

STATEMENT OF TIMOTHY M. DONOVAN

Good morning, Chairman Greenwood, distinguished members of the Subcommittee. My name is Timothy Donovan. During the time period relevant to the matters before you today, I was acting as Senior Vice-President, General Counsel and Corporate Secretary of NEC USA, Inc. and Corporate Secretary of NEC Business Network Solutions, Inc. (BNS). Although I left my position at the end of March 2004, having completed almost 20 years within the NEC organization, I remain an officer today of one of the affiliated companies.

I appreciate the opportunity to appear before the Committee today and address matters relating to the E-Rate Program, created by the FCC under the Telecommunications Act of 1996. As Secretary of BNS, I had no role in its day-to-day activities. Other corporate executives of BNS might have more direct knowledge of the events that are the subject of your questions today, but as you are no doubt aware, the Department of Justice is conducting an ongoing criminal investigation. It is expected that this investigation may be concluded in a matter of a month or so. I am advised that, due to the pendency of that investigation, legal counsel to other executives you invited to testify advised them that it would be inappropriate for them to testify today. I understand that counsel for these individuals have asked that these hearings be postponed until September or October, to give the Justice Department time to complete their ongoing investigation, so that management of BNS would be able to participate and give substantive testimony after the conclusion of that process. Since the Committee's schedule would not allow a postponement, and consistent with BNS' commitment to provide full and complete cooperation with all relevant inquiries into this matter, BNS asked, and I agreed to appear and give testimony for the Committee today. With your understanding of these circumstances, I will do my best to assist the Committee in its inquiry at this time.

I. Background of BNS Involvement in the E-Rate Program in San Francisco and Elsewhere

BNS was founded in 1989 as a multi-systems integrator and a direct sales and service organization for NEC America, the NEC America subsidiary that markets and sells telecommunications equipment and systems in the U.S. BNS designs, sells, installs and services a broad range of voice, data, and video communication systems and networks. BNS has in excess of 1000 employees spread across 36 regional sales and operations offices. A very small proportion of these employees ever had any involvement in the E-Rate Program.

BNS' first serious involvement in the E-Rate Program began in late 1999. Although BNS was aware of the program, prior to 1999 it had no significant involvement in the E-Rate Program, or government contracting in this sector, for all intents and purposes. In 1999, however, BNS entered into a teaming arrangement with VNCI, a consultant in the telecommunications field and vendor of certain telecommunications (video related) products. The main contact with BNS at VNCI during the early stages of the relationship was Ms. Judy Green. VNCI assisted BNS in identifying potential school districts and opportunities. Ms. Green and VNCI assisted the schools in their consideration of E-Rate funding. BNS participated in the E-Rate Program by selling and installing data equipment and telecommunications equipment to school districts that qualified for funding under the E-Rate Program.

BNS provided systems and installation and maintenance not only to educational institutions, but to the financial sector, healthcare sector, and many other industries and customers. During the time that BNS was actively involved in the E-Rate Program the E-Rate Program revenues constituted a little over 3% of the gross revenues of BNS. At the start of its venture into the E-Rate business, BNS had three sales and marketing employees who were involved full or part time in this sector. At the conclusion of BNS' participation, there were

about 5. The activities were conducted for the most part in one of the company's regional offices in the San Francisco Bay Area. These individuals did not have extensive prior experience in government contracting or, for that matter, the E-Rate Program prior to the Year 3 bids that BNS submitted.

The initial effort involving NEC and VNCI included the project for San Francisco Unified School District (the "SFUSD"), an opportunity identified by Ms. Green and VNCI. This was a bid effort for what is generally referred to as Year 3 E-Rate Funding. In January 2000, a few weeks after establishing the teaming relationship with VNCI and Ms. Green, BNS submitted a bid for E-Rate work to the SFUSD. By the time BNS suspended all activity relating to E-Rate, it had already severed the consulting relationship with VNCI and Ms. Green.

II. The Justice Department Investigation, BNS Cooperation and the Resulting BNS Settlement

In the Summer of 2001, BNS learned that there was an investigation into the SFUSD; and BNS cooperated with the investigation, unaware at that time that the investigation concerned BNS. By the end of October 2002, it had become apparent to BNS that some of its employees' activities were in fact involved in the investigation. At that time, BNS retained independent legal investigators to begin a full scale internal investigation into BNS' E-Rate operations. That process continued over many months and included interviews of witnesses, review of documents, e-mail and other records. As soon as BNS began to appreciate the nature of the activities by this small group of individuals engaged in E-Rate Program marketing and sales, BNS suspended all requests for payment with the Schools and Libraries Division ("SLD"), pending a determination of the outcome of the investigation so as to ensure that there would be no further injury to the Government or to any other affected party as a result of continuing this business.

BNS also resolved at that point that it should cooperate fully and completely with the federal investigators. BNS made a commitment to the Justice Department to accept full and complete responsibility for the conduct of the employees and sought to resolve all issues. Well along in the inquiry and negotiations, we learned that there was a civil *qui tam* complaint that the City and County of San Francisco had commenced. BNS sought to resolve this matter as well, as part of its overall resolution and commitment to make restitution. In order to make good on its commitment to resolve the criminal issues and the civil *qui tam* action, BNS agreed to pay, and did pay, \$15 million in cash fines and restitution, and further agreed to provide equipment, continuing maintenance and services (valued at an additional \$5.7 million) to school districts that are BNS customers under the E-Rate Program. We believe the Government has been made whole with this settlement. BNS sincerely regrets that the conduct by these several employees caused this kind of financial harm. Some of these individuals are no longer employed by the company. Any further action with regard to the others will be suspended until the DOJ completes its investigation as to individual culpability.

III. Legislative Solutions to the Perceived Problems in the E-Rate Program

We understand that this Committee is making inquiry into what can be done to eliminate the factors that led to this disappointing state of events. BNS does not pretend to have answers to this inquiry from the standpoint of operations of the SLD and the E-Rate Program. However, from the vendor side, BNS has become aware that in the E-Rate Program arena, a few employees, improperly supervised, trained and overseen, can engage in conduct that, in short time, can cause a great deal of damage. In the BNS case, BNS is first and foremost a private sector vendor. There was no substantial line of business and operations dedicated to the government sector for any significant time period. Further, the company did not have the checks

and balances in place to supervise the sales personnel who responded to this business opportunity. Working with the Justice Department, BNS is taking key steps to ensure that such conduct is not repeated and that all of its employees will act responsibly and properly. BNS is taking the following first steps as part of a long-term process to improve oversight and management:

- Empowering a Chief Compliance Officer with broad powers to oversee compliance in governmental contracting and elsewhere.
- Commencing the training of all employees in established ethics and compliance policies and procedures.
- Implementing expanded services for its anonymous hot-line for employees to report suspected wrongdoing or unethical conduct.
- Scheduling regular audits of all government contracts.

BNS has also agreed to permit the FCC Enforcement Bureau and the FCC-OIG, at BNS' expense, to conduct an annual audit of BNS' compliance with applicable laws and regulations relating to the E-Rate Program and other government sponsored or funded telecommunications programs. BNS will make annual reports to the FCC Enforcement Bureau and the FCC-OIG concerning its compliance with the established compliance policy.

It would be impossible, from a legislative standpoint, to codify a code of conduct that might directly address all anticipated problems on the vendor side. However, from BNS' experience, it has become clear that any vendor involved in the E-Rate Program needs to have employees who are properly trained in the requirements of government contracting and, in particular, the rules and regulations of the E-Rate Program. To be sure, even in Year 3 of the E-Rate Program, there was still an absence of clear definition as to what products and services were to be funded and a lack of clarity in other areas as well. Bright line rules are better than leaving

matters to subjective judgment. This, however, does not excuse in any way BNS' conduct, but the ambiguity fostered an environment for mistake, negligence and active misconduct to occur.

We are also concerned that the present operational parameters under the E-Rate Program leaves an informational void between the vendor of systems and services and the school districts. School administrators, especially in the neediest districts, have little or no expertise in the installation of sophisticated voice, video, and data networks. The vendors do, but they are in the business of selling equipment and services that are requested by customers. This information void can be exploited by opportunistic or dishonest individuals in some cases. Although it would be laudable if vendors would spend their time and efforts in scaling down a project to save unnecessary expense for the school districts and the E-Rate program, since this would reduce their revenues, it is unrealistic to think this will often be the case, even in a competitive response to an RFP. Many of the school districts need to have the assistance and advice of an informed and independent consultant. They should not be left in a position of either asking the vendor to provide those consulting services or providing a reference for those services.

The E-Rate Program, with effective oversight and management, can assist needy schools in acquiring technology that may enhance the education of children in the urban and rural schools. There were many diligent, hardworking field engineers and other employees within BNS who were implementing Internet solutions within schools unaware to the wrongdoing by a few. They believed they were making a meaningful effort to enhance the success of students in those schools. Mistakes that were made by a few BNS employees tarnished this effort and their beliefs.

Thank you for the opportunity to appear before the Committee today.