fell just below the funding threshold.

- Impose some sort of program sanction on an applicant that fails to use a large percentage of its funding by the end of the funding year, and never freed up the funds for use by another applicant. We anticipate that such a proposal would be opposed by applicants, but suggest that without sanctions and/or rewards, applicants themselves have no incentive to be concerned about their own unspent funds.

- Require that applicants seeking funding of a certain magnitude re-certify, at the time their funding commitment decision letters are distributed, that their plans have not changed, that their approved budget for that school year will still be able to support those projects and that the timetable is still reasonable. These kinds of questions might be of greater value to the program’s operations than some of the queries posed during the so-called Item 25 reviews.

If the Commission decides to make no changes in its current policies, then we think the SLD should be instructed to commit significantly more than \$2.25 billion a year, based on four years of program history that demonstrate that disbursements will be substantially lower than commitments. We expect that the disbursement gap will actually worsen in Year 5 because technology budgets are likely to contract over the course of the year because of funding cutbacks at both the state and local level.

Treatment of Unused Funds

We oppose any change in regulations that would require the Commission to credit unused funds back to the contributors. The history of the program clearly demonstrates that there is ample demand each year for \$2.25 billion worth of discounts; the challenge becomes in adjusting the program's rules and procedures so that the money actually gets into the hands of those who can put it to use. Since no individual applicant is sanctioned for its failure to use (or failure to return) a funding commitment, crediting unspent funds to contributors will only further distort program demand and the technology choices that are made, based on the relative priority of different services and the scarcity of funding.

The Commission never anticipated setting up USAC as a banker that earned large amounts of interest on unspent dollars. Thus, it is incumbent on the program's administrators to get the dollars into the hands of applicants that need them—and can use them. We see two ways this could be accomplished.

- As has been suggested elsewhere, by March 31, USAC should have a good idea of where it stands in terms of the previous funding year. That total of committed but undisbursed funds could then immediately be transferred to the pool of available funds for the commitments that are then under review. For example, at the end of March 2002, USAC should know what funds were not disbursed from its Year 3 commitments and what funds are still subject to appeals. The vast majority of those undisbursed funds could be rolled over and made available to support Year 5 funding requests—or even Year 4 internal connections requests that fell just below the 86 percent threshold.

- The better, and we believe, the more equitable and legally defensible approach, would be to place the funding requests that fall just below the threshold for approved internal connections on a “pending list.” Based on the history of disbursements versus commitments, the SLD could conclude that sufficient dollars would be available for these applicants, but that it was not prepared to authorize that disbursement until it was certain. For instance, at the end of January 2002, USAC reported that it had disbursed \$1.421 billion in Year 3 funds (or \$839 million below

the \$2.25 billion it was authorized to disburse), and \$574 million worth of internal connections support to applicants with discount rates ranging between 89 and 82 percent. When it did its initial demand projection for Year 3, USAC projected that applicants at the 80 percent discount band had requested a total of \$1.383 billion worth of support. Thus, there was, at most, \$809 million worth of unfunded demand at that discount band. Since that number would probably drop further if the applications were subject to a review, it appears that with \$839 million worth of unspent money three months after the end of the funding year, the SLD could have supported applicants at the 81 percent discount rate, and most, if not all, of the requests at the 80 percent level.

SLD could ask these applicants to specify within 30 days of the payment paperwork deadline whether they still wanted to pursue those earlier funding commitments (or had, in fact, already purchased the equipment) and then review the applications of those that signaled they were still interested in using the funding. While this approach might require the SLD to modify some of its application processing procedures, the advantage is that it would tend to drive funding commitments down to a lower threshold of applicants, rather than simply increasing the funds available in a future year—yet again—to applicants who qualify for a 90 percent discount. (Without any changes in program rules, we anticipate that the neediest applicants will simply continue to ask for more and more, as there is no incentive for them not to, assuming that they could demonstrate, if asked, that they had the resources available to use their funding.)

To speed USAC's ability to recapture unused funding, the Commission may wish to require that applicants that have qualified for substantial amounts of funding must provide a more timely notification if they will not be able to use a certain percentage of it. It would seem reasonable that those applicants that have locked up large amounts of money in a particular funding year bear some responsibility to make it available for the use of others if they determine they cannot use it. We believe that a review of the SLD's data on applicants' record for spending approved funds would suggest appropriate thresholds for these reporting requirements.

Revising or Eliminating Outmoded Rules

In our discussion above, we have identified a number of regulations and policies that we feel are outmoded. In general, we believe that over the course of the program, the demands of managing the volume of applications involved, through a third-party contractor whose payments, we understand, may be based on meting productivity benchmarks, has created a system that rewards rejecting applications for infractions that are inconsequential from a policy perspective, while much larger infractions, involving substantial violations of program rules, are not addressed

because resources are directed to managing volumes of paper rather than substantive issues. Annual changes in filing procedures and requirements, changes in application forms immediately before the deadlines by which they must be used, Minimum Processing Standards that reward attention to detail rather than attention to substance all have contributed to this. These problems will not go away unless the Commission permits USAC to commit higher-level resources to these issues. As for potential congressional concerns about “building a bureaucracy,” we believe this policy change will ultimately result in fewer complaints by applicants to their congressional representatives that their worthy applications have been rejected for reasons that had no relation to promoting the goals of the program, nor guarding against waste, fraud and abuse. The General Accounting Office has already documented for Congress that USAC has relatively low administrative expenses, relative to the substantial amount of money it distributes.

In addition, we highlight these additional areas where we think the existing regulations should be revisited:

•**Discount Rates**—Year after year, far too much attention is directed to challenging applicants on the discount rates they have used. Applicants are asked to certify numbers that are not reported elsewhere, but to our knowledge, in four years of the program, no public school has been sanctioned for submitting willfully fraudulent, or even incorrect numbers. (If applications have been rejected on this basis, then the SLD should publicize the names of the wrong-doers.)

For school districts, the Education Department already has a variety of mechanisms for determining eligibility for Title I, the program of support for low-income students and schools. Why can't the Commission simply rely on an existing data-collection mechanism by an agency in a far better position to do it, for making this determination? The procedures that private schools would have to follow would parallel the range of data that it is permissible to submit.

Thus we believe the Commission should revisit its position on the so-called “feeder school” method for determining discount rates, and permit schools to qualify for a higher discount rate if all the schools that “feed” into the higher-level school enjoy that higher discount rate. We believe that a review of the program's history would reveal that to the extent to which applicants are, in fact, installing internal connections in their 90-percent-discount schools, it is their high school buildings that are getting left behind. If funds are limited, we believe that high schools arguably have a greater need for Internet access and technology than do elementary schools.

Further, we believe that the current mechanisms for computing discount rates for libraries unfairly discriminate against libraries. It is widely accepted that libraries play a critical role in eliminating the “digital divide” that exists for poor families that do not currently have access to

the Internet but that live in areas where a large segment of the population does. Nevertheless, a library branch serving a low-income neighborhood in an otherwise wealthy school district does not enjoy the same discount-rate advantage that the elementary school serving the same neighborhood enjoys. We believe it would be a more equitable application of the rules to allow libraries to qualify for the same discount rate enjoyed by the elementary school that is closest to a branch. To take advantage of this, libraries could simply be asked to submit a map that demonstrated which elementary school was closest to each branch, a document that should be easy for most libraries to produce.

•Application of the Certification Under the Children’s Internet Protection Act—

We respect that Congress required E-rate applicants that are subject to the Children’s Internet Protection Act (CIPA) to certify within 120 days of the start of the funding year that they were in compliance. The Commission adopted a sensible solution—putting the certification on the Form 486 application and requiring that certification be made within 120 days of the start of the funding year, or 120 days of when the funding was used or a funding commitment approved. Nevertheless, USAC’s enforcement of this has turned out to be needlessly bureaucratic, penalizing applicants that are not even subject to the law. Imposing a requirement that applicants must submit a Form 486 certification within 120 days of the service start date for every funding request, regardless of whether they have already made a CIPA certification statement for that funding year and regardless of whether the services are actually subject to CIPA (which in the case of telecommunications services they are not) unnecessarily penalizes applicants for failing to meet a new, arbitrary deadline. Unless the Commission couples this new rule with some “carrot” that will get undisbursed funds into the hands of applicants more quickly, this policy will have the unintended effect of further widening the gap between commitments and disbursements as applicants are denied funds to which they are otherwise qualified.

•Second Year CIPA Enforcement—We take this opportunity to raise an issue that neither the Commission nor the SLD has yet addressed, namely when will applicants that do not use any Year 4 internal connections or Internet access discounts until late in the fourth funding year be expected to be in full compliance with the CIPA requirements? For instance, under current regulations, an applicant that did not use these discounts until after July 2002 would not be required to certify until October 2002 (and possibly as late as January 2003). Nevertheless, most applicants assume that they must be in full compliance with the law by July 1, 2002. There may be only a limited number of applicants who will fall into this category, but they should be given additional guidance on these requirements.

•**Form 500**—As currently used, there is virtually no reason why an applicant should have to file a Form 500. Although the form must be filed to “turn off” services that were incorrectly “turned on” when a Form 486 was filed before the start of the funding year, that procedure is irrelevant if the SLD does not issue funding commitments before July 1, as was the case in Year 4. Since the SLD is not currently redistributing unused funds to other applicants, there is no reason for an applicant to file the form to return money to the system. Nor is there any good reason to require an applicant to notify the SLD on a separate form that it has extended a contract to take advantage of a delayed funding commitment. The Commission automatically grants waivers from its competitive bidding rules in these cases and thus the contract extension is implicit in the filing of the Form 486 to proceed with the services. (Indeed, this is yet another case in which a successful appellant is forced to do *more* work to receive its funding than the applicant whose requests were processed correctly.) The Form 500 *could* be put to use if, in fact, the SLD did provide incentives or sanctions that encouraged applicants to release money they knew they would not use, or to provide a mechanism through which applicants could temporarily stop payments to vendors where problems occurred after the initial submission of a Form 486.

Applicant Education

The E-rate program could be substantially improved if the SLD were instructed to make a proactive, positive use of the hours and hours of data collection that go into the annual submission of more than 30,000 Form 471 applications.

In connection with work we have done for the Consortium for School Networking’s Taking Total Cost of Ownership to the Classroom project, we know that there is relatively little up-to-date information available on the costs associated with wiring the nation’s classrooms. Projections made in the mid-1990s—and that, in fact, helped guide the determination of the size of the Schools and Libraries fund—have been replaced by four years worth of hard data on what schools and libraries are actually paying for POTS, long distance services and high-speed bandwidth, Internet access, cabling, servers, network maintenance and the like.

Many E-rate applicants are ill equipped to know what a particular service should cost, and what their peers are paying for it. A review of E-rate applications to provide applicants with better guidance on what they should be paying for services like these would be money well spent. Certainly, the SLD must have its own guidelines on what these services should cost to help guide its Program Integrity Assurance review. We believe that more information could be shared with applicants—without telegraphing auditing thresholds—and that schools and libraries would benefit by learning more about the costs associated with various technology choices.

CoSN has previously expressed interest in working with the SLD to analyze, on an aggregate basis, the information supplied as part of the Item 25 reviews. We believe that sharing more aggregate data about simply the prices that E-rate applicants are paying for various services would help guard against waste, promote greater competition in the program and help turn all E-rate applicants into “smarter shoppers.” It would also help school leaders and government policy makers plan and budget more effectively for technology over the long term.

Summary

In summary, we recommend that the Commission take these specific steps:

- Make public the SLD’s product-specific eligibility determinations and institute a process through which companies can submit products for review;
- Review the eligibility of caching and proxy servers and caching devices;
- Review whether the method of calculating discount rates discriminates against certain kinds of applicants;
- Require vendors to obtain the certification of their customers before submitting a service provider invoice;
- Provide more information about enforcement activities and the names of vendors, consultants and applicants that the SLD has substantial reason to believe are in violation of program rules;
- Withhold additional payments to vendors who have not remitted BEAR payments to their customers, and publicize their names;
- Process appeals and funding commitments for meritorious appeals more quickly, particularly those involving clerical and processing mistakes on the part of the SLD;
- Refocus enforcement activities on “big-ticket” items and situations involving substantial abuse rather than clerical errors;
- Provide information indicating the extent to which applicants actually used their approved funding commitments;
- Permit service substitutions when new products would cost more if the applicant is willing to pick up the difference in cost;
- Require applicants to notify the SLD when a funding request duplicates a request that was submitted in another funding year;

- Use the information provided by schools and libraries in their applications to help inform those communities about what their peers are spending for telecommunications services and networking projects.

In four short years, the E-rate program has succeeded in boosting the percentage of classrooms that are wired to the Internet from only 27 percent to close to 80 percent. Schools and libraries, and their students and patrons, have begun to enjoy the benefits of high-speed Internet connections and access to distant learning resources. At the same time, schools and libraries have evolved into a substantial market for telecommunications and technology services—a market that the thousands of companies that participate in the program are only now beginning to fully appreciate.

We believe the program’s goals—of promoting connectivity and access to advanced telecommunications services as well as telecommunications competition—are still worthy ones. Although there are a number of ways in which the program could be improved, we believe that its underlying framework is still sensible. We praise program officials for their hard work in putting in place a program that could touch so many individual applicants—and so quickly—despite real political challenges. Now, with the understanding gained by four years of real-world experience, we believe the Commission is in a much better position to modify the program’s rules and procedures to ensure that the program achieves its very worthy goals and uses its available resources wisely.

Submitted by:

Funds For Learning, LLC

2111 Wilson Blvd. #700

Arlington, VA 22201

Orin Heend, President

Sara Fitzgerald, Vice President, Communications

John Harrington, Vice President, Operations

