

E-Rate Rip-offs

FCC program to bring Internet access to neediest schools becomes a pit of waste, fraud and abuse

By Wilson P. Dizard III, GCN Staff

Arlene Ackerman, the San Francisco Independent School District's superintendent, didn't like the looks of a \$50 million project proposal submitted for her approval shortly after her appointment in 2000.

As she delved into the project application-made under a program known as E-Rate-Ackerman began a five-year journey into the sordid maze of a well-intentioned but disastrous effort to provide hard-pressed schools and libraries with access to broadband service.

The E-Rate program provides 20 percent to 90 percent discounts on telecommunications services and equipment, with its funds targeted to schools and libraries serving children of low-income families, based on the percentage of students participating in the federal school lunch program. In addition to Internet networking equipment and services, the program also pays for telecommunications equipment and services.

The E-Rate program has attracted blistering criticism from Congress and the Office of Management and Budget.

It also has spawned criminal prosecutions from coast to coast; civil cases that already have revealed more than \$200 million in waste, fraud and abuse; and sent several people to prison, according to a conservative estimate of funds recovered in court and waste reported by legislative branch investigations.

The Federal Communications Commission is proceeding haltingly to overhaul E-Rate, under a program known as the Universal Service Fund Comprehensive Review. FCC officials refused to officially comment, but one manager did defend the steps the agency is taking to fix the program's shortcomings.

Meanwhile, the Justice Department and the FBI are proceeding with criminal investigations. The Justice Department has chosen to increase its attention to E-Rate fraud prosecutions, with pressure for the move coming from the highest levels of the department, sources said. The department did not respond directly to questions about whether it has shifted resources to E-Rate prosecutions from other tasks, but officials reaffirmed their determination to punish and therefore deter this type of theft from the government.

E-Rate was one of the Clinton administration's signature e-government programs. It has distributed more than \$10 billion to schools across the country, some of them in relatively high-income areas.

But as a result of lax oversight and an administrative structure prone to conflicts of interest, abuses have plagued the program and bilked it of hundreds of millions of dollars.

Opportunistic vendors and consultants have developed a business model in which they approach needy school districts with promises of equipment-and, sometimes, bribes to prepare bogus applications for E-Rate funds. They line their pockets by overcharging the schools and libraries, providing faulty equipment or none at all, building gold-plated systems that require a lot of maintenance, and other abuses.

The resulting frauds have spawned civil settlements and criminal convictions coast to coast. The Justice Department is now investigating dozens of potential criminal cases.

And dozens of other whistleblower cases are pending.

Last year's congressional hearings drew more attention to E-Rate fraud, sources said, and increased the pressure on Justice to focus on the problem.

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Justice also is reviewing dozens more whistleblower cases, still under seal, that are being brought under the Federal Civil False Claims Act, or "qui tam" law.

The criminal and civil cases, criticism from Congress, and OMB's failing grade for the program stem from fundamental flaws in the E-Rate program that build conflicts of interest into the system and exposed it to fraud, waste and abuse.

Despite the drumbeat of warnings and scandals, the FCC has not yet established an effective oversight or performance measurement regime for E-Rate projects even as billions of dollars flowed to tens of thousands of applicants, federal, congressional and private-sector experts said.

The problem trickles down to individual schools and libraries nationwide, as San Francisco's Ackerman discovered. "I was asked to sign an E-rate application that gave a description of a city that didn't look like San Francisco," she said last week.

"I said, 'This doesn't appear to describe San Francisco as I know it. What city are we describing?'" She then learned that the project application described Los Angeles.

Probing further, Ackerman found more problems with the project application, such as requests for funds to wire schools that were already equipped with broadband links. Later, she received documents from a disgruntled contractor who had publicly blasted the corrupt school system bidding process.

"At that point, I called the city attorney, Louise Renney, discussed the matter with her and asked if I could call in the FBI," Ackerman said.

When the FBI agents arrived, she provided working space for them and told her staff to cooperate.

"I did suffer a lot of criticism at the time," Ackerman said. "The media pitched the story as my having turned down a \$50 million grant."

Owen Clements, chief of special litigation for the city attorney's office, described the fraud scheme: "They had a road show. They convinced school districts that they could get the money and put a lot of it in their own pockets."

Clements noted that "sometimes whistleblowers are criticized on the grounds that they are acting out of motives of personal financial gain. In this case, the school district itself was the whistleblower and received the money."

Ackerman personally did not receive any of the funds recovered.

On May 27, 2004, the Justice Department announced a settlement under which NEC-Business Network

Solutions Inc. of Irving, Texas, a subsidiary of NEC America Inc., agreed to pay a total of \$20.6 million in criminal fines, a civil settlement and restitution. The company also entered guilty pleas to one count of wire fraud and an antitrust violation.

Of that sum, the company agreed to pay \$15 million in fines and restitution and provide \$5.6 million in ongoing maintenance, equipment and services to its E-Rate customers, which were five different school districts in Arkansas, Michigan, South Carolina and Wisconsin, as well as San Francisco.

San Francisco schools garnered \$3.4 million from that settlement, which was the first shoe to drop in the case.

When it fled the plea, NEC issued a statement acknowledging its mistakes and taking responsibility for them. The company instituted stricter controls to prevent such violations, as required by the settlement.

NEC BNS is no longer an operating company, an NEC Unified Solutions Inc. spokeswoman said last week.

"While currently not participating in the E-Rate program, NEC strongly supports its mission," according to an e-mail statement by NEC spokeswoman Dana Burger last week.

The San Francisco E-Rate whistleblower case illustrates the pattern of waste, fraud and abuse that has plagued the E-Rate program since Congress launched the program.

That law, which was designed to foster competition in telecommunications, became a Christmas tree" for lobbyists' ornaments.

"We have seen a pattern in which consultants take control of the bidding, applications and invoicing in E-Rate projects," said Phillip Warren, chief of the San Francisco Field Office of Justice's Antitrust Division. "Then they submit false and misleading information to Universal Service Administrative Co. that [if truthfully reported] would have led to the applications being rejected."

The E-Rate ornament has been drawing funds from consumers' phone bills for 10 years in the form of a levy of about 10 percent, and now generates some \$2.25 billion annually for some \$2.25 billion annually for the Universal Service Fund, which provides money for the E-Rate program.

OMB gave the E-Rate program its lowest possible grade, "Not performing," in its Program Assessment and Rating Tool evaluation posted at Expectmore.gov. OMB cited E-Rate's lack of performance goals and measures, sufficient federal oversight or rigorous financial management.

In a PART evaluation last updated in January and covering 2005, OMB gave the E-Rate program the following scores:

- Program purpose and design, 60 percent
- Strategic planning, 11 percent
- Program management, 31 percent
- Program results and accountability, 0 percent

"While there have been numerous evaluations of the E-Rate program, there have been no evaluations examining how well the program is accomplishing its mission and meeting its long-term goals," OMB said.

The White House added that, "The FCC has requested funding to help combat fraud, waste and abuse in the E-Rate program, and is working with [the Universal Service Administrative Co., which administers the program] to conduct audits on a statistically valid sample of beneficiaries."

OMB reported that Justice and the FBI are conducting 21 investigations in the E-Rate field, and that the

FCC inspector general has referred five additional cases for investigation. It is not clear whether OMB's figures are up to date or whether they include investigations started by U.S. attorney's offices. Justice officials declined to comment on current investigations.

OMB noted that the FCC inspector general has conducted about 200 audits of E-Rate projects, but characterized that audit work as "sporadic and not performed in accordance with government auditing standards."

The San Francisco case is but one example that has caught the eye of lawmakers. The parade of civil settlements and criminal convictions in the E-Rate program prompted investigations by the House Energy and Commerce Committee in dating back to 2002 that led to hearings in 2004 and 2005.

The hearings relied in part on a year-long investigation by the Government Accountability Office that concluded in 2004 that "the FCC long ago sowed the seeds for gross mismanagement of the program."

Committee chairman Joe Barton (R-Texas) said as the hearings opened in March 2005, "The government mismanagement of the E-Rate program seems to know no bounds." Committee investigators had found that, "Unscrupulous vendors also fleeced the program while underserved communities and telephone customers pay the price," Barton said. "The FCC, these merchants and certain schools all must share in the blame for this disgrace."

The subsequent hearings revealed:

Puerto Rico's E-Rate program, which cost more than \$100 million, did not provide effective equipment or services for the island's school children as a result of mismanagement by USAC and the FCC, and led to a three-year prison sentence and \$4 million fine for Puerto Rico's former secretary of education.

Chicago's public schools had stockpiled more than \$8.5 million of Internet connection equipment, while the E-Rate program and the Chicago school system paid twice for equipment that was never installed.

Investigators charged that IBM Corp. had convinced officials of the El Paso Independent School District in Texas that they needed a gold-plated \$27 million E-Rate program, which eventually failed, for a single year; IBM testified that it had acted properly.

The committee found that the E-Rate program was well-intentioned but "is extremely vulnerable to waste, fraud and abuse, is poorly managed by the FCC and completely lacks tangible measures of either effectiveness or impact."

The panel directed the FCC to immediately begin a tangible method, such as statistically significant auditing, of measuring waste, fraud and abuse in the program.

FCC responded to the committee's concerns by launching a rulemaking proceeding last July to overhaul the E-Rate program. Nine months later, that rulemaking still is pending, and the commission is reviewing hundreds of comments.

An e-mail an FCC spokeswoman sent to a colleague and inadvertently copied to GCN said, "Yikes. He wanted an on-the-record [interview] and I said no. This is going in the wrong direction. I told him I couldn't promise an interview."

An FCC official who agreed to be interviewed only on condition of anonymity cited the progress of the agency's reform program.

"The [Notice of Proposed Rulemaking] looks at fundamental systemic reform with an eye on the application and fund distribution process, the official said. "The goals would be to make the process more

efficient, to get more money in hands of schools and to develop further ways to prevent waste, fraud and abuse."

As for the recurring problems in the program, the official said, "If a whistleblower is in place, there is a mechanism to get an investigation started. The commission's policy is that whenever there is an investigation or audit that has identified funds not used properly we basically recover the funds. Bad actors can be barred from the program."

Bad actors

The FCC adopted a rule change in 2003, seven years after Congress established the E-Rate program, that bars persons convicted of criminal misconduct or held civilly liable for misconduct from participating.

As part of the same 2003 reform, the commission barred duplicate applications for services that would provide services to the same people at the same place during the same time.

The FCC Inspector General's Office, now led by acting IG Kent Nillson, cancelled an interview request, citing staff illness.

But the commission's former inspector general, H. Walker Feaster III, repeatedly warned of program abuses, and the lack of audit resources.

"It has been our observation that audit findings are not being resolved in a timely manner," Feaster told the Energy and Commerce Subcommittee on Oversight and Investigations last October.

"There are many dozens of cases that are under investigation . The ones I know about range in the tens of millions of dollars." --Attorney Steven Cohen

Brian Kenney is a partner in the Philadelphia law firm of Kenney, Lennon and Egan PC, and a former federal prosecutor who has brought a number of whistleblower cases.

Kenney said that E-Rate fraud "is particularly offensive to the Justice Department because the program is intended to help the neediest students. What has occurred is a national phenomenon in which large companies have been able to influence the school districts and pervert the bidding process."

In Chicago, veteran E-Rate and qui tam attorney Stephen Cohen of the firm of Cohen Law Group said, "I would venture to say that there are many dozens of cases that are under investigation, while there are only a few that have percolated up." Cohen said that his firm has three E-Rate qui tam fraud cases pending and that he is investigating several more.

Cohen said he was aware of pending, sealed E-Rate qui tam cases in Dallas, Atlanta, the southwestern region and elsewhere.

"The ones I know about range in the tens of millions of dollars," he said. Some of those most familiar with its weaknesses defend the need for the subsidy. "We are dealing with another government subsidy program that has gone bad because of greed of participants who saw an opportunity to take advantage of nobility of the program," Cohen said.

"I don't think that the right approach here is to throw out the baby with the bath water [by canceling

E-Rate]. We need to change the oversight mechanism. What it comes down to is that the FCC and USAC have to be given real auditing resources." Ackerman now is the superintendent emeritus of the San Francisco School system, and will shift to a tenured professorship at Columbia University's Teachers College in the fall. She still backs the program, but says that oversight has to be strengthened.

"The numbers of schools that have benefited from the E-Rate program far outweigh those who have not," Ackerman said last week. "I was called to testify in last year's [Energy and Commerce Committee] hearings. I was a strong proponent of keeping the program."

Ackerman added, "I don't think the children should be punished because adults did bad things."

E-Rate Probes Target Texas Vendor

Federal agents are investigating the E-Rate activities of value-added reseller Micro System Enterprises Inc. of Houston.

The flap over how MSE and the Houston and Dallas school districts may or may not have abused the E-Rate program shows the pattern of the civil and criminal cases due to emerge over the coming months.

MSE's contracts with school districts in Dallas and Houston have prompted controversy in both cities, with charges flying in the media about abuses. The fracas has attracted the attention of federal investigators and prompted at least one whistleblower, or qui tam, investigation that is still under seal.

Federal investigators have issued subpoenas to the Dallas Independent School District for documents related to a \$125 million E-Rate contract the school system signed with MSE and a consortium of other vendors in December 2003.

MSE denies that it is involved in any type of improper conduct, and stated that it has provided services to the school district on time and under budget.

In an e-mail statement to GCN, the company said, "MSE denies all allegations of waste, fraud and abuse."

Donnie Claxton, spokesman for the Dallas school system, confirmed the investigation.

"We will cooperate with whoever makes such a request," he said, referring to reports that the school district has turned over documents subpoenaed by the FCC. "We are cooperating and providing [the investigation by the FBI and the FCC] with the information that is requested."

FCC officials declined to comment on the investigation.

The Dallas Morning News has described instances of officials receiving incentives such as frequent trips on a lavish, 59-foot fishing boat owned by MSE.

Last August, MSE issued a statement rejecting the Dallas Morning News allegations, charging that the articles were factually incorrect, and stating that the articles unfairly ignored the benefits the E-Rate program affords to the city's schoolchildren.

An FBI special agent in Houston said, "We are aware of the E-Rate program, and we are aware of the allegations in the news about the program. We have concerns about how the program is administered."

On a separate front, MSE faces at least one sealed investigation under the Federal False Claims Act involving E-Rate fraud charges. Qui tam investigations typically take several months to complete.

MSE said it was not aware of the qui tam investigation and requested details about it. -Wilson P.

Dizard III