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USAC Enforces the E-rate Gift Rule

In 2010, the Federal Communications Commission supplemented the E-rate program's competitive bidding rules by adopting a specific gift rule. Under the gift rule, E-rate eligible schools and libraries (and their personnel) may not solicit or accept gifts or items of value from service providers or prospective service providers, with minimal exceptions. The gift rule applies all year round, not just during the competitive bidding process.[1]

Two sets of appeals recently filed with the FCC by school districts and service providers show that USAC continues to be alert for gift rule violations. One set involved relatively modest gifts given before the gift rule was in effect, and the other set involved free services of a type that the service provider routinely included in contracts with commercial customers.[2]

Robeson County Public Schools

According to FCC appeals filed by a school district and service provider on December 12 and 13, 2016, USAC is seeking to recover almost $900,000 in E-rate payments based on relatively modest gifts (college basketball tickets) the service provider gave the school district in 2007, years before the FCC adopted its formal gift rule in 2010.

The appeals reported the facts as follows.

In 2007, Robeson County Public Schools selected Time Warner Cable Information Services as the service provider for a multi-year E-rate contract. In June 2010, USAC initiated a Special Compliance Review based on evidence that the service provider had given tickets and other gifts to several E-rate applicants, including Robeson. Open funding requests were held

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[1] *See* FCC 6th Report and Order (Sept. 28, 2010) (FCC 10-175, https://apps.fcc.gov/edocs_public/attachmatch/FCC-10-175A1.pdf), FCC Clarification Order (Dec. 15, 2010) (DA 10-2355, https://apps.fcc.gov/edocs_public/attachmatch/DA-10-2355A1.pdf).

[2] In addition, the FCC recently issued a Notice of Apparent Liability to a Rural Healthcare Program service provider, alleging among other things that it had given a $10,000 server as a gift to induce a healthcare provider to award it a contract. http://transition.fcc.gov/Daily_Releases/Daily_Business/2016/db1104/FCC-16-158A1.pdf. The Rural Healthcare program's competitive bidding rules are for the most part comparable to E-rate program rules, though they do not include a specific rule addressing gifts.

until the review was completed. According to Robeson, Time Warner gave it two tickets to a college basketball game in 2007. Robeson valued the tickets at about $35 apiece and said they had no influence on the decision to award a contract to Time Warner, who was the most qualified, lowest priced responder. Time Warner, in response to a USAC inquiry in 2009, had valued the tickets at $150.

After the review was completed in 2011, USAC funded the application, the services were rendered, and E-rate discounts were applied. The applicant and service provider assumed the issue had been resolved. Five years later, in August 2016, USAC issued a commitment adjustment letter and demanded repayment. Robeson asked USAC to reconsider. USAC denied the request on October 12, 2016, citing the FCC's gift rule – which, as the appeals emphasized, was adopted several years after the tickets were given – and an earlier FCC decision involving a service provider and school district employee convicted of bribery. As the appeals also noted, FCC held in 2011 and 2012 that the strict limits of the gift rule should not be applied retroactively, and that modest gifts before the rule was adopted would not invalidate an otherwise fair and open competitive bidding process. [3] In addition to denying Robeson's request for review, USAC placed Robeson on Red Light status, precluding it from receiving any funding commitments or disbursements.[4]

The service provider (now Charter Communications) filed its own appeal, covering essentially the same points and stating that its competitor's bid had been over 50% higher than its bid.[5]

Lawrence Unified School District

Another set of FCC appeals filed by a school district and service provider on December 14 and 16, 2016, involved a five-year contract that included a provision allowing the district up to 15 free residential Internet accounts. The free services were used by the district's school board members and managers and were worth a total of approximately $17,000. USAC concluded the free services were prohibited gifts and created conflicts of interest that undermined the competitive bidding process. USAC therefore demanded repayment of all of the district's E-rate

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[3] *See, e.g., in the Matter of Kings Canyon Unified School Requests for Review* (Apr. 17, 2012), ftp://ftp.fcc.gov/pub/Daily_Releases/Daily_Business/2012/db0417/DA-12-604A1.txt.

[4] Robeson appeal, https://ecfsapi.fcc.gov/file/1213454508342/Robeson%20Appeal.pdf.

[5] Charter appeal, https://ecfsapi.fcc.gov/file/1212055936637/Charter%20Request%20for%20Review%20(2016.12.12).pdf.

funding awards for FY 2011-2013, totaling over $500,000, and denied an additional $340,000 in funding for FY 2014 and 2015. USAC denied the parties' requests for review and they appealed to the FCC.[6]

In their FCC appeals, the parties (Knology, an Internet provider, and Lawrence Unified School District) provided a thorough analysis of the issues, including tensions created by the interplay of the E-rate program's gift rule, free services advisory, cost allocation rules, and Lowest Corresponding Price rule. We look forward to seeing how the FCC resolves these issues, including whether it distinguishes between free services provided to entities and to individuals.

The arguments included the following.

First: The parties took the position that the complimentary accounts were not prohibited gifts, but, instead, were part of Knology's "pricing and promotion strategy" for "commercial customers who meet certain volume or term commitments." [7] Knology had given the district similar packages for more than 30 years, starting before the E-rate program existed, on terms equivalent to those given to other similarly situated customers. The accounts were intended to help school officials perform official functions, and were not intended to circumvent E-rate rules or influence the competitive bidding process. Four of the accounts were put in service before the gift rule was adopted. The others were put service after the parties' five-year contract was already in effect.

Second: Knology argued that as both a common carrier and a participant in the E-rate program, it had an obligation to give the District pricing and service terms consistent with those it gave to similarly situated commercial customers. Laws and tariffs governing common carriers prohibit discrimination in price and level of service, and the Lowest Corresponding Price rule requires service providers to give E-rate eligible schools and libraries their lowest price (including promotions) available for services provided to similarly situated commercial customers. For these reasons, Knology stated, it "had no option but to offer the District the same

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[6] *See* Knology appeal, https://ecfsapi.fcc.gov/file/1216167905475/Knology%20E-Rate%20Appeal%20with%20Exhibits%20-%2012.16.2016.pdf; District appeal, https://ecfsapi.fcc.gov/file/12142379005241/Lawrence%20Public%20Schools%20Appeal%20%2012-14-16%20FINAL.pdf (saying it took steps to remove the residential accounts from its contracts in 2014, after it hired a former state E-rate coordinator as technology director and she identified the complimentary services as a potential issue). The summary below is based on these appeals.

[7] Knology appeal, at 5.

package at the same rate as was offered commercial customers of the same size, including the complimentary accounts."[8]

Third: The parties argued that the E-rate rules permit service providers to offer complimentary services to schools and libraries as long as there is no intent to influence the competitive bidding process. The parties cited the following:

- The FCC's 2010 clarification order, which stated that the gift rule was "not intended to discourage charitable donations to E-rate eligible entities as long as those donations are not directly or indirectly related to E-rate procurement activities or decisions and provided the donation is not given with the intention of circumventing the competitive bidding or other E-rate program rules."[9]

- The FCC's E-rate cost-allocation rules, which, during the relevant time period, allowed service providers to bundle "free" services with E-rate eligible services even if the free services were themselves ineligible, as long as the free services were "available to some other class of subscribers or segment of the public."[10]

- USAC's free services advisory, which allows "free" services to be included in E-rate contracts so long as the value of those services is subtracted from the pre-discount cost included in the applicant's E-rate funding request.[11]

Fourth: The parties argued that the complimentary services did not prevent fair and open competitive bidding because Knology was either the only bidder or the lowest bidder for each contract it was awarded.

Fifth: The parties argued that USAC's decision to rescind or deny all E-rate funding to the District for five funding years was disproportionate. Even if, at most, the District did not

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[8] Knology appeal, at 8-9.

[9] *See* FCC Clarification Order, ¶ 10 (Dec. 15, 2010) (DA 10-2355, https://apps.fcc.gov/edocs_public/attachmatch/DA-10-2355A1.pdf). The parties did not, however, mention the FCC's qualification that it "presumptively prohibit[ed] as indicative of undue influence certain gifts like cash, travel, and equipment provided for the benefit of a specific individual or discrete group of individuals associated with or employed by an E-rate participant." *Id.*, ¶ 12.

[10] *See* FCC Clarification Order, ¶ 11 & n.25.

[11] Free Services Advisory, http://www.usac.org/sl/applicants/step01/free-services-advisory.aspx.

properly cost allocate ineligible services bundled with E-rate eligible services, the maximum recovery should be the actual value of the complimentary residential accounts.

We will continue to monitor these appeals. Regardless of outcome, however, USAC and the FCC take the gift rule seriously. Both applicants and service providers should be vigilant to ensure their personnel know and follow E-rate program rules.

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