

The Tangled Web of E-Rate

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Some say those who manage the program also profit from its grants to schools and libraries

Congress created the E-Rate program as part of the Telecommunications Act of 1996 in a bid to provide Internet access to schools and libraries that otherwise would not have been able to afford broadband cabling and associated equipment, such as routers and servers.

In the years since, the E-Rate program has come under fire partly because of its arcane and incestuous administrative structure.

Many observers have cited poor oversight of the projects and built-in conflicts of interest in its administrative structure. Federal auditors have criticized the unusual and opaque methods the commission has used to hand out E-Rate funds. The FCC has defended itself against Government Accountability Office criticism, saying that commission lawyers have reviewed and approved the program's structure.

Nonprofit corporation

The FCC doles out the funds via a nonprofit corporation, Universal Service Administrative Co., which receives project applications, rates them and disburses the money.

The company also administers programs to subsidize telecommunications in high-cost and low-income areas, and rural health care facilities.

>From 1998 through the end of 2005, USAC committed more than \$16.48 billion in E-Rate funding to schools and libraries nationwide. The program has disbursed about \$10 billion so far, divided among more than 20,000 applications.

USAC itself is neither fish nor fowl. Under its own bylaws and FCC regulations, it is barred from making policy decisions or interpreting the program's law and regulations.

As a nonprofit organization created to carry out the will of the FCC, its murky legal status created questions about how federal accounting laws and procedures apply to USAC, according to GAO.

GAO cited an analysis by the FCC inspector general in May 2004 stating that the foggy distinction between the commission's regulations and USAC's procedures weakens the program and hinders oversight.

For example, the FCC has a policy of allowing USAC to implement procedures, which the commission later codifies in regulations.

That codification policy raises the question of whether the FCC or USAC itself is actually setting program policies, GAO said in a February 2005 report.

Only now, 10 years after Congress established the E-Rate program and nine years after the FCC created the company, is the commission thoroughly evaluating which federal laws apply to the nonprofit corporation.

USAC executives declined to be interviewed for this story, stating that they are “neutral umpires” in the program and that the FCC should respond to inquiries.

Interest groups

But USAC is not exactly neutral. Under its bylaws, the organization’s 19 board seats are allocated among specific interest groups that nominate prospective members for approval by the FCC. The board has:

- Six representatives of various factions of the telephone industry
- Three from schools eligible to receive USAC funds
- Two representing rural health care providers, which also are eligible to receive program funds
- One representing commercial mobile radio service companies
- One representing information service providers
- One representing cable operators
- One representing low-income consumers
- One representing libraries
- One representing state telecommunications regulators
- One representing state consumer advocates
- USAC’s chief executive officer

The USAC board’s structure prompted one congressional aide with long experience in the issue to observe, “All the USAC directors have conflicts of interest.”

In addition, USAC’s ownership structure adds another level of participation by program beneficiaries.

The FCC directed the National Exchange Carrier Association, a nonprofit corporation the commission sponsors, to create USAC shortly after the Telecommunications Act became law in February 1996. NECA is USAC’s sole stockholder.

The commission created the exchange carrier association to allocate the process of “access charges” that long distance service providers pay to local phone companies for their services. NECA’s board consists entirely of telecommunications company executives, according to the organization’s Web site.

USAC contracts with a for-profit corporation, NECA Services Inc., for administrative support of the E-Rate program. A NECA spokeswoman said the for-profit corporation was a spinoff from the nonprofit corporation.

According to the GAO report and NECA, NECA Services Inc. is independent of NECA. NECA Services Inc. recently changed its name to Solix Inc. The change is so recent that Solix's Web site refers mainly to NECA activities, and a call to Solix's media relations office, as presented on the for-profit corporation's Web site, was answered by a spokeswoman for NECA, the nonprofit organization.

Solix Inc.'s ownership structure is not presented on its Web site and the NECA spokeswoman could not immediately describe it.

According to USAC's annual report, the support services contract through NECA Services Inc., now Solix, has been in place since 2000. It cost about \$33.8 million in 2005 and is estimated at \$32.2 million in 2006.

In that way, one FCC-sponsored nonprofit company hired a for-profit corporation spun off from another FCC-sponsored nonprofit company to provide its administrative support, without competitive bidding, according to the GAO report and USAC's annual report.

The fact that the two boards of directors that oversee USAC are dominated by program beneficiaries has not escaped Congress' attention.

During the hearings last March before the Energy and Commerce Committee, Rep. Ed Whitfield (R-Ky.) asked witnesses, "Do you not see an inherent conflict of interest with this Universal Service Administrative Co. that is administering this program being a subsidiary of the companies that benefit by selling the equipment?"

The FCC witness who responded to that question, former Wireline Competition Bureau chief Jeffrey Carlisle, said that he did not see a conflict of interest. Witnesses from the GAO and the commission's Inspector General Office said they had not studied it.

Conflicts of Interest? Vendors, Recipients Help Run E-Rate

Follow the money. The FCC has built a unique structure to operate the E-Rate program. Funds from the Universal Service Fund, raised through a fee on phone bills, are distributed by nonprofit organizations operated by vendors and program beneficiaries. GAO and Congress have questioned the apparent conflicts in this murky legal structure.

SOURCE: GAO analysis of USAC information