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# The E-Rate Program: Universal Service Fund Telecommunications Discounts for Schools

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# The E-Rate Program: Universal Service Fund Telecommunications Discounts for Schools


## Summary

Under language enacted in the Telecommunications Act of 1996 (P.L. 104-104), a discount on telecommunications services was implemented for schools and libraries as part of the universal service framework. Universal service seeks to ensure the availability of telecommunications services for all consumers, including low-income consumers as well as those in rural and high-cost areas.

The universal service discount for schools and libraries, known as the E-rate program, is now in its sixth award cycle. The E-rate program has an annual budget cap of $2.25 billion — although the FCC has recently ruled that unused funds can be carried over for usage in subsequent years. Although the future of E-rate is not as questionable as in its earlier years, some Members of Congress continue to question the utility of the program, and instances of fraud and abuse in the program have been reported.

This report provides background information on the E-rate program, focusing specifically on its support of schools. It will be revised to reflect any substantive changes in the program. For legislative activity, see CRS Issue Brief IB98040, *Telecommunications Discounts for Schools and Libraries: The "E-Rate" Program and Controversies*.

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## Introduction

The universal service concept was created to ensure the availability of telecommunications services for all consumers, including low-income consumers as well as those in rural and high-cost areas. The Telecommunications Act of 1996 (P.L. 104-104) codified universal service principles in a new section (Section 254) added to the Communications Act of 1934. Within the broad framework of universal service, the Telecommunications Act newly included elementary and secondary schools and libraries as beneficiaries of universal service for telecommunications services. This specific support, in the form of discounts on telecommunications services provided to schools and libraries under the universal service program, has become known as the education rate or *E-rate* program.

This report provides an overview of the E-rate program, including background information, current status of participation and funding information. It also considers selected issues involving the program. The report focuses solely on the participation of schools in the E-rate program. It does not address the participation of libraries or universal service in general.

## E-Rate Provisions

Section 254 of the Communications Act of 1934 contains statutory provisions codifying universal service principles in general. As has been noted, under the provisions of Section 254, schools and libraries are designated as beneficiaries of the universal service program. Section 254 requires that, upon a legitimate request, any telecommunications carrier serving a geographic area is required to make any of its services that are within the definition of universal service available at reduced rates to elementary and secondary schools and libraries for educational purposes [Section 254(h)(1)(B)].

Among seven principles for universal service, the legislation also provides that "[e]lementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services" [Section 254(b)(6)]. In describing the telecommunications services that are to be provided, the legislation states that the Federal Communications Commission (FCC) is to establish competitively neutral rules "to enhance, to the extent technically feasible and economically reasonable, access to advanced telecommunications and information services for all public and nonprofit elementary and secondary school classrooms, health care providers, and libraries" (Section 254(h)(2)(A)).

# E-Rate and Schools

## Program Administration

In its May 7, 1997 order addressing the universal service provisions enacted under the Communications Act, the FCC stated that up to $2.25 billion a year would be made available to support universal service discounts for schools and libraries.[1] The funds are to be used to subsidize discounts on services provided to schools and libraries. Although E-rate is a federal program, it is funded by providers of telecommunications services. All interstate telecommunications providers are required to contribute to the program. Funds for E-rate[2] come from contributions that are based on a percentage of the telecommunications providers' interstate and international revenues.[3] Many telecommunications service providers have elected to transfer the cost of their universal service contribution to their subscribers, thereby shifting the costs of the program to the consumer.

The E-rate program is administered by the Schools and Libraries Division (SLD),[4] of the Universal Service Administrative Company (USAC). The USAC is a nonprofit corporation appointed by the Federal Communications Commission (FCC). The SLD provides discounts to assist schools and libraries in the U.S. with obtaining affordable telecommunications services and Internet access. The SLD provides discounts for connectivity, the means to communicate using telecommunications services and the Internet. Schools are expected to provide the requisite equipment and additional resources to support the connectivity.

**Eligibility.** To qualify for funding under the E-rate program, a school must meet the definition of an elementary or secondary school as delineated in the Elementary and Secondary Education Act of 1965 (ESEA), as amended by the No Child Left Behind Act of 2001 [(NCLBA), P.L. 107-110]. Eligible schools can include either public or nonprofit institutional day or residential schools, as well as

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[1] Federal Communications Commission, *Report and Order*, FCC 97-157, May 7, 1997.

[2] The contributions from telecommunications providers are to support universal service goals in general not just the schools and libraries component of universal service.

[3] This percentage or "contribution factor" is calculated by the FCC's Common Carrier Bureau on a quarterly basis and varies depending on the anticipated funding needs for the program. As of the date of this report, the monthly contribution factor is 8.9%.

[4] In 1996, the FCC created a nonprofit corporation, known as the Schools and Library Corporation (SLC) to manage E-rate. However, amid congressional criticisms and a General Accounting Office determination that the FCC exceeded its authority when it directed the creation of the SLC, on Jan. 1, 1999, the SLC was merged into the Universal Service Administrative Company, which currently administers other portions of the universal service system, and changed its name to the Schools and Libraries Division.

public charter schools. Schools that operate as for-profit schools or that have an endowment in excess of $50 million are not eligible.

**Discounts.** The discounts for the services are divided into four categories: telecommunications services, Internet access, internal connections, and basic maintenance of internal connections. Telecommunications services are those recurring services that are used to communicate information between two parties, such as the telephone. The second area, Internet access, applies to basic access to the Internet, including e-mail. Internal connections consist of the wiring and other components that expand access throughout the school, such as wiring classrooms for computer and Internet access. The final category, basic maintenance of internal connections, is limited to maintenance of existing connections. Under FCC rules, requests for telecommunications services and Internet access are considered top priority (Priority 1) and are funded first. Any remaining funds are for schools seeking discounts for internal connections (Priority 2).[5] Priority is given to schools that are the most economically disadvantaged; this applies to both priority areas.

The discounts for these services range from 20% to 90% depending upon the school's percentage of pupils from low-income families and the urban/rural location of the school (see **Table 1** for a breakdown of the discounts).[6] Generally, the service provider seeks reimbursement from USAC for the discounted portion of the services provided; schools and libraries are responsible for paying service providers the non-discount portions of eligible service costs. Schools can also pay the service provider in full and then seek reimbursement from USAC.

## Table 1. E-Rate Discount on Eligible Services

| Income measured by % of students eligible for National School Lunch program | Urban location discount | Rural location discount |
|---|---|---|
| If the % of students in the school who qualify for free or reduced price lunch is ...* | ...and you are in an URBAN area, your discount is ... | ... and you are in an RURAL area, your discount is. |
| Less than 1% | 20% | 25% |
| 1% to 19% | 40% | 50% |
| 20% to 34% | 50% | 60% |
| 35% to 49% | 60% | 70% |
| 50% to 74% | 80% | 80% |

[5] In 2005, the "two in five" year rule was implemented. The rule essentially prohibits applicants from applying for funding for internal connections more than twice in a five-year period.

[6] This matrix of discounts is also used for libraries. The discount for libraries is based on the percentages of students eligible for free or reduced price meals in the school district in which the library is located.

| Income measured by % of students eligible for National School Lunch program | Urban location discount | Rural location discount |
|---|---|---|
| 75% to 100% | 90% | 90% |

* The income threshold is 185% of the relevant poverty income level.

**Application Process.** To apply for E-rate, interested schools must annually submit a technology plan specifying how technology will be integrated into the curriculum and professional development to improve education. Although the technology plan should be long term, due to technology's rapidly changing status with new developments in software and hardware, the technology plan should not cover more than three years. The technology plan must contain the following components:

- Clear goals and a realistic strategy for utilizing technology to improve education;
- Professional development that indicate staff are able to use technology to improve education;
- An assessment of the telecommunications services, hardware, and software, that are necessary to improve education;
- A budget illustrating the school's ability to acquire the non-discounted components of the technology plan; and
- An evaluation that enables the school to monitor progress and achievement of specified goals.

Technology plans must be independently approved by a state agency overseeing schools or libraries or another SLD certified technology plan approver. Applicants who seek discounts only for basic local and/or long distance telephone services do not need to prepare a technology plan.

After the applicant has identified the requisite products and services necessary to support the technology plan, Form 470 — *Description of Services Requested and Certification Form* — must be submitted either online or as a paper application. The SLD posts all Form 470s on their website to notify interested service providers of the needed products and services. Form 470 is posted on the SLD website for a competitive bidding period of 28 days during which time potential service providers submit bids for the requested services to applicants. At the conclusion of this period, an applicant is required to select the most cost effective provider.

Form 471 — *Services Ordered and Certification Form* — enables the applicant to request funding for what was submitted in the technology plan. Because funding for E-rate is capped each year at $2.25 billion, and the actual requests for funding have annually exceeded the cap, FCC rules allow all form 471s to be submitted during a *window* period, whereby all applications are treated as though they were received simultaneously. The 2006 *window* is open for 73 days (December 6, 2005 through February 16, 2006).

SLD informs applicants of its decisions through "waves." The waves are actually groups of Funding Commitment Decision Letters (FCDL) — notifying applicants of SLD's decision — which are sent to applicants as decisions are made, rather than waiting for all applications to be processed. Waves are based on the FCC rules of priority (as detailed above).

## Funding and Participation

The year 2006 marks the eighth funding year of E-rate's existence (January 1998 through January 2006). In its inaugural funding year, which was 18 months (January 1998 to June 1999),[7] the Commission supported approximately 25,000 programs and provided close to $1.7 billion in funding discounts. In the second grant cycle, the program experienced a significant increase, providing more than $2.1 billion to applicants. Subsequent years have witnessed similar numbers of applicants and each year funding has been provided up to the program's maximum cap of $2.25 billion.

During the seventh funding year, E-rate provided funding discounts to approximately 26,000 applicants.[8] For the first seven years of the program, $15.3 billion in funds have been committed. The total committed as of January 2006 is $1.16 billion, with an average discount of $44,500. Nearly 27% of the applicants awarded received the maximum discount available. Of the funded applicants, approximately 25% were from schools, 58% from school districts, 14% from libraries or library consortia, and approximately 2% from school/library consortia. The percentage distribution of the dollar value of the discounts awarded was 7% for schools, 84% for school districts, 6% for libraries and library consortia, and 4% for school/library consortia.[9]

# Selected Issues

The defining legislation for the E-rate program (Telecommunications Act of 1996) did not explicitly state how the E-rate program was to be administered, which has subsequently raised some issues for the how the program operates. For example, does the FCC have the authority to use USF funds for oversight of the E-rate program? The E-rate program is both highly regarded for its ability to bring telecommunications to rural and poor schools and libraries, but it is also highly criticized because of the increasing incidents of fraud, waste and abuse. This section presents a brief discussion of selected program and policy issues.

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[7] The FCC issued an order in June 1998 (CC docket No. 96-45) making several modifications to the program, one of which revised the funding year from a calendar year to a fiscal year cycle. The first year was extended by six months to allow subsequent grant cycles to correspond to the fiscal year, thereby synchronizing the program with the budgetary cycles of schools and libraries.

[8] Data retrieved from the USAC's website at [http://www.sl.universalservice.org/funding/y2005/national.asp].

[9] Percentages do not sum to 100% due to rounding.

**Fraud and Abuse.** There has been much written lately about fraud and abuse within the E-rate program. The Center for Public Integrity authored a report entitled *Phone Fund for Schools, Libraries Riddled with Fraud*, in which E-rate was described as being "... honeycombed with fraud and financial shenanigans."[10] The Inspector General (IG) for the FCC conducted an investigation in which they noted errors ranging from regulatory non-compliance to computational errors, all of which resulted in approximately $8 million being erroneously disbursed (Federal Communications Commission, Office of Inspector General, Semiannual Report, October 31, 2002).

The year 2002 marked the first time that federal prosecutors filed criminal charges against a telecommunications provider that participated in the E-rate program. The complaint alleged that the owner and three employees of Connect2 Internet Networks, Inc. (hereinafter Connect2) conspired to defraud the program of several million dollars by persuading administrators from schools with the highest need (those that qualify for a 90% telecommunications services discount) to purchase expensive equipment that they did not need. Connect2 further informed the administrators that they would not be financially responsible for the requisite percentage due because a foundation would pay the balance. As a result, several administrators reportedly purchased equipment that was significantly more expensive than what they would have purchased if they had to pay a portion of the bill. By doing this, it was charged that Connect2 was able to sell large quantities of equipment and services to schools with little to no restriction on the amount charged.[11] The owner of Connect2 and the employees who were charged subsequently pleaded guilty and are barred from participating in the E-rate program for three years.[12]

The SLD created both a Task Force and a *Whistle Blower* hotline to deal with fraud, waste, and abuse. The Task Force initially reported[13] that the structure of the E-rate program and the ambiguity of certain policies and procedures likely contributed to wasteful program management. They recommended that the SLD develop and publicize a list of products and services and reasonable prices for the products and services. In 2005, a web-based database of eligible services was added to the SLD website to enable applicants to search a list of eligible products and services. It is expected that the list will help limit ambiguity and wasteful practices.

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[10] [http://www.publicintegrity.org].

[11] See David McGuire, *Fraud Issue Could Undermine E-Rate Program*, [http://www.washingtonpost.com/ac2/wp-dyn?pagename=article&node=&contentId=A4333-2003Jul17&notFound=true].

[12] See *Notice of Debarment, File No. EB-04-IH-0460* [http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-04-3828A1.pdf].

[13] The full report is available at [http://www.sl.universalservice.org/taskforce/update2.asp].

The *whistle blower* hotline allows interested persons to report waste, fraud or abuse, and to remain anonymous if they so choose. Each call received is referred to USAC's General Counsel for assessment and investigation.

**Oversight.** The E-rate program has very few resources dedicated to oversight of the program. A recent report[14] by the FCC's IG, noted that lack of funds was a significant problem for independent program oversight. The report states that additional funds have been requested for staff to provide independent oversight for FY2006 and FY2007. With respect to the E-rate program, the IG stated that a "lack of adequate resources has made it difficult for the OIG to provide an adequate level of support to federal law enforcement as they investigate fraudulent activity in the E-rate program."

In October 2002, the IG issued a report stating that the FCC was unclear whether the funds could be utilized for oversight (Federal Communications Commission, Office of Inspector General, Semiannual Report, October 31, 2002). The most recent IG report (2005) appears to suggest that this issue has not been resolved:

> These budget requests reflect our inability to use the USF itself to provide funding for the cost of oversight. Report language in the Commission's FY2004 final budget indicated that the monies for USF audits should come from the Fund itself. However, neither the Senate nor the House of Representatives has included language to permit the FCC to use USF funds in the draft funding bills to date for FY2006 (Federal Communications Commission, Office of the Inspector General, Semiannual Report to Congress, April 1, 2005-September 30, 2005).

**Universal Service Fund and the Anti-Deficiency Act.** The question of how to treat the funds used to support the E-rate program is a perennial and contentious issue. According to the Government Accountability Office (GAO), "the fund has been listed in the budget of the United States and since FY2004, has been subject to annual apportionment from the Office of Management and Budget (OMB)"[15], thereby making the USF federal funds. However, in a Senate hearing regarding exempting the USF from portions of the Anti-Deficiency Act (ADA), Acting General Counsel for the FCC, Austin Schlick, stated that the FCC has operated the USF according to OMB's interpretation that the USF is a special fund,

[14] See *Federal Communications Commission, Office of the Inspector General, Semiannual Report to Congress*. April 1, 2005-September 30, 2005. The full report is available at:[http://www.fcc.gov/oig/SAR35_10-31-05.pdf].

[15] Government Accountability Office, Testimony Before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives. *Telecommunications Concerns Regarding the Structure and FCC's Management of the E-Rate Program*. GAO-05-439T.

and does not constitute public money.[16] To date, this issue has not been completely resolved.

The issue presented itself again in late 2003, when the FCC ordered USAC to prepare financial statements for the USF. During this period, it was determined that the FCDLs (previously discussed) that were sent to grantees constituted obligations. Because the ADA does not allow an agency or program to make financial obligations in excess of the amount that is available, it was determined that the E-rate program was in violation of the ADA. As a result of this discovery, in August 2004, the USAC suspended the mailing of additional FCDLs for funding year 2004, and was ordered to liquidate investments to comply with the Anti-Deficiency Act requirement for the FCDLs that were previously issued. It was reported that the liquidation, which occurred over a two-day period, cost the Fund approximately $4.6 million in immediate losses and possibly more in future interests.[17]

During the suspended funding period, it was reported that many schools were unable to continue programs that depended upon financial support from the E-rate program.[18] The decision received a significant amount of attention from the media and the Congress. The suspended funding and lack of clarity regarding the ADA resulted in the passage of the Universal Service Anti-Deficiency Temporary Suspension Act (P.L. 108-494), which exempted the USF from the Anti-Deficiency Act until December 31, 2005. In November 2005, it was extended by one year in the annual appropriations bill for Science, State, Justice, Commerce and Related Agencies for 2006 (P.L. 109-108).

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[16] U.S. Congress, Senate Committee on Commerce, Science and Transportation, *S. 241, Permanently Exempting the Universal Service Fund from Portions of the Anti-Deficiency Act*, hearing on S. 241, 109th Cong., 1st sess., April 11, 2005 (Washington: GPO, 2005).

[17] Government Accountability Office, Testimony Before the Subcommittee on Oversight and Investigations, Committee on Energy and Commerce, House of Representatives. *Telecommunications Concerns Regarding the Structure and FCC's Management of the E-Rate Program*. GAO-05-439T.

[18] See Katherine Shek, *Schools Suffer as E-rate Suspension Affects Services*, Education Daily, p. 3, October 8, 2004. Cara Branigan, *eRate flows again; '04 apps still pending*. Full article available at:[http://www.eschoolnews.com/news/PFshowstory.cfm?ArticleID=5376].