

**WRITTEN STATEMENT**

**of**

**WILLIAM F. MAHER, JR.**

**Chief**

**Wireline Competition Bureau  
Federal Communications Commission**

**Before the  
Subcommittee on Oversight and Investigations  
of the Committee on Energy and Commerce  
United States House of Representatives**

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## **Executive Summary of the Statement of William F. Maher, Jr.**

Good morning, Chairman Greenwood, Representative DeGette, and distinguished members of the Subcommittee. I am chief of the FCC's Wireline Competition Bureau, and have served in this post since August 2002. I appreciate the opportunity to discuss the FCC's continuing efforts to improve the E-rate program and the lessons learned from the recently concluded criminal and civil case involving NEC-BNS, an E-rate service provider, associated with Funding Year 2000. Your attention to the issues involved with the E-rate program, as evidenced by this and last month's hearings, confirms the FCC's understanding that Congress wants the program administered efficiently and fairly.

In its first six years, the E-rate program has committed over \$11 billion to permit an average of almost 90,000 schools and libraries each year, including those in the nation's poorest and most isolated communities, to pay more affordable, discounted rates. In 1998, the first year of the program, only 51 percent of classrooms in public schools were connected to the Internet. The figure reached 92 percent in 2002. And 94 percent of schools now have broadband connections.

In reviewing these numbers, the E-rate program has been an overall success. But at the same time, the program has been the target of some bad actors and those who have tried to beat the system. The subject of today's hearing, involving NEC-BNS, is an object lesson for the FCC, for USAC, and for all participants in the E-rate program.

On May 27, 2004, NEC-BNS agreed to plead guilty to two criminal charges – wire fraud and bid rigging – and to pay a total \$20.6 million criminal fine, civil settlement, and restitution for its activities related to the E-rate program, largely in Funding Year 2000. NEC-BNS was charged with wire fraud for entering a scheme to defraud the E-rate program and the San Francisco Unified School District. NEC-BNS was also charged with bid rigging and allocating contracts at five school districts in Michigan, Wisconsin, Arkansas, and South Carolina. The monetary amount of the civil settlement makes the E-rate program whole. Because NEC-BNS has pled guilty to activity related to the E-rate program, it is subject to suspension and debarment under the Commission's E-rate debarment rule. On May 27, 2004, NEC-BNS petitioned the Commission for waiver of its suspension and debarment rule, and there is a proceeding pending on that petition.

There are multiple lessons to be learned from the NEC-BNS case. This case illustrates the importance of deterring those who would seek to defraud or abuse the E-rate program. To deter bad actors, E-rate applicants must be held accountable for the contents of their applications and other filings. The Wireline Competition Bureau has already recommended a number of relevant rule changes, described below, to the Commission for action at its August 2004 Open Meeting. In the past 15 months, the Commission has adopted several new rules that address aspects of the NEC-BNS situation. Moreover, I have directed USAC's chief executive officer to report to the Bureau on changes to procedures in light of NEC-BNS, and the staffs of the FCC and USAC are in close communication to improve USAC's review process.

An initial step in deterring bad acts is to require applicants to document thoroughly their participation in the E-rate program. The Wireline Competition Bureau has recommended expansion of the document retention requirements for applicants, in order to maintain a comprehensive paper trail for five years after receipt of E-rate supported services. The Bureau has also recommended improvements to the certifications that beneficiaries make regarding their compliance with substantive program rules. We plan to modify numerous E-rate forms to expand

the required certifications. Expanded certifications help deter bad actors because their falsification is a federal criminal violation.

As an additional deterrent to bad actors, the Bureau is recommending that the Commission reinforce that USAC should engage in heightened scrutiny of applications from E-rate beneficiaries that have violated the statute or the Commission's rules in the past. This is consistent with the general framework adopted in the *Puerto Rico DOE Order* of 2003 to deal with situations in which one or more parties to an E-rate application is under investigation for potential waste, fraud or abuse.

The Commission's E-rate debarment rule is a significant deterrent to fraudulent behavior. Since the rule's adoption in 2003, the FCC's Enforcement Bureau has debarred three individuals in matters not related to NEC-BNS. The Commission has sought comment on whether to expand the reach of the debarment rule as a further deterrent to E-rate waste, fraud and abuse.

Encouragement of whistleblowers and early outreach to potential applicants and service providers regarding the E-rate program are also important components of deterrence. Continuing strong review and auditing programs serve as a long-term deterrent to waste, fraud, and abuse. We on the Commission staff will continue to work with our Office of Inspector General to implement such programs.

The Commission must also encourage efficient use of program funding by those who respect and follow the program rules. In December 2003, the Commission asked for comment on fundamental E-rate policy issues in this area. The Commission asked whether to adjust the schedule of discount rates so that, for example, applicants would pay for a greater share of their E-rate services. This would provide greater incentives for applicants to make only prudent, cost effective purchases. The Commission also sought comment on possible means of determining whether applicants have made "cost effective" funding requests. We are evaluating the record compiled on these issues.

We at the FCC are proud of the schools and libraries support program, but we will never be satisfied with the status quo. We are happy to assist the Subcommittee as needed. Thank you, Mr. Chairman, for the opportunity to participate in your review of the universal service fund's schools and libraries support mechanism, and I look forward to your questions on these issues.

## **STATEMENT OF WILLIAM F. MAHER, JR.**

Good morning, Chairman Greenwood, Representative DeGette, and distinguished members of the Subcommittee. My name is William Maher. I am chief of the FCC's Wireline Competition Bureau, and have served in this post since August 2002. I appreciate the opportunity to discuss the FCC's continuing efforts to improve the E-rate program and the lessons from the recently concluded criminal and civil case involving NEC Business Network Solutions, Inc. ("NEC-BNS"), an E-rate service provider, regarding its activities associated with Funding Year 2000. Your attention to the issues involved with the E-rate program, as evidenced by this and last month's hearings, confirms the FCC's understanding that Congress wants the program administered efficiently and fairly.

### **INTRODUCTION**

The schools and libraries mechanism of the FCC's universal service program, known as the E-rate program, implements the directive of the Telecommunications Act of 1996 to help schools and libraries gain access to modern telecommunications and information services for educational purposes. In its first six years, the E-rate program has committed over \$11 billion to permit an average of almost 90,000 schools and libraries each year, including those in the nation's poorest and most isolated communities, to pay more affordable, discounted rates. While in 1998, the first year of the program, only 51 percent of classrooms in public schools were connected to the Internet, the figure reached 92 percent in 2002. Moreover, 94 percent of schools now have broadband connections.

In reviewing these numbers, the E-rate program has been an overall success. But from day one, it has been the Commission's goal to improve operation of the E-rate program. The FCC seeks to learn from its experience with this program.

The Commission and its staff work closely with the Universal Service Administrative Company ("USAC"), the not-for-profit company that is responsible for day-to-day administration of the E-rate program. In particular, whenever we discover examples of potential waste, fraud, or abuse, we seek to address the individual cases and to improve the relevant program rules or practices.

The Wireline Competition Bureau works to oversee and implement the E-rate program with several other FCC bureaus and offices, including the Office of the Inspector General, the Office of General Counsel, the Office of Managing Director, and the Enforcement Bureau. As Commission staff described in detail in the recent hearing regarding Puerto Rico, we are improving program performance through actions in rulemakings, fact-specific adjudicatory decisions, and an improved audit program.

The FCC also works closely with law enforcement agencies when those agencies investigate and prosecute possible criminal activity by E-rate participants. The E-rate program has been the target of some bad actors and those who have tried to beat the system. The subject of today's hearing, involving NEC-BNS, is an example of such activity. It is an object lesson for the FCC, for USAC, and for all participants in the E-rate program. The Commission is committed to applying this lesson in eradicating waste, fraud and abuse in the E-rate program.

## THE NEC-BNS CASE

*Criminal Plea Agreement and Civil Settlement:* On May 27, 2004, NEC-BNS, a subsidiary of NEC America Inc., agreed to plead guilty to two criminal charges – wire fraud and bid rigging – and to pay a total \$20.6 million dollar criminal fine, civil settlement, and restitution for its activities related to the E-rate program, largely in Funding Year 2000. The Justice Department charged NEC-BNS with wire fraud for entering a scheme to defraud the E-rate program and the San Francisco Unified School District (“the San Francisco schools”). The Justice Department also charged NEC-BNS with bid rigging and allocating contracts at five school districts in Michigan, Wisconsin, Arkansas, and South Carolina. Among other things, the plea agreement requires NEC-BNS to cooperate with the United States in investigating and prosecuting others involved in criminal violations at E-rate funded projects, and NEC-BNS agreed to enter into a comprehensive Corporate Compliance Program as well.

In addition to its criminal plea agreement, NEC-BNS entered a settlement agreement to end a civil lawsuit initially brought by the San Francisco schools, in which the United States, acting through the Department of Justice, intervened. Among other things, the monetary portion of the settlement agreement makes the E-rate program whole.

The settlement agreement notes that the civil claims of the United States and others against NEC-BNS included (1) engaging in non-competitive bidding practices; (2) paying fees termed “marketing fees” to at least one entity involved in selecting vendors to obtain e-rate funds; (3) requesting and receiving E-rate funds for goods and services that were ineligible for such funding; (4) providing false information to the United States

regarding the goods and services that were be provided to schools and school districts under the E-rate program; (5) disregarding the requirement that schools and school districts make a co-payment to match a percentage of their E-rate funding; and (6) inflating prices on invoices and other documents provided to the United States to conceal some or all of these practices.

*San Francisco as an Example:* I summarize, as a case study of the foregoing practices, the situation with the San Francisco schools, based largely on the description in the NEC-BNS criminal plea agreement. In December 1999, NEC-BNS agreed with a switch manufacturing company (“VX Company”) to pay VX Company a fee for all business opportunities brought to NEC-BNS, and NEC-BNS agreed to include VX Company equipment in its E-rate proposals and bids. VX Company employed two consultants to work as its sales representatives. The consultants specialized in marketing VX Company products to school districts, and acted as consultants to school districts in identifying potential government-sponsored funding sources, including E-rate.

On or before December 1999, the consultants began working with the San Francisco schools to obtain E-rate funds. The consultants worked with an official of the San Francisco schools to put together a request for proposal for equipment and services for E-rate to fund. In January 2000, NEC-BNS submitted its bid on the E-rate project for the San Francisco schools. One of the consultants managed the opening of the bids and, together with an official of the San Francisco schools, opened and reviewed them. That consultant declared that NEC-BNS had submitted the winning bid for the data equipment portion of the project, and that two other firms had submitted low bids on other portions of the project. The consultants and the official of the San Francisco schools then decided

to make NEC-BNS the prime contractor for the project and to have other firms act as subcontractors to NEC-BNS.

Still in January 2000, NEC-BNS employees and the consultants met to prepare the USAC Form 471, which is the application form for E-rate funding. With the assistance of NEC-BNS, one of the consultants prepared the Form 471 with prices inflated over the amounts originally bid, and the other consultant then delivered the Form 471 to USAC.

In late May or early June 2000, USAC began to review the San Francisco schools' Form 471 submitted in January 2000. USAC asked the San Francisco schools to supply information to justify certain parts of the project. One of the consultants, and others acting under her direction, submitted spreadsheets to USAC that contained false information regarding the bidding process, the bidding participants, the winning bids, and the bid amounts. USAC subjected the San Francisco schools' application to a review to determine whether the services requested were supported by adequate resources. The San Francisco schools passed the review. In September 2000, USAC approved funding for the San Francisco schools in part, but denied E-rate funding for some requests for ineligible equipment, products, and services.

***The Investigation:*** The NEC-BNS plea agreement and civil settlement resulted from a two-year investigation conducted by the Department of Justice and the Federal Bureau of Investigation. The FCC's Office of Inspector General assisted in the investigation, and various FCC bureaus and offices, including the Wireline Competition Bureau, reviewed the civil settlement agreement earlier in 2004.

The monetary amount of the civil settlement makes the universal service fund



whole. Because NEC-BNS has pled guilty to activity related to the E-rate program, it is subject to suspension and debarment under the Commission's E-rate debarment rule, 47 C.F.R. § 54.521. On May 27, 2004, NEC-BNS petitioned the Commission for waiver of its suspension and debarment rule. On July 7, 2004, the Commission's Enforcement Bureau sought public comment on the waiver petition, and the pleading cycle will close on July 29, 2004.

### **POLICY AND PROGRAM LESSONS**

There are multiple lessons to be learned from the NEC-BNS case. This case illustrates the importance of deterring those who would seek to defraud or abuse the program. Deterrence is an essential and challenging goal because, as the San Francisco experience shows, defrauders and bad actors will stop at very little to cover their tracks. At the same time, the Commission must encourage efficient participation by the large majority of E-rate applicants and service providers who are law-abiding.

The Wireline Competition Bureau has already recommended a number of relevant rule changes, described below, to the Commission for action at its August 2004 Open Meeting. In the past 15 months, the Commission has adopted several new rules that address aspects of the NEC-BNS situation. Moreover, I have directed USAC's chief executive officer to report to the Bureau on changes to procedures and rules in light of NEC-BNS, and the staffs of the FCC and USAC are remaining in close communication to improve USAC's review process. Tightening our rules and USAC's review procedures will expose, at the front end, improper or fraudulent activities.

***Deterring Bad Actors:*** To deter bad actors, E-rate applicants must be held accountable for the contents of their applications and other filings.

An initial step in such deterrence is to require applicants to document thoroughly their participation in the E-rate program. Based on input from our Office of Inspector General, the Wireline Competition Bureau has recommended to the Commission that it expand the document retention requirements for applicants, in order to maintain a comprehensive paper trail for five years after receipt of E-rate supported services. By documenting every step in the E-rate process – from initial application, through competitive bidding and selection of a service provider, to final service and equipment delivery and invoicing – such a paper trail aids the initial review of applications as well as later program audits. It places a major obstacle before those who would consider lying to the federal government for their personal gain.

The Wireline Competition Bureau has also recommended to the Commission improvements in the certifications that beneficiaries make regarding their compliance with substantive program rules. Upon adoption of the Bureau's recommendations, we will modify numerous E-rate forms to expand the required certifications. Expanded certifications help deter bad actors because their falsification is a federal criminal violation. This reform is the product of discussions among the Bureau, the FCC's Office of Inspector General, and the Justice Department.

As an additional deterrent to bad actors, the Bureau is recommending that the Commission reinforce that USAC should engage in heightened scrutiny of applications from E-rate beneficiaries that have violated the statute or the Commission's rules in the past. This is consistent with the general framework adopted in the *Puerto Rico DOE Order* of 2003 to deal with situations in which one or more parties to an E-rate application is under investigation for potential waste, fraud or abuse.

The Commission has already acted in several ways to deter conduct similar to that of NEC-BNS. In April 2003, the Commission adopted its E-rate debarment rule, which bars from E-rate participation for a period of three years any individuals or companies that have been found criminally or civilly liable for activities associated with or related to the E-rate program. We believe the debarment rule to be a significant deterrent to fraudulent behavior. Since the rule's adoption in 2003, the FCC's Enforcement Bureau has debarred three individuals in matters not related to NEC-BNS. The Commission also has sought comment on whether to expand the reach of the debarment rule as a further deterrent to E-rate waste, fraud and abuse.

Encouragement of whistleblowers and early outreach to potential applicants and service providers regarding the E-rate program are also important components of deterrence. Timely information from well-informed and honest citizens is one of the best means of exposing fraudulent activity. Wider understanding of E-rate rules can help USAC and program participants isolate and identify potential bad actors. For example, in 2000, roughly the time of the San Francisco situation, the Commission's *Mastermind Order* found a violation of the competitive bidding rules where a service provider listed in the Form 470 as a contact person for an applicant also participated as a bidder in the applicant's competitive bidding process. Wider understanding of that ruling in the San Francisco schools could have helped expose the NEC-BNS case earlier. USAC has announced plans to increase its outreach regarding the E-rate program.

Continuing strong review and auditing programs also serve as a long-term deterrent to waste, fraud, and abuse. We on the Commission staff will continue to work with our Office of Inspector General to implement such programs.

*Incentives For Good Actors To Use The Program Efficiently:* The Commission must also encourage efficient use of program funding by those who respect and follow the program rules. In December 2003, the Commission asked for comment on fundamental E-rate policy issues in this area. The Commission asked whether to adjust the schedule of discount rates so that, for example, applicants would pay for a greater share of their E-rate services. This would provide greater incentives for applicants to make only prudent, cost effective purchases. The Commission also sought comment on possible means of determining whether applicants have made “cost effective” funding requests. We are evaluating the record we have compiled with the goal of making recommendations to the Commission in this calendar quarter.

### **CONCLUSION**

We at the FCC are proud of the schools and libraries support program, but we will never be satisfied with the status quo. We will continue to use all tools at our disposal to help us identify areas of E-rate program administration that are vulnerable to fraud, waste, or abuse. At the same time, we will continue to encourage participation in the program so that those that the program’s true beneficiaries – the nation’s students, library patrons, and all Americans – receive the support they need.

We are happy to assist the Subcommittee as it considers these important issues. Thank you, Mr. Chairman, for the opportunity to participate in your review of the NEC-BNS matter, and I look forward to your questions on these issues.