

**SUMMARY OF TESTIMONY OF GEORGE M. COTHRAN, INVESTIGATOR,  
CITY ATTORNEY, CITY AND COUNTY OF SAN FRANCISCO:**

On May 16, 2002, City Attorney Dennis J. Herrera on behalf of the People of California, and the San Francisco Unified School District, as whistleblower under the provisions of the False Claims Act, sued among others, Desmond McQuoid, a SFUSD custodial supervisor; NEC Business Network Solutions (NEC BNS); Inter-Tel Technologies, Inc.; Video Network Communications, Inc. (VNCI); US Machinery; and Sprig Electric, for their misdeeds in San Francisco and elsewhere in the United States where a City Attorney investigation uncovered evidence of the likely involvement of some of the same parties in similar wrongdoing.

The City Attorney's Office concluded from its investigation that as it pertained to the San Francisco fraud attempt defendants hijacked and rigged a government procurement and competitive bid process, concealed the presence of equipment ineligible for E-Rate funding in funding applications; filed fraudulent and inflated funding applications to the E-Rate program; conspired to use the fraudulently obtained E-Rate funds for ineligible and improper purposes including the payment of a so-called marketing fee to VNCI which the City Attorney's Office contends is little more than a kickback; and submitted false and fraudulent documentation to the E-Rate program in order to conceal their wrongdoing and facilitate the award of E-Rate monies they were not properly due.

**CONGRESSIONAL TESTIMONY**  
**OF GEORGE M. COTHRAN, INVESTIGATOR,**  
**CITY ATTORNEY'S OFFICE, CITY AND COUNTY OF SAN FRANCISCO**

**"Problems With The E-Rate Program: Waste, Fraud, and Abuse Concerns in the  
Wiring of Our Nation's Schools to the Internet"**

**JULY 22, 2004**

Beginning in the fall of 1999 and extending into fall of 2000, San Francisco Unified School District (SFUSD) served as the staging ground for an attempted defrauding of the E-Rate program. The fraud scheme was expansive in its ambition.

Involved parties included 1) Desmond McQuoid, a SFUSD custodial supervisor; 2) NEC Business Network Solutions (NEC BNS), a United States affiliate of the multi-national corporation, NEC Corp. of Tokyo, Japan; 3) Inter-Tel Technologies, Inc., a publicly-traded telecommunications firm; 4) Video Network Communications, Inc. (VNCI), a publicly traded manufacturer of video-conferencing equipment; 5) US Machinery, a San Francisco Bay Area computer re-seller; and 6) Sprig Electric, a San Francisco Bay Area electrical contractor.

City Attorney Dennis J. Herrera on behalf of the People of California, and the San Francisco Unified School District, as whistleblower under the provisions of the False Claims Act, sued the above parties on May 16, 2002 for their misdeeds in San Francisco

and elsewhere in the United States where our investigation uncovered evidence of their likely involvement in similar wrongdoing.

In San Francisco, the parties had varying degrees of culpability. The main wrongdoers were McQuoid, NEC BNS, VNCI, and Inter-Tel Technologies.

VNCI was the ringleader.

Through two grossly inflated and fraudulent SFUSD E-Rate funding applications, NEC BNS, Inter-Tel, and VNCI sought to defraud the E-Rate program out of \$60,387,081.56.

To accomplish this defendants

- hijacked and rigged a government procurement and competitive bid process, suppressing competition and making the resulting E-Rate proposal vastly more expensive;
- concealed the presence of equipment ineligible for E-Rate funding in the bids and the funding applications;
- filed fraudulent and inflated funding applications to the E-Rate program;
- conspired to use the fraudulently obtained E-Rate funds for ineligible and improper purposes including the payment of a so-called marketing fee to VNCI which the City Attorney's Office contends is little more than a kickback; and

- submitted false and fraudulent documentation to the E-Rate program in order to conceal their wrongdoing and facilitate the award of E-Rate monies not properly due to them.

### **THE RIGGED BID:**

Though VNCI had a financial interest in the outcome of the bid, two VNCI employees, Judy Green and George Marchelos, controlled nearly every aspect of the San Francisco bid process, from provision of design specifications to the selection of winning bidders and the disqualification of a firm not involved in the conspiracy.

a) VNCI, through Green and Marchelos, authored and provided a Request for Proposal (RFP), the equipment specifications mandating the type and amount of equipment bidding firms were required to include in their responses – a job that should have been left to SFUSD.

The VNCI RFP required firms bidding on the Private Branch Exchange (PBX), or phone switch, to include a video-conferencing solution, thus tailoring the project, and the bid responses, in the direction of equipment VNCI manufactured.

The VNCI RFP required a video-conferencing solution even though VNCI and its co-conspirators knew or should have known that video-conferencing equipment was not eligible for E-Rate funding at the time.

Inter-Tel, which had an agreement with VNCI whereby it provided VNCI equipment as part of its E-Rate bids, introduced Marchelos and Green to McQuoid and the SFUSD E-Rate opportunity during the fall of 1999.

From the onset, Inter-Tel included ineligible VNCI equipment as part of the company's proposal.

And as VNCI, through Marchelos and Green, increasingly took control of the bid process, Inter-Tel representatives did nothing to interrupt that control even though they were aware of VNCI's conflict of interest and stood to profit financially from it.

By the time of the San Francisco bid, Inter-Tel's relationship with VNCI was entering its second year. Evidence suggests Inter-Tel had made E-Rate bids including VNCI equipment in other school districts the year prior to the San Francisco bid.

By late 1999 and early 2000, when the San Francisco bid was corrupted, VNCI had business agreements with both Inter-Tel and NEC BNS whereby the two firms included VNCI video-conferencing equipment in their E-Rate bids.

In the case of the San Francisco E-Rate bid, VNCI was planning on selling its equipment to Inter-Tel in order for Inter-Tel to comply with the PBX specifications of the VNCI RFP.

But at the same time, VNCI was bundling its ineligible equipment in NEC BNS's E-Rate bids in approximately 10 school districts across the United States.

Evidence demonstrates that when Inter-Tel submitted its San Francisco E-Rate bid on January 14, 2000, nearly three-quarters of the equipment was manufactured by VNCI.

Consequently, when VNCI representatives Green and Marchelos manipulated the bid process in favor of the NEC BNS and Inter-Tel bids, they were doing so, for the most part, to benefit their employer, VNCI.

On January 3, 2000, Marchelos ran a pre-bid meeting where he distributed and explained the VNCI RFP.

Marchelos introduced himself to the participants of the meeting as a consultant to the school district, though this was not true. Moreover, witnesses said, he did not reveal that he was employed by VNCI.

Regardless, evidence suggests that employees or representatives of Inter-Tel, NEC BNS, and Sprig Electric present at the January 3, 2000 meeting most likely knew some or all of the following facts: Marchelos's VNCI affiliation, VNCI's role as author of the RFP, the RFP's requirement for a video-conferencing solution, the ineligibility of video-conferencing equipment for E-Rate funding, and VNCI's role as certain or most likely supplier of the video-conferencing equipment to the winning PBX bidder.

All three firms were at the time or had been in the recent past involved in E-Rate bid opportunities elsewhere where Marchelos and Green represented VNCI's interests, sometimes influencing school district decisions at the same time as they were doing in San Francisco.

b) VNCI, through Marchelos and Green, and McQuoid took steps to control who responded to the San Francisco E-Rate bid opportunity. Green and Marchelos invited bidders they had past or current business arrangements with – NEC and Sprig Electric

(Inter-Tel did not need to be invited as they alerted VNCI to the opportunity in San Francisco).

Desmond McQuoid failed to advertise the existence of the bid in a local newspaper, as required by California law. At the same time he invited US Machinery with whom he was engaged in a separate criminal fraud conspiracy that would eventually net him a federal prison sentence.

The City Attorney's Office suspects that McQuoid did so at the suggestion or direction of Green and Marchelos and is confident that this suspicion will be confirmed as true through the course of our ongoing litigation and investigation.

c) The bidders, for the most part, did not compete against each other. Sprig Electric bid on cabling, and no other aspect of the RFP. US Machinery bid on servers, and no other aspect of the RFP. NEC bid on servers and switches and routers, and no other aspect of the RFP. And Inter-Tel bid on the private branch exchange (PBX), and no other aspect of the RFP.

The City Attorney's Office suspects that this failure to compete was by agreement between the parties and is confident it will be shown to have been so arranged during the course of litigation and further investigation.

One firm, Pacific Bell Network Integration (PBNI), was invited by McQuoid at the last minute, the day the RFP was distributed to bidders. The City Attorney's Office investigation concluded that PBNI was invited only because McQuoid had been warned by other school district employees that the work prefigured in the VNCI RFP conflicted

with contracts PBNI had with SFUSD. The City Attorney's Office concluded that PBNI was not part of the E-Rate fraud conspiracy in San Francisco.

d) VNCI, through Green and Marchelos, ran the meeting where bids were received and ruled on. Green and Marchelos awarded contracts to firms with whom VNCI had ongoing business relationships and disqualified PBNI, which was in competition with VNCI business partner NEC BNS and Sprig Electric, a Green invitee into the process.

On January 14, 2000, at approximately 3 p.m. in the afternoon, bidders convened in McQuoid's office at 834 Toland St., San Francisco, Calif., the headquarters of the buildings and grounds division of SFUSD.

Bids were turned in and Marchelos and Green ruled on and announced the winners, according to individuals present at the meeting.

The City Attorney investigation concluded that most of the participants in the meeting, with the exception of U.S. Machinery and PBNI, knew Green and Marchelos were VNCI employees, that VNCI had a conflict of interest and that their decision-making role over the bids was improper.

The Inter-Tel representatives certainly knew VNCI had a conflict of interest; nearly three-quarters of the bid they were submitting consisted of VNCI equipment.

NEC BNS representatives knew Green and Marchelos were with VNCI, and they knew VNCI had a conflict of interest as it related to their bid as well. They had worked with Green and Marchelos to include VNCI equipment in approximately 10 NEC BNS E-



Rate bids nationwide during the same funding cycle prior to involving themselves in the San Francisco bid.

Findings of the City Attorney Office investigation suggests Sprig Electric also was aware of the VNCI conflict of interest and the office is confident that its ongoing litigation and investigation will demonstrate conclusively that Sprig Electric was aware of VNCI's conflict of interest and Green and Marchelos' improper control over the bid process.

The City Attorney investigation concluded that Green and Marchelos assumed a key role not only in declaring winning bids for their co-conspirators, but also in declaring PBNI's bid on data (switches and routers) and cabling non-compliant with the VNCI RFP and disqualifying it.

PBNI sales representative Jim Pillsbury later informed the City Attorney's Office during its investigation that he believed the VNCI RFP to be overblown, far too expensive, and much more elaborate than what the district needed.

He felt confident that he knew what the district needed and required in terms of information technology because PBNI was already under contract with the school district, laying cable at 30 schools and providing other telecommunications and information technology services. In fact, around the time of the bids, PBNI had been laying cabling in many of the schools covered by the VNCI RFP.

Pillsbury said he had engaged in discussions with McQuoid about what kind of technology solutions made the most sense for the district, and he felt he had received

McQuoid's consent to produce a bid response that did not exactly conform to the VNCI RFP, but which, he believed, was more reasonable, dramatically less expensive, and would work just as well.

Pillsbury recalls that at the January 3, 2000 meeting where Marchelos distributed the VNCI RFP, McQuoid informed the gathering that the data communications (switches and routers) solution called for in the VNCI RFP – Asynchronous Transfer Mode (ATM) -- was not necessarily his preferred solution and that he would also entertain other types of data solutions.

Likewise, Pillsbury believed that since PBNI was laying cable at 30 schools for the district he knew enough about the district's cabling needs to depart from the VNCI RFP cabling specifications. Again the PBNI proposal for cabling was less expensive and less grandiose than that called for in the VNCI RFP.

The VNCI RFP called for 30 cable lines into each classroom. The cable jobs PBNI was working on for the district at the time included 5 to 7 lines into each classroom. Pillsbury believed this more modest, less expensive cabling scheme was what was best for the district, especially considering that most of the schools covered by the VNCI RFP were elementary schools and less computer intensive.

Pillsbury instructed his team to prepare a bid that departed from the VNCI RFP in these two ways: Instead of the more expensive ATM data solution, PBNI proposed a less expensive alternative; PBNI also offered a less expensive and more modest cabling scheme.

But according to meeting participants, both Marchelos and Green intervened and declared the PBNI bids on cabling and data, or switches and routers, non-complaint, thus paving the way for VNCI business partner NEC BNS to win the data bid and Sprig Electric, which had been invited into the procurement process by Green, to win the cabling portion.

Marchelos and Green orchestrated this result even though it produced a much more costly solution and would have eaten up many millions more E-Rate dollars.

PBNI offered a range of data bids costing between \$1.2 million and \$7.5 million. After Green and Marchelos eliminated PBNI, they awarded the work to NEC BNS at a cost of \$19.7 million.

PBNI submitted a \$6.7 million cabling bid. After Green and Marchelos eliminated the PBNI bid, they awarded the work to Sprig Electric for \$13.6 million.

In its guilty plea on May 27, 2004, NEC BNS provided a version of events at the bid open meeting that supports City Attorney investigative findings regarding Judy Green's and George Marchelos' roles in selecting winning bidders.

#### **THE CONCEALMENT OF VNCI EQUIPMENT IN THE INTER-TEL BID:**

Despite the ineligibility of its equipment for E-Rate funding, VNCI had bundled \$15,312,435.60 of its equipment into Inter-Tel's \$20,633,732.60 bid, according to Inter-Tel documents.

When the Form 471 application was prepared by VNCI, Inter-Tel and NEC BNS representatives, Inter-Tel's funding request was characterized as being merely for a PBX, a phone switch, which was eligible for E-Rate funding. The PBX parts list that accompanied the Form 471 was crafted in such a way as to conceal the fact that nearly three quarters of the dollar amount of the request was ineligible for E-Rate funding in Year 3 of the program (FY 2000-01)<sup>1</sup>

Based on the findings of its investigation, The City Attorney's Office suspects Green and Marchelos and representatives from Inter-Tel of conspiring to falsify these PBX parts lists and conceal the true nature of the equipment so it could defraud the E-Rate program into funding ineligible equipment. The City Attorney's Office is confident its ongoing litigation and investigation will confirm this suspicion.

The City Attorney's Office further believes that VNCI, NEC BNS and Inter-Tel similarly falsified PBX parts lists and E-Rate applications nationwide in fiscal year 2000-01 to conceal VNCI equipment.

Evidence further suggests that as part of other school district E-Rate applications, NEC BNS, Inter-Tel and VNCI provided false and misleading answers to the E-Rate program administrators when asked specifically about the function of the fraudulently-described VNCI equipment.

When it plead guilty on May 27, 2004, information provided by NEC BNS supported City Attorney findings indicating that Inter-Tel and VNCI conspired to falsely

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<sup>1</sup> Video-conferencing equipment became eligible for E-Rate funding in Year 4 of the program (FY 2001-02).

describe PBX parts to conceal the ineligible VNCI equipment in the San Francisco E-Rate application.

**THE FRAUDULENT INFLATION OF THE SFUSD APPLICATIONS:**

As a result of its investigation, the City Attorney's Office concluded that the rigged bid process orchestrated by the defendants in San Francisco produced costs much higher than would have grown out of a legal, competitive bid.

The rejection of the PBNI bid is one example of how the defendants' corrupt process spiked prices.

Another example lies in the NEC BNS design of the Local Area Networks it planned to implement in SFUSD, which called for servers and switches in every classroom, a magnitude of equipment deployment that was entirely unnecessary and constitutes "gold plating." (As a point of interest, this same "gold plating" technique of placing servers and switches in every classroom was proposed nationwide by NEC BNS in fiscal year 2000-01.)

If the San Francisco bid had been open and competitive, it is unlikely a firm would have submitted a bid calling for servers and switches in every classroom, and inconceivable that any such bid would have been selected in a truly competitive process. The conspirators' gold-plated proposal thus greatly inflated the cost of the proposed project.

While the rigged bids were fraudulently inflated, a more dramatic financial fraud attempt occurred when NEC, Inter-Tel and VNCI conspired to submit two grossly inflated Form 471 applications in January 2000.

One of these applications for funding was premised on no bid process whatsoever.

These three parties, with the acquiescence and later acceptance of McQuoid, took the total of the rigged bid prices – \$63,383,768.66 – and inflated that total project cost to \$135,142,258.70 when they submitted Form 471 202712 and Form 471 202719 to the Universal Service Administrative Company (USAC) in mid-January 2000.

After factoring in discount rates, Form 471 202719 asked for \$75,020,586.05 in E-Rate funds and Form 471 202712 asked for \$37,975,023.45 in E-Rate funds for a total E-Rate funding request of \$112,995,609.50.

Had McQuoid, VNCI, Inter-Tel and NEC BNS used the results of the rigged bid process they would have requested \$52,608,527.94 in E-Rate money, itself a fraudulent request in that it grew out of a rigged bid process.

But the second layer of fraud – the inflation of the Form 471s – was more ambitious by far. It amounted to \$60,387,081.56 ( $\$112,995,609.50 - \$52,608,527.94$ ).

But even \$52,608,527.94 would have been dramatically more than what was reasonable and ethical.

In 2000, SFUSD had a wide area network affording nearly every classroom and office a phone system, access to the Internet and all the other benefits of a modern information technology and telecommunications system including computers for students. It could be argued that the entire VNCI RFP project was not needed nor wanted by SFUSD. The individuals the City Attorney's Office spoke to in the SFUSD Information Technology and Telecommunications division – the proper avenue for E-Rate applications – certainly voiced this point of view.

When inflating project costs on the Form 471s, NEC BNS and VNCI abandoned the results of the rigged bid process and created a new, even less competitive, and even more costly scheme, relegating Sprig Electric and US Machinery to subcontractor status and elevating NEC to prime contractor over the server and cabling portions of the project, areas in which they had lost the bid to Sprig Electric and US Machinery.

The City Attorney's Office believes this was done in order to ensure that E-Rate money flowed to firms with which VNCI had formal business ties.

NEC BNS and Inter-Tel had agreements with VNCI whereby NEC BNS and Inter-Tel shared with VNCI a percentage of profit from successful E-Rate deals identified and brought to the attention of NEC and Inter-Tel by VNCI. The agreement also called for NEC BNS and Inter-Tel to bundle VNCI video-conferencing equipment into its E-Rate bids.

The more E-Rate money VNCI steered toward NEC BNS and Inter-Tel, the more money these firms would presumably pay VNCI under their arrangements.

The City Attorney's Office has long believed this "marketing fee" paid to VNCI constitutes little more than a kickback. These fees were paid to VNCI not only for identifying and bringing E-Rate funding opportunities to the attention of NEC BNS and Inter-Tel, but also to compensate VNCI for illegal activity, such as rigging bids and inflating costs.

Though Sprig Electric had produced the lowest responsive bid on the cabling portion of the RFP, and though US Machinery produced the lowest responsive bid on the servers portion of the RFP, McQuoid, NEC BNS and VNCI employees Green and Marchelos orchestrated a process by which US Machinery and Sprig were replaced by NEC BNS when it came time to fill out the Form 471 E-Rate funding application.

According to the City Attorney investigation, Judy Green informed a Sprig Electric consultant at the January 14, 2000 bid opening meeting that NEC would most likely be the prime contractor for the cabling portion, despite the fact that NEC had issued a more expensive bid on that section of the RFP. Later, Marchelos convinced a Sprig Electric official to sign a letter agreeing to become a subcontractor to NEC BNS for the cabling portion of the project.



Representatives of US Machinery told the City Attorney's Office that Desmond McQuoid called them shortly after the January 14, 2000 bid opening meeting and presented them with a choice. Either fill out the application for E-Rate funding by the following Monday or Tuesday (January 14, 2000 was a Friday) or accept subcontractor status to NEC for the server portion of the project. Since US Machinery did not have the means nor the expertise to fill out an E-Rate funding application, they relented to NEC as prime contractor.

The City Attorney's Office suspects that McQuoid performed this act at the direction of Green, Marchelos, and representatives of NEC BNS and is confident this suspicion will be confirmed through the course of litigation and further investigation.

US Machinery did not strike a subcontracting agreement with NEC BNS until August 2000. Representatives of US Machinery informed the City Attorney's Office during the course of its investigation that the firm felt as if NEC BNS was ignoring US Machinery's frequent requests to formalize their subcontractor role. They said it took many calls to NEC BNS and McQuoid, in addition to hiring a business manager to concentrate his efforts on obtaining the agreement, for the effort to be realized.

It is unclear if Sprig Electric ever signed an actual subcontract with NEC BNS. What is known is that a NEC BNS representative asked a Sprig Electric manager to sign a document swearing that Sprig Electric had assessed the capacity of the SFUSD electrical system and its ability to accommodate the additional information technology

equipment the E-Rate applications was requesting – even though Sprig had conducted no such analysis. When the Sprig manager declined to do so, he said he never heard again from NEC BNS on any issue related to the E-Rate project.

Despite the fact that on January 14, 2000 when the bids were opened and VNCI, through Marchelos and Green, picked the winners, including Sprig Electric and US Machinery, and despite the fact that US Machinery did not strike an agreement to subcontract for NEC until August and Sprig may never have signed any such agreement, NEC BNS prepared and signed a purchase agreement with SFUSD on January 14, 2000 which included portions of the bid won by US Machinery and Sprig Electric.

A signature purporting to be that of Thomas J. Burger, the then-president and CEO of NEC BNS, is on the signature line of the purchase agreement for NEC BNS. The City Attorney's Office has no way of commenting on the authenticity of this signature.

A signature purporting to be that of Desmond McQuoid is on the signature line for SFUSD, even though he had no such authority. This signature is a forgery.

The City Attorney's Office suspects that either Green or Marchelos or a NEC BNS representative committed this forgery.

In pleading guilty to federal criminal charges on May 27, 2004, NEC BNS provided information that supports the City Attorney's conclusion that Green and

Marchelos were the prime movers behind the decision to relegate Sprig Electric and US Machinery to subcontractor status in order to benefit VNCI business partner NEC BNS.

Placing NEC BNS into the prime contractor role, and therefore placing NEC BNS on the E-Rate funding application as it pertained to cabling and servers, meant more E-Rate money would potentially flow to NEC BNS and presumably meant more money would flow to VNCI through their "marketing fee" arrangement with NEC BNS.

After rigging the bid process and allocating contracts as they saw fit, regardless of price or merit, representatives of NEC BNS and Inter-Tel, and Green and Marchelos, on behalf of VNCI, placed NEC and Inter-Tel's E-Rate identifier number (called a spin number) on two Form 471 applications (numbers 202712 and 202719) requesting a total of \$112,995,609.50.

Form 471 202712 included an additional 18 schools not included in the bid process governed by the VNCI RFP. This Form 471 was premised on no bid process whatsoever. The prices on this Form 471 were most likely plucked out of thin air. Only NEC BNS and Inter-Tel's spin numbers were included. This entire application was denied by the Universal Service Administrative Company due to the use of an improper discount rate.

The City Attorney investigation found that McQuoid, Sprig Electric and US Machinery were most likely unaware of the fraudulent inflated nature of Form 471

202719 or even the existence of Form 471 202712 until after they were submitted. The evidence supports a conclusion that VNCI, through Green and Marchelos, and representatives of NEC BNS and Inter-Tel joined together in preparing and submitting these fraudulently inflated applications without consulting with or including anyone from SFUSD, including three of their bid rigging co-conspirators.

When NEC BNS pled guilty to federal criminal charges and settled civil claims with the City Attorney's Office and the SFUSD on May 27, 2004, NEC BNS admitted the following:

*On or about January 15-18, 2000 Consultants One and Two<sup>2</sup> and defendants' employees met to prepare the USAC application Form 471 for the SFUSD and other school districts. The Form 471 is a school district's application for E-Rate funding. It is supposed to set out the selected vendors' bid amounts, memorialized in contracts, for the equipment and services called for by the district's Request for Proposal. Consultant One told the defendant's employees the total prices she wanted to submit to USAC on the Form 471s and then directed them to prepare false spreadsheets justifying those prices. With NEC/BNS's assistance Consultant One prepared the SFUSD Form 471 with inflated prices. On or about January 19, 2000, Consultant Two delivered the SFUSD Form 471 to USAC. ... In addition, Consultants One and Two worked with others to falsely describe*

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<sup>2</sup> In the NEC BNS guilty plea, Consultant One and Consultant Two are identified as sales representatives working for a "company that manufactured and installed video-teleconferencing switches," also described in the plea document as "VX Company." In its plea, NEC BNS acknowledged entering into an agreement with this VX Company "under which (NEC BNS) agreed to pay VX Company a fee for all business opportunities VX Company brought to the (NEC BNS)."

*the actual equipment to be supplied to SFUSD, including VX Company equipment, which is not eligible for funding under the E-Rate program, in order to have E-Rate pay for that equipment."*

During the course of its investigation, the City Attorney's Office discovered that the business relationship between VNCI and Inter-Tel and VNCI and NEC BNS reached across the United States.

The City Attorney investigation found that at the same time VNCI and its co-conspirators were rigging the San Francisco bid, concealing VNCI equipment in and inflating the San Francisco applications, VNCI and its employees, including Green and Marchelos, were most likely conspiring with NEC BNS and others to rig bids, conceal equipment, and inflate applications in several other school districts, a suspicion supported by NEC BNS when it entered a guilty plea in federal court on May 27, 2004 to anti-trust violations in other states.

In the course of its investigation, the City Attorney's Office had an opportunity to speak to Dorothy Travis Johnson, the principal and chief executive officer of the Ceria M. Travis Academy in Milwaukee, Wisconsin.

She described her experience in dealing with Green and Marchelos and NEC BNS as, "This is a little nightmare to me."

In the course of interviews conducted in the Spring of 2002, Johnson told the City Attorney's Office that in fiscal years 2000-01 and 2001-02, VNCI, through Green and Marchelos, selected winning bidders and filled out and submitted Form 471s that included NEC BNS and VNCI equipment.

In fiscal year 2000-01, the Marchelos and Green application netted \$1.2 million for NEC BNS and VNCI.

Johnson said Marchelos took bids submitted to her by local companies back to California and she never saw them again. "George has vendors pre-selected," she said, referring to Marchelos. "Local people gave me bids. George took that but I know he's going to give it to his vendors."

Referring to both Marchelos and Green, Johnson said, "They walked us through this. They did all the numbers. George did the whole application for me."

She said the NEC BNS was one of the main vendors in the fiscal year 2000-01 and fiscal year 2001-02. She told the City Attorney's Office she believed her name was forged on several documents including a purchase agreement with a company providing servers.

The purchase agreement, she said, called for 12 servers to be deployed at her school. Johnson said she showed the purchase agreement to a friend who was

knowledgeable about information technology and he informed her that she needed only one server for a school her size.

During the course of its investigation, the City Attorney's Office came to suspect that VNCI was conspiring with Inter-Tel and other firms to rig bids, conceal VNCI equipment, and inflate applications in California (West Fresno School District, Fresno) and Michigan (Highland Park School District, Highland Park) during the same general time period as the other school district frauds.

In August 2003, Duane Maynard, the former chief estimator for the Fresno-based Howe Electric, pled guilty to federal criminal bid rigging charges and in the process pointed toward the involvement of co-conspirators.

Maynard stated in his plea:

*On or about February 19, 1999 the defendant, on behalf of his employer, attended a pre-bid meeting at the West Fresno Elementary School District (WFESD), in the Eastern District of California. The pre-bid meeting related to a project to provide, among other things, equipment and services related to telecommunications, Internet access, and internal connections to the WFESD ("the WFESD E-Rate Project"). Those present at the pre-bid meeting understood that the project was related to the E-Rate program, in which the Universal Service Administrative Company ("USAC") subsidizes the provision of*

*telecommunications, Internet access, and internal connections to underprivileged schools.*

*Competitive bidding was required for the WFESD E-Rate Project. Nonetheless, the defendant, together with school district representatives, a consultant, and others representing potential competitors, combined, conspired, and agreed that:*

*1) The defendants' employer would be the successful bidder and have general responsibility for the WFESD E-Rate Project;*

*2) No co-conspirator other than the defendant's employer would submit a general bid for the WFESD E-Rate Project;*

*3) Other co-conspirator companies would be the defendant's employer's subcontractors for the WFESD E-Rate Project; and*

*4) any bid competing with the defendant's employer's bid would be stricken as nonresponsive.*

*The defendant, his superiors at his company, and his other co-conspirators did what they agreed to do to carry out the conspiracy. They further acted in concert to provide equipment and services related to the WFESD E-Rate Project and receive from USAC payment therefor.*



Documents obtained from USAC by the City Attorney's Office show Inter-Tel subcontracting to Howe as part of Howe's E-Rate contracts during the same time period. The City Attorney's Office suspects Inter-Tel to be one of the co-conspirators Maynard referred to in his guilty plea and is confident its ongoing litigation and investigation will confirm this suspicion and show Inter-Tel to indeed be one of Howe Electric's bid rigging co-conspirators.

Likewise, documents obtained from USAC by the City Attorney's Office show VNCI involved in E-Rate applications out of West Fresno Elementary School District during the same funding years in which Howe Electric was the prime contractor.

Sprig management officials and its consultant Bob Waters informed the City Attorney's Office that the firm was involved in West Fresno E-Rate bids during the same time period.

The City Attorney's Office suspects that both VNCI and Sprig were among the co-conspirators Maynard referred to in his guilty plea and is confident its ongoing litigation and investigation will confirm this suspicion and show that VNCI and Sprig were indeed among Howe Electric's bid rigging co-conspirators in West Fresno.

## **THE PLAN TO MISUSE E-RATE FUNDS:**

In other school districts where Inter-Tel and NEC BNS appear to have acted in concert with VNCI to rig bids, conceal VNCI equipment in bids and inflate applications, evidence suggests the firms agreed to not charge the school districts their portion of the project costs, which usually came to 10 percent of the total cost.

Based on its evidence, the City Attorney's Office believes VNCI, Inter-Tel, and NEC BNS built this cost into their non-competitive bids and later into the inflation of E-Rate applications.

The City Attorney's Office believes the inflated costs associated with the two San Francisco Form 471s were to be used, in part, for this purpose.

Another purpose of the fraudulently inflated project costs in San Francisco would have gone to fund equipment not eligible for E-Rate monies – in addition to the ineligible VNCI video-conferencing equipment.

The City Attorney investigation found that NEC BNS had agreed to spend more than \$10 million of the inflated project costs to pay for 2250 computer work stations, which are not eligible for E-Rate funding. When NEC BNS pled guilty and settled civil claims with our office, they admitted as much, and stated that though NEC BNS

characterized this \$10 million expense as an "in-kind" donation, it had indeed planned on using a portion of its E-Rate award to pay for the workstations.

**LYING TO USAC:**

On September 22, 2000, USAC issued a Funding Commitment Decision Letter (FCDL) to McQuoid regarding Form 471 202719.

The FCDL announced a total award to Inter-Tel for the PBX of **\$14,791,335.38**. Inter-Tel had requested \$17,769,776.27 for the PBX.

The request had been reduced to remove some of the VNCI equipment as ineligible though it is not clear from USAC documents if the equipment was deemed ineligible because USAC understood it to be video-conferencing equipment.

NEC BNS was awarded **\$18,156,829.34** in funding for cabling, the exact amount they had requested.

NEC BNS was awarded **\$15,731,613.33** in funding for data equipment (switches and routers). USAC reduced the requested amount of \$18,953,751.00 to remove funding for an extended warranty.

NEC BNS was not awarded the \$18, 249,395.09 it requested for servers. USAC denied the entire funding request because more than 30 percent of the use of the servers would have been for ineligible purposes. It is not clear from USAC documents what ineligible purposes the servers would have been put to.

Likewise NEC BNS was denied its entire service contract request of \$1,898,970.78.

The total E-Rate award to SFUSD as a result of the two fraudulently inflated applications was \$48,679,778.05

Prior to issuing the award, USAC pursued its normal program integrity review process. In addition, USAC subjected the McQuoid applications to an Item 25 review, a higher level of scrutiny USAC brings to bear on some but not all applications.

In the course of this two-fold review, USAC asked many questions of McQuoid regarding his applications. Moreover, USAC asked for documents to support McQuoid's answers.

Based on the findings of our investigation, the City Attorney's Office concluded that VNCI, through Green and Marchelos, controlled this process as well – with NEC BNS and McQuoid's knowledge and consent.

We discovered a July 27, 2000 letter from McQuoid to VNCI Chief Financial Officer Bob Emery authorizing VNCI to assist SFUSD in the preparation and submittal of School's and Library Division's (SLD) Item 25 review.

"Under the direction of the District, VNCI will be aggregating the information required to complete the Item 25 review. We authorize VNCI to collect, collate and prioritize documentation for our intended contractors to facilitate the completion of the Item 25 review."

Likewise the City Attorney's Office discovered a letter from John Colvin, NEC BNS Director of Sales, Public Sector, to Judy Green, identified as VNCI Regional Manager, authorizing her "to provide documentation on behalf of NEC BNS to facilitate the completion of the Item 25 review."

But it also appears from the evidence that Green and Marchelos, on behalf of VNCI, NEC BNS, and Inter-Tel controlled pre-Item 25 responses to USAC inquiries as well.

We base this conclusion in part on the fact that McQuoid's signature was forged on an initial pre-Item 25 review submittal of information justifying various aspects of the applications.

Evidence suggests that Green and Marchelos, acting on behalf of VNCI, NEC BNS, and Inter-Tel either prepared, helped to prepare, directed the preparation of and transmitted or knew of the preparation of and transmittal of counterfeit, misleading and fraudulent documentation meant to conceal wrongdoing and facilitate the award of E-Rate money not properly due to NEC BNS, Inter-Tel, and VNCI.

Evidence indicates that as part of the Item 25 review, Green, Marchelos, and McQuoid caused to be sent to USAC a list of individuals who purportedly attended the pre-bid meeting on January 3, 2000. Two of the fourteen supposed attendees listed as having signed in and being present were not actually present.

Both names and signatures are clearly in the handwriting of McQuoid. City Attorney interviews with both individuals indicated that neither was present. In one instance, the individual purported on the sign in sheet to have been present at the pre-bid meeting had never been to San Francisco.

A third individual who signed in as having attended the pre-bid meeting and picked up an RFP in order to submit a bid, informed the City Attorney's Office that he was a friend of McQuoid's who was doing some minor alarm repair for McQuoid at the buildings and grounds division when McQuoid asked him to come to the meeting where he was asked by another individual believed to be Marchelos to sign in as having been present as a potential bidder. This individual informed the City Attorney's Office that he had no intention of bidding, had no capacity to do so, and had no real understanding of

what transpired in the meeting except that he was asked to sign in as if he were a potential bidder.

During the review process conducted by USAC, documents bearing the NEC logo were transmitted to USAC purporting to show the size of seven of the schools to receive cabling funded by the San Francisco E-Rate proposal.

The size of these schools was grossly exaggerated on these documents, increasing the seven elementary schools by 73 rooms and 58.75 acres. The City Attorney's Office concluded that the reason for the exaggeration was to better justify the excessive request for cabling funds.

In submitting to USAC proof that SFUSD had the ability to pay its approximately \$10 million share of the E-Rate project costs, McQuoid conspired with Judy Green and others to submit fraudulently altered budget documents.

The key document, a budget summary page, was altered to show that the school district had \$41.5 million available under a line item fraudulently titled "E-Rate District Match."

By the time this falsified document was transmitted to USAC in August 2000, the SFUSD Board of Education had already approved a fiscal year budget for July 1, 2000 to

June 30, 2001 and no such line item was included. In fact, in a separate portion of the true budget, SFUSD reduced the available E-Rate match fund from \$1.26 million to zero.

Inter-Tel sales representative Jason King informed the City Attorney's Office that he attended a meeting where Judy Green of VNCI, Gerard McNulty of NEC BNS, and he assisted McQuoid in responding to the USAC Item 25 review. During this meeting, Green asked for and received SFUSD budget information and documentation to submit to USAC.

When USAC asked McQuoid to provide a Technology Plan, a requirement of receiving USAC funding, McQuoid simply obtained one from Green which had been written by Green and others as part of a Los Angeles Unified School District planning process. The Green-provided plan had not been subject to any discussion or deliberative process by anyone at SFUSD nor had it been submitted and approved by the SFUSD Board of Education.

As part of the Item 25 review, USAC requested a copy of bid results, the RFP, and other bid-related documents. Spreadsheets prepared by and transmitted to USAC by McQuoid and others, most likely VNCI, through Green and Marchelos, on behalf of NEC BNS and Inter-Tel, contained false information about the bid results. And the copy of the VNCI RFP sent to USAC had the references to the required video conferencing solution omitted in order to conceal the fact that PBX bidders were required to include ineligible equipment in their bids.



Evidence suggests that in justifying the cost of a labor/service agreement with NEC BNS, Green and Marchelos, on behalf of NEC BNS, submitted a document to USAC claiming that the costs were at the proposed rates because San Francisco had "no mass transit" system when in fact it has a robust mass transit system, and some schools were 45 miles apart even though San Francisco is seven miles by seven miles.

McQuoid's signature on this document is clearly forged.

### **CONCLUSION**

The City Attorney's investigation into the E-Rate proposal that was purportedly submitted on behalf of the San Francisco Unified School District demonstrated that the proposal was fraudulent in almost every respect. The proposal resulted from a bid process that was rigged from its inception. The bid process was controlled by parties who had a direct financial stake in its outcome. After the conspirators prevailed in the rigged process, they included a large amount of ineligible equipment in their funding requests. They also grossly inflated the prices used in their funding requests, and made numerous misrepresentations during the funding process.

Fortunately, when Superintendent Arlene Ackerman learned of these proposals, she suspected they were fraudulent. The San Francisco Unified School District therefore did not accept any funding from the E-Rate program as a result of these applications. However, the City Attorney's investigation demonstrated that these same conspirators successfully obtained E-Rate funding for other school districts, based on similar fraudulent tactics. Investigations into the scope of these improper activities are on-going.

## *George M. Cothran*

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### **EMPLOYMENT:**

- *San Francisco City Attorney (9-7-99 to present)  
1390 Market St., Suite 250, San Francisco, Calif., 94102  
415-554-3900*

Position: Investigator

Duties: Conduct interviews and interrogations, surveillance, document review and analysis, and public records research; write reports and memoranda, confer with deputy city attorneys on strategy, findings of investigation and preparation of litigation.

- *San Francisco Weekly (11-1-90 to 9-1-99)  
185 Berry St., Lobby 4, Suite 3800, San Francisco, Calif., 94107  
415-536-8100*

Position: Staff writer

Duties: Researched and produced written reports on newsworthy events and individuals.

### **EDUCATION:**

- *San Francisco State University  
1600 Holloway Ave., San Francisco, Calif., 94132  
415-338-1111*

Major: Journalism  
Attended 1988 to 1991

### **PROFESSIONAL TRAINING:**

- *Behavioral Analysis and Training Institute  
P.O. Box 2497  
Livermore, Calif., 94551-2497  
925-455-5021*

Completed Interview and Interrogation Techniques course (12-6-99 to 12-11-99)

- *Investigation Training Institute  
P.O. Box 770579  
Orlando, Fla., 32877-0579  
407-816-7273*

Completed Fraud Investigations Methods Course (9-9-02 to 9-11-02)

Completed Tracing the Money Trail Course (9-12-99 to 9-13-02)

### House Committee on Energy and Commerce

Witness Disclosure Requirement -

"Truth in Testimony" Required by House Rule XI, Clause 2(g)

Your Name: GEORGE COCHRAN

- 1. Are you testifying on behalf of a Federal, State, or Local Government entity? Yes  No
- 2. Are you testifying on behalf of an entity other than a Government entity? Yes  No

3. Please list any federal grants or contracts (including subgrants or subcontracts) which you have received since October 1, 1999:

I HAVE RECEIVED NO SUCH GRANTS OR CONTRACTS

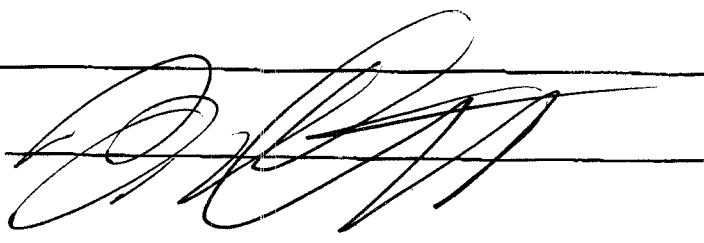
4. Other than yourself, please list what entity or entities you are representing:

SAN FRANCISCO CITY ATTORNEY

5. If your answer to question number 2 is yes, please list any offices or elected positions held or briefly describe your representational capacity with the entities disclosed in question number 4:

6. If your answer to question number 2 is yes, do any of the entities disclosed in question number 4 have parent organizations, subsidiaries, or partnerships to the entities for whom you are not representing? Yes No

7. If the answer to question number 2 is yes, please list any federal grants or contracts (including subgrants or subcontracts) which were received by the entities listed under question 4 since October 1, 1999, which exceed 10% of the entities revenue in the year received, including the source and amount of each grant or contract to be listed:

Signature: 

Date: 7-18-04