E-Rate Update:
Critical of FCC Administration of E-rate, House Oversight Subcommittee Recommends Administrative and Other Changes Be Adopted by the FCC Which is Currently Reviewing Public Comments on FCC Proposed Alternatives; Otherwise Congress Threatens to Make Changes Through the Legislative Process Early Next Year

A Technology Monitoring and Information Service (TechMIS)
SPECIAL REPORT

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Following numerous hearings, GAO reviews, and internal FCC Inspector General audits, the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, concludes in its October 18, 2005, Report to the Committee as a whole, "While the E-rate has arguably benefited children, the program falls short as an example of efficiency, effectiveness, or integrity…In sum, the Subcommittee's investigative work reveals a well-intentioned program that nonetheless is extremely vulnerable to waste, fraud, and abuse, is poorly managed by the FCC, and completely lacks tangible measures of either effectiveness or impact." Beyond the extensive media reports of fraud, abuse, and waste allegations, and in some cases criminal verdicts of certain vendors, the Subcommittee findings included:

- The FCC has not developed performance goals to assess the specific impact of the $15 billion which has been committed under the E-rate program during the last eight years and implemented measures to improve the management of the program.

- Some districts have received E-rate discounts without having adequate technology plans which protect against "gold plating," i.e., purchasing technology products far beyond reasonable district needs.

- Following media coverage of fraud and abuse cases involving hundreds of millions of dollars in funding year 2001-02 due to non-competitive procurement processes, the FCC "continues to allow anti-competitive or insufficiently competitive procurement practices due to remaining weaknesses in the application process."

- Because of ambiguous rules and procedures, extensive delays have occurred in distributing funding, including prompt decisions on appeals, has increased program waste.

The Subcommittee recommends at least eleven "overarching principles that should guide program reform." Below we identify those which have implications for firms which have benefited from the E-rate program in the past. Two key issues which the subcommittee recommends that Congress should consider, include:

- Whether the largely arbitrary $2.25 billion annual price tag is appropriately set;

- The extent to which E-rate program discounts should cover technological infrastructure and related services, i.e., whether the program covers too much or should expand to subsidize key technology components that are not currently eligible, such as computers, software, and teacher training.

As several E-rate observers have noted, because the Subcommittee Report nor other groups appear to be talking about "killing" the E-rate program, the amount of funding under the "cap" becomes an important issue. On the second issue, firms providing instructional software and teacher training might initially benefit if these products were approved as being eligible up front for receiving E-Rate discounts. However, as we and others have pointed out in the past, because these firms do not pay into the E-rate fee structure, the telecommunication carriers, which do fund the E-rate program based upon fees which consumers pay them, would likely drop their support for the program which would result in the E-rate program as we know it today being killed.

In order to minimize "gold plating" the Subcommittee recommends that applicants complete and have approved E-rate program planning documents as the required first step before posting Form 470 Request for Proposals, and that USAC should develop mechanisms to verify that applicants' requests match legitimate education technology needs. If district applicants, for example, have to submit and/or post very clear overall education technology plans for the district, this can assist firms by providing advanced notice of potential opportunities when and if their E-Rate applications are approved by the SLD/USAC or otherwise identify district needs.

Another guiding principle is that school districts "should hold a greater stake in their applications for E-rate discounts." One possibility would require higher co-payments by the school district or conversely reducing the highest 90 percent discount rates to, for example, 80 percent or even 70 percent, for applicants with the highest enrollment of students from low income families. This could mean more technology-related funding from state or local sources or even other Federal funding sources such as Title I that will have to be earmarked, for example say 20 percent (as opposed to the 10 percent current matching high priority districts), which could postpone the purchasing cycle of non-eligible items such as software and training until funding commitment letters are received from the SLD/USAC by the district applicant. Another recommendation is that the FCC and USAC should act "immediately" to specify for all Priority Two (internal connections) above a certain amount, that a portion of the districts funding must be set aside for an independent audit of the total funds committed. Again, this could result in funds being reallocated from technology-related purchases to the cost of conducting audits.

And last, based upon findings and general complaints of extensive delays in the SLD distribution of funding, in response to the FCC solicitation of comments on the Notice of Proposed Rule Making

(NPRM) issued several months ago by the FCC, COSN and ISTE jointly recommended, "The Commission should undertake to streamline the application process including allowable multi-year priority one applications but should also establish deadlines for USAC processing of applicant funding, commitments, and appeals." One positive implication if such a recommendation is implemented, would be that districts would know the results of their appeals much quicker and therefore help them in their planning for subsequent year E-rate applications. On the other hand, with such deadlines the number of "aged" appeals would likely be reduced. As many firms with non-E-rate eligible products and services are aware, significant opportunities have occurred in the past when 2-3 year old appeals have been found to be "meritorious," which allow the districts to request the E-rate refunds in the form of a check after they paid the full pre-discount price for the contested item or service. These funds collected through the so-called BEAR process have amounted in previous years to almost half of the $2-3 billion of funding commitment letters. While BEAR refunds were significantly reduced as districts increasingly were unable to pay the prediscount price up front because of tighter local budgets beginning in about 2002, as state and district revenues for education have increased over the last year, refunds through the BEAR process could once again increase "significantly." About every quarter when data are available for analysis, we have reported on districts receiving "meritorious" appeals for 2-3 year old appeals which have resulted in funds being used to purchase non-eligible products and services, such as instructional software, computers, and staff development.

As of now, the E-rate program appears to be a "going concern" for the next 12 months. Congress is very likely once again through the appropriations process to exempt E-Rate from under the Anti-Deficiency Act (ADA), which disrupted a year ago the actual notification of Funding Commitment Letters to districts for 4 months. The new exemption would be through December 2006. While no new legislation is anticipated this session of Congress, if the FCC does not take into account many of the Subcommittee recommendations in modifying E-rate rules, regulations, and procedures, then one can expect Congress to move quickly in its second session to pass legislation along the lines of many "recommended guiding principles." For a copy of the Subcommittee Report go to http://energycommerce.house.gov/108/Markups/10182005/Business_Meeting/ERate%20Investigation%20Staff%20Report.pdf.