

March 17, 2003

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SPECIAL ADVISORY

CONGRESSIONAL AND CRIMINAL INVESTIGATIONS FOCUS ON E-RATE PARTICIPANTS

Over the past several months, the FBI, the Antitrust Division of the U.S. Justice Department, U.S. attorneys, the U.S. House Energy and Commerce Committee, and state law enforcement agencies, as well as the FCC's Office of Inspector General, have begun to investigate allegations of fraud in the E-rate program. These investigations appear to be national in scope and both civil and criminal in focus, and they have now yielded federal criminal charges in the Southern District of New York.

I. What the E-Rate Is

The E-rate—or, more precisely, the Schools and Libraries Universal Service Support Mechanism—provides discounts to assist schools and libraries in obtaining telecommunications and Internet access. Discounts 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. Established in 1996 as part of the Telecommunications Act, the E-rate disburses nearly \$1.5 billion per year.

The E-rate supports connectivity—that is, the conduit or pipeline for communications services. The school or library is responsible for providing additional resources such as the end-user equipment (computers, telephones, and the like), software, professional development, etc.

The E-rate is the second largest component of the Universal Service Fund (“USF”), which also includes the High Cost, Low Income, and Rural Health Care support mechanisms. The USF is funded by a fee charged to interstate and international telecommunications service providers. The Universal Service Administrative Company (“USAC”), a private, not-for-profit corporation, administers the USF under the direction of the Federal Communications Commission.

While the E-Rate has many supporters in Washington, it also has had many detractors. House Energy and Commerce Committee Chairman W.J. “Billy” Tauzin (R-LA) has been one of its most prominent critics over the years. Thus the political context surrounding E-rate may give these investigations a higher profile in Washington than they might otherwise have.

II. The Investigations

In Washington, D.C., the FCC, the Antitrust Division of the Justice Department, the FBI, the House Energy and Commerce Committee, and the FCC Office of the Inspector General (“FCC OIG”) are now investigating the E-Rate program. Indeed, as of October 31, 2002, the FCC OIG was working on 26 investigations, and the House Energy and Commerce Committee this week claimed to be aware of 30 active state and federal investigations. Earlier this week, the OIG created a new position, Assistant Inspector General for Universal Service Fund Oversight, to head up the effort.

The E-Rate investigations have expanded well beyond the FCC OIG’s previously known work, in terms both of their participants and their scope. The OIG appears now to be working closely with the federal criminal law enforcement agencies. The FBI’s Governmental Fraud Unit is now working on E-rate fraud investigations, and the Antitrust Division of the Department of Justice has established a USF task force working alongside the OIG and the FBI. The task force is comprised of attorneys in the National Crime Office and in all seven Justice Department field offices. Congressional interest is likely to keep the E-rate investigations in the public eye. House Energy and Commerce Committee Chairman Tauzin has launched a preliminary investigation, announced its staffing, and just this week requested documents on the E-rate program from both the FCC and USAC. Although they have recently made more news, the federal investigations have been underway for some time. They are now starting to show signs of yielding criminal cases across the country. Late last year the first E-rate criminal charges were filed in New York (discussed below), but press accounts of investigations elsewhere suggest more may be forthcoming.

- In Tennessee, the FBI, Tennessee Bureau of Investigation, and a federal grand jury are apparently investigating the bidding process for several large E-rate contracts awarded by the state government, and USAC has frozen funding for the contractor involved.
- In Texas, the Ysleta Independent School District was denied an \$18 million E-rate grant request due to concerns about competitive bidding and other issues. Officials of the El Paso Independent School District are reportedly worried that their \$45 million request may be denied for similar reasons.
- In California, the Fresno County School Superintendent has been quoted as charging that, during the tenure of another administrator, the West Fresno Elementary School District never paid the required 10% share of the E-rate program costs to the E-rate contractor.
- Also in California, the FBI, US Attorney’s Office, and a federal grand jury are reportedly investigating the San Francisco Unified School District’s handling of \$48 million dollars in E-rate funds and the possibility of fraud and kickbacks.
- In Florida, the press has reported that the FBI is investigating the Miami-Dade Public School District for possible misappropriation of E-rate funds, and that the district’s E-rate funding has apparently been frozen.

III. Reading the Tea Leaves on E-rate Criminal Exposure

The Southern District of New York case mentioned above appears to be the first publicly disclosed criminal case brought for alleged E-rate abuse, and it may shed light on the theories being explored in E-rate investigations more generally. In the complaint, the government takes a classic procurement-fraud approach, charging conspiracy to commit a violation (18 U.S.C. §371), false claims (18 U.S.C. §287), false statements (18 U.S.C. §1001) and wire fraud (18 U.S.C. §1343). With respect to the fraud claim, the Complaint alleges that the vendor (1) either (a) did not charge the schools their required share of the costs of internet connectivity provided under the program, or (b) kicked back that share to the schools in creative ways; and (2) deceived USAC about it. This allegedly allowed the conspirators to increase their sales, since the schools got the equipment and services for free.

The Complaint also alleges that the defendants obstructed a federal grand jury and an FCC audit investigating their sales by withholding documents and suggesting others lie to investigators, violating both the long-standing obstruction provision of 18 U.S.C. §1503 and the new obstruction provision passed as part of the Sarbanes-Oxley Act, codified in 18 U.S.C. §1519.

The Complaint is interesting for a number of reasons. First, the false-claims and false-statements charges indicate that deception of USAC, the private corporation hired to run the program, will be treated as deception of the government itself. Second, it suggests that E-rate fraud will be attacked using the criminal statutes and techniques used in procurement-fraud cases, despite the inapplicability of the Federal Acquisition Regulation. Third, the government reveals in a footnote that at least one individual from a recipient of E-rate funding (as opposed to vendor personnel) is being treated as having criminal liability, too, and is “working it off” as a government informant. This raises the question of whether other individuals or organizations outside the target implementation organization (such as equipment vendors or services subcontractors, for example) may have criminal exposure based on their knowledge of the fraud and participation in related transactions. Finally, the obstruction charges based upon alleged deception of FCC auditors highlight the risks audit respondents face, a factor that may grow in significance as the FCC IG continues to expand its audit and other investigatory work on E-rate.

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