

Michigan School Districts Face Challenges Concerning Use of the Universal Services Fund (E-rate) Dollars

MSBO and Thrun Law Firm, P.C., are teaming together to alert you to an area of increased liability facing Michigan school districts. Most Michigan school districts participate in the Universal Services Fund ("USF") program, overseen by the Universal Services Administrative Company ("USAC"), and the Federal Communications Commission ("FCC"). The E-rate program provides school districts with significant discounts on telecommunications, technology, and Internet services. However, in order to benefit from the program, School Districts must meet certain criteria and comply with complex program rules. Unfortunately, too many school districts throughout the nation fail to meet those obligations.

On September 12, 2008, the FCC released a "Notice of Inquiry" (FCC 08-189), requesting public comment regarding the FCC's intent to vastly increase oversight of the USF program. FCC 08-189 was driven in part by a FCC Inspector General's audit and report which found "issues ranging from poor program design to improper use of funds, including intentional efforts to defraud the program by unscrupulous actors." The FCC's audit of the USF Schools and Libraries program found an improper payment rate of almost thirteen percent (13%). Further, the audit found major deficiencies in "recordkeeping; eligible services; using the correct discount; and entering into a contract too early in the application process."

The FCC requested over twenty-one million dollars for fiscal year 2008, and over twenty-five million dollars for fiscal year 2009, to conduct audits of program participants, including six hundred fifty audits alone in fiscal year 2008. Importantly, as noted in FCC 08-189, when the FCC conducts an audit and finds non-compliance, the penalties may be severe. The FCC often refers the case to the Department of Justice ("DOJ"), which may result "in settlements favorable to the Government and/or *criminal convictions* or civil judgments against the wrongdoers. In addition, where wrongdoers have been convicted or subject to civil judgments, the Commission has debarred or proposed debarment of the wrongdoers consistent with our rules." (Emphasis added). DOJ intervention may be accompanied by a FBI investigation of school district employees' inappropriate conduct involving the USF program.

Given the increased emphasis on oversight, coupled with serious consequences for non-compliance, MSBO and Thrun Law Firm believe that it is important for Michigan school districts to gain a greater understanding of the USF program and moreover, review their own participation in order to ensure full compliance with program rules. To this end, MSBO will include a section on E-rate Compliance, taught by attorneys from Thrun Law Firm, at the upcoming MSBO Financial Strategies Conference, scheduled for January 21-22, 2009. Furthermore, MSBO and Thrun Law Firm offer the following advanced excerpt to provide you with a basic understanding of the program and your responsibilities therein:

The Universal Service Fund

The Communications Act of 1934 first established the national policy of Universal Service: "[t]o make available, so far as possible, to all the people in the United States...a rapid, efficient, Nation-wide and world-wide wire and radio communications service with adequate facilities at reasonable charges." 47 U.S.C. § 151. In the 1996 Telecommunications Act, Congress explicitly codified this federal policy of Universal Service by adding section 254 to the Communications Act.

Section 254, which was intended to ensure that access to the communications network is affordable and ubiquitous, ratified the use of the USF program to assist low income consumers and consumers in high cost areas in obtaining affordable telephone service. It also extended USF support to schools and libraries (known as the "E-rate" or "Schools and Libraries" program). Congress placed the regulatory details of implementing Section 254 in the hands of the Federal Communications Commission ("FCC") and the Federal-State Joint Board on Universal Service.

The USF program is overseen by USAC and the FCC. USAC is a private, not-for-profit corporation, organized at the direction of the FCC. The FCC has designated USAC by federal regulation as the Administrator of the Universal Service support mechanisms established pursuant to the 1996 Act. USAC has been delegated the responsibility by the FCC to collect mandatory contributions from telecommunications carriers to the USF program and distribute those funds in accordance with federal law and regulations. USAC's sole function is to administer the federal universal service support mechanisms, including the E-Rate Program.

As referenced above, the E-Rate Program provides Universal Service Funds to eligible telecommunications service providers and non-telecommunications service providers that provide eligible services to eligible schools, school districts and libraries in the United States.

Four service categories are funded by the E-Rate Program: telecommunications services, Internet access services, the internal connections necessary to permit eligible entities to access the Internet, and basic maintenance of internal connections. Discounts funded by the E-Rate Program range from 20% to 90% of the costs of eligible services, depending on the level of poverty and the urban/rural status of the population served by the eligible school or school district. The dollar amount of discounted services can be quite high.

Applicants apply for funding by submitting one or more FCC Form(s) 470 and 471 to USAC for each annual funding year for which they seek discounts. Each FCC Form 470 and 471 contains one or more Funding Request Numbers (FRNs). Each FRN requests funding in a certain amount for goods and/or services to be provided by a particular service provider. When submitting FCC Form 470, among many other items, the applicant must certify that the applicant has complied with program rules, including:

- (1) That all bids submitted will be carefully considered and the bid selected will be for the most cost-effective service or equipment offering, with price being the primary factor, and will be the most cost-effective means of meeting educational needs and technology plan goals.
- (2) That the services the applicant purchases at discounts provided by 47 USC § 254 will be used solely for educational purposes and will not be sold, resold or transferred in consideration for money or any other thing of value, except as permitted by the Commission's rules.
- (3) That the entity or entities listed on the application have not received anything of value or a promise of anything of value, other than services and equipment sought by means of the form, from the service provider, or any representative or agent thereof or any consultant in connection with this request for services.

Additionally, the applicant must certify that they acknowledge that persons willfully making false statements on FCC Form 470 may be punished by fine or forfeiture, under the Communications Act, 47 U.S.C. Secs. 502, 503(b), or fine **or imprisonment** under Title 18 of the United States Code, 18 U.S.C. Sec. 1001 (false claims or fraud in a government program).

When submitting FCC Form 471, among other items, the applicant must certify that the applicant has complied with program rules, including:

- (1) That the applicant will pay the non-discount portion of the cost of the goods and services to the service provider(s).
- (2) That all bids submitted were carefully considered and the most cost-effective service offering was selected, with price being the primary factor considered, and is the most cost-effective means of meeting educational needs and technology plan goals.

- (3) That the applicant has reviewed all applicable FCC, state, and local procurement/competitive bidding requirements and that the entity or entities listed on this application have complied with them.
- (4) That the services the applicant purchases at discounts provided by 47 USC § 254 will be used solely for educational purposes and will not be sold, resold, or transferred in consideration for money or any other thing of value, except as permitted by the Commission's rules.
- (5) That the applicant has not received anything of value or a promise of anything of value, other than services and equipment requested under the form, from the service provider(s), or any representative or agent thereof or any consultant in connection with the request for services.
- (6) That the applicant acknowledges that failure to comply with program rules could result in civil or criminal prosecution by the appropriate law enforcement authorities.
- (7) That the applicant has examined the request, that all of the information on the form is true and correct to the best of the applicant's knowledge, that the entities that are receiving discounts pursuant to this application have complied with the terms, conditions and purposes of the program, that no kickbacks were paid to anyone and that false statements on the form can be punished by fine or forfeiture under the Communications Act, 47 U.S.C. Secs. 502, 503(b), or fine or imprisonment under Title 18 of the United States Code, 18 U.S.C. Sec. 1001 and civil violations of the False Claims Act.
- (8) That the non-discount portion of the costs for eligible services will not be paid by the service provider. And moreover, that the pre-discount costs of eligible services featured on the Form 471 are net of any rebates or discounts offered by the service provider, and that the provision, by the provider of a supported service, of free services or products unrelated to the supported service or product constitutes a rebate of some or all of the cost of the supported services.

In addition to the above certifications, applicants must comply with rules and regulations codified both within the Code of Federal Regulations, as well as program rules. These rules and regulations include prohibitions against:

- (1) Procuring E-rate funds to subsidize a wide area network, which is owned by the applicant, or to subsidize any other service or equipment that is ineligible for E-rate support.
- (2) Having a relationship with a service provider that is anything but an arms length interaction.

After completing the review of the applicant's FCC Form 471, USAC issues one or more Funding Commitment Decision Letters (FCDLs) setting out USAC's decisions with respect to each of the applicant's separately identified funding requests.

Applicants may pay their bills in full, and then be reimbursed for the discounted amount by submitting, together with the service provider, FCC Form 472 ("BEAR form"). When USAC receives a BEAR Form, it disburses the approved discounted amount to the service provider and requires the service provider to remit payment to the applicant. FCC regulations and the structure of the E-Rate Program do not allow USAC to make payments directly to the applicant schools or libraries. Therefore, USAC must disburse the approved amount on the BEAR Form to the service provider, which then is required to reimburse the applicant school or library. FCC regulations require the service provider to remit the reimbursement to the applicant school or library no later than 20 business days after receiving the reimbursement check, and prior to

tendering or making use of the payment.

Alternatively, service providers may request disbursements from the USF directly. The applicant can pay the non-discounted portion to the service provider, and the service provider can submit a request for the discounted portion by submitting an FCC Form 474 to USAC. When USAC receives an FCC Form 474, it disburses the approved discounted amount to the service provider. By way of example, assume the contract price of services was ten dollars (\$10) and was approved by USAC, and that the applicant's poverty level entitled it to receive a sixty percent (60%) discount. The applicant would pay its non-discounted portion up front totaling forty percent (40%), or four dollars (\$4) to the service provider. The service provider would then recoup the remaining six dollars (\$6) from USAC after it provided the services.

Following the receipt of services and the discounts associated therewith, applicants are required to retain all records associated with the funding request for a period of five years from the last date of service (usually the end of the funding year). This may include all records related to the creation of a technology plan, the request for proposal ("RFP"), the competitive bidding process, the request for funding, the receipt and payment of services, and the receipt of any discounted amounts.

Program Pitfalls

Often school districts believe they are in compliance with program rules, but later learn that they have overlooked serious mistakes. Given the increased emphasis on oversight, it is vitally important that you review your program to ensure compliance. When reviewing your program, watch for these simple pitfalls:

(1) Signatures on FCC Forms: Often administrators sign FCC forms with no knowledge of the program or program rules. Remember, when signing FCC forms 470 and 471, you are certifying, upon threat of civil *and criminal* penalty, that you have complied with program rules, as well as the requirements contained within Federal code and statute. FCC forms should not be signed unless you can *personally* make the required certifications. Remember, though a fellow school district employee may assure you that all the requirements have been met, they are not the one who will receive a visit from an auditor, or potentially the DOJ and FBI, if a rule was violated.

(2) Technology Plans: Participation in the full E-rate program requires that your school district maintain an approved technology plan. Your plan must be based upon the educational needs of your school district and may not be fashioned in a way which is intended to give preference to any specific service provider. Further, with some *very* limited exceptions, the technology plan should not be approved by someone with whom you have an applicant-service provider relationship. You must pay special attention to situations where a school district (usually an ISD) acts as a service provider and concurrently as the approving authority for your technology plan. While this may be allowed under *very* limited and specific circumstances, certain safeguards must be present. Check with your E-rate attorney if you find yourself in that situation.

(3) Competitive Bidding Requirements: Competitive bidding forms the backbone of the USF program, yet remains perhaps the most abused program rule. Program rules and Federal regulations require an arms length relationship. That arms length relationship is violated where a school district shows preference for one service provider above another. Though other factors may be considered, cost *must* be the primary consideration in choosing a service provider. School districts will find it difficult to refute a contention that competitive bidding requirements were violated where the chosen service provider is far more costly than the disappointed bidder.

(4) No Freebies: The no freebies rule is the equivalent to an anti-kickback/bribery rule. The arms length relationship required by competitive bidding may be violated where the service

provider offers free items or services to the school district or its employees. Free items or services may come in several forms. For example, the service provider may offer to pay the school district's portion of the contract, sometimes as a "donation." *Do not allow this to happen*, as it may be viewed as a bribe and most likely violates program rules. Another example occurs where the service provider offers free services (such as free home internet), to administrators or tech personnel. Do not accept the free services. The service provider may also offer to add ineligible services to the package at no cost to the district. You must be careful, as this most likely violates program rules. Sometimes these freebies may be disguised as "rentals." For example, the service provider may offer to "rent" a room in your school, your cell or wireless tower, or part of your network. Though neatly disguised, these schemes may appear to have the same functionality as a kickback for using their services. Above all, make sure you, and only you, are paying your non-discounted portion.

(5) Cost Considerations: As noted above, cost must be the primary consideration when choosing a service provider. While appearing straight forward, your analysis may be complicated by the addition of ineligible services. Often a service provider will "bundle" eligible services with ineligible services. The service provider may offer substantial savings on USF eligible services as long as you also sign up for services not covered by USF. Conversely, the service provider may offer substantial savings on ineligible services if you are willing to award a more expensive USF eligible contract. While on the surface these schemes appear attractive because the increased costs are either offset by savings on ineligible items, or are allocated to items which are discounted by USF, both these schemes may result in awarding a contract to a service provider based upon non-USF eligible criteria and may violate program rules. Especially if the various services or items are not allocated correctly. Eligible and ineligible cost items should be considered separately, with cost of "eligible" services being the primary consideration. Another pitfall may arise if your school district demands the latest, greatest technology, when an older, cheaper means of obtaining the same service exists. Remember, the USF program is designed with cost as a primary consideration.

(6) Reselling or Transferring Services: Program rules prevent a school district from reselling or transferring discounted services or items except in very limited situations. Your district may violate program rules if you allow non-eligible entities to use equipment and services purchased with USF discounts. Be especially careful where you "rent" space to a college or university who then uses your internet and infrastructure, or when you allow other governmental entities to similarly utilize your discounted services.

(7) Wide Area Networks: Except in extremely limited circumstances, wide area networks ("WAN") are ineligible for USF discounts if the transaction provides an ownership interest in the wide area network. School districts should be especially careful of "lease" agreements which have a buy out clause or which have the same functionality as a purchase. School districts must also avoid using USF funds to maintain a WAN previously purchased using non-USF funds.

(8) Adjusting Eligible Services for Ineligible Services: School districts should be especially careful when determining their internet band width needs. While internet for educational use is usually an eligible service, increasing your band width to accommodate ineligible services may violate program rules by utilizing additional USF funds to support an ineligible service. When analyzing your program, remember that certain services may be eligible when provided by a telecommunications carrier, but ineligible for USF funding when provided by a pure internet service provider.

(9) Redundant Services: Some E-rate consultants have advocated drawing USF funding for "redundant" services, reasoning that a school district should have a back-up in case the primary system fails. The FCC previously issued a ruling regarding "redundant" services, finding them ineligible for USF discounts. Do not allow your E-rate consultant to convince you to draw USF discounts on "redundant" services, even if they use a different term. Services which provide the same functionality, to the same population, at the same location, and during the same time frame

(same funding year) are most likely ineligible for USF discounts.

(10) Record Retention: Applicants are required to retain detailed documentation related to the USF program for a period of *at least* five years after the end of services. *ALL* USF related records should be retained, from the initiation of a technology plan, to the final BEAR refund, and everything in between. Remember, emails between your school district and your service provider may be considered a USF related "record" which most likely must be retained. You may want to err on the side of caution and retain anything you believe may be related to the USF program.

Potential Liability

School district employees must take compliance with program rules seriously. Failure to comply may result in serious civil and criminal liability. USF rules and regulations require an arms length relationship with service providers. The rules further require strict adherence to the competitive bidding rules found within 47 CFR 54.504. The FCC has provided guidance for the recovery of E-rate funds when program rules and regulations have been violated. The most egregious violation is identified as a violation of the competitive bidding rules. In the case of a violation of the competitive bidding rules, the FCC has *mandated* the full recovery of *all E-rate funds which have been disbursed*. The same result may occur for violations of other program rules and regulations.

Additionally, false statements on FCC forms for the purpose of obtaining federal funds, such as FCC forms 470 and 471, may be punished by fine or forfeiture under the Communications Act, 47 U.S.C. Secs. 502, 503(b), or fine or imprisonment under Title 18 of the United States Code, 18 U.S.C. Sec. 1001 and civil violations of the False Claims Act. The FCC has self-imposed a five year statute of limitations on recovery; however, a violation constituting a "false claim" carries a six year statute of limitations.

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